Research Article

Public Debt and Economic Growth in Albania

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Doi: 10.2478/mjss-2018-0174

Abstract

A high public debt and its consequences in the economy remain a very important issue to be discussed, especially during the periods of crisis and recessions. During the crisis, although Albania managed to maintain a positive economic growth, its public debt remains high and worrying for the economists. The purpose of this paper is to determine if there exist a correlation between the public debt and the economic growth in Albania, where the economic growth will be considered as the increase of GDP. Many authors have provided their contributions with various empirical analyzes to study the mutual link between economic growth and public debt and the results and the methodologies are different in different countries and periods. What is the situation in Albania at about the last 25 years? Analyzing the macroeconomic situation (the structure of Albanian public debt, the data on economic growth and public debt, the reasons of a high deb etc.) and the main causes of a positive growth and a macroeconomic stability, but a high public debt, we can conclude over the expectations and the trend of the future.

Keywords: *Economic Growth, Public Debt, GDP, Albania, Post dictatorship*

1. Introduction

The relationship between the public debt and the economic growth is a highly studied and discussed issue. This paper intends to focus on some fundamental questions. A high public debt affects negatively economic growth? But is a low economic growth boosting debt growth? What are the factors that influence the performance of these indicators and transmission mechanisms from one to another? The future policy debates, the fiscal policy performance, the public debt control and the public finance sustainability are among the most discussed issues nowadays. In my paper, I chose to address this topic, taking the cause of the European debt crisis, where the level of borrowing reached high levels in both developed and emerging economies. Although Albania managed to maintain a positive economic growth, its state debt remains high and worrying for scholars and economists. A high short term debt in our country means high risk of fiscal financing and in the medium term that growth may lower private sector lending and economic growth itself. A sustainable economic growth is very important for every economy (as it is the growth of production, production capacities and all other components of an economy) and of course for Albania, which as a developing country aims to make progress to realize membership in the European Union. On the other hand, it is equally important the public debt, the indirect government debt towards taxpayers. It can affect the monetary policy, the international level of credibility, the political process, the outflows of capital and the replacement of assets, so it has an effect on economic, social, political and international relations. It should be kept below the level allowed by the EU (below 60% of GDP). Theoretically we can say that it can only be owed when the country has a lack of liquidity and in cases when it faces major difficulties that would have serious consequences for the domestic economy and debt remains the only option since other measures have failed. But that does not always happen. The results achieved so far are different in different countries and periods, but how does the situation in Albania last for the last 25 years? Analyzing the macroeconomic situation and the main causes of a positive growth and of a macroeconomic stability (over the last decade), but of a high public debt, we can conclude on the expectations and trend of the future and make interpretations and recommendations as far as possible valid.

2. Macroeconomic Situation in Post-Dictatorship in Albania

The public debt in our country is most apparent in the post-1993 period. Prior to this period, Albania had to determine which countries would cooperate politically and economically, and the existence of a debt at that time was called external command. However, many facts mention the existence of foreign funding even in the communist system.

Before the 1990s, the state (the government) decided what would be the economic activities that would be carried out in the country, demanding their realization in every sector. Detailing the percentages that they were supposed to achieve and, in most cases, requiring and overcoming planning. The annual statistics presented very well the situation in the country, with achievements and excellent results in every sector of the economy.

But we can't think that a small country and an underdeveloped economy did not need foreign trade, but to avoid a large amount of imports, it was required to overcome the plan, because we would not need any help from the outside and the country would become more and more isolated. There is often talk of trade deficit, because the amount of imports continued to exceed the country's exports. In order not to lose the established reputation, by not raising taxes in order to balance the budget, the only solution left was to borrow, in or out of the country. From this point on, the debt situation is created, highly disputed even nowadays, although the system at that time could not tolerate the fact of borrowing at a high level, and we even mentioned above that it owed only from countries with which the state cooperated. Albania could not get help from the economic power of that time with which had broken the relationship.

Albania entered in 1991 on the path of deep political and economic reforms aimed at creating a democratic system through the protection of human rights and the raising of the standard of living in a market economy. The Albanian economy has undergone some important structural changes, which have strengthened incentives for sustainable economic growth. Albania has kept the domestic product down since the economic crisis in Europe, maintained a low and stable inflation, maintaining a stable banking system, all thanks to fiscal stimulus and an effective and prudent Monetary Policy. (Bank of Albania, Annual report, 2012)

The highest public debt in post-dictatorship in Albania was in 1997. This is due to bankruptcy of pyramid schemes. Even in the following years, it has been high, but following the IMF recommendations. From 2003 to 2007 it decreased from 58.8% to 53.5% and in these years the GDP growth was high. This trend has moved in the opposite direction, starting in 2008, when the public debt was 54.1% of GDP, due to increased public investment, so in 2010 it results that the public debt level was 58.6% of GDP of the country.

After 1991, Albania's integration with the economies of neighboring countries grew and is increasingly being integrated into global production systems, becoming more dependent on international trade and international technology and capital. Both the financial crisis and the debt crisis have left their mark, as the link with Europe and especially with the countries of the region has its impact. This was a consequence of Albanian emigrants in Europe and mainly in Greece and Italy, too.

According to the level of debt, Albania has a high level of it and has often been subject to criticism from the IMF, under the call to measure the consolidation of public finances. What makes the situation worse is the rapid change in the debt level, given the EU's conditions and the Maastricht Treaty standards. If in 2010, it was 57.7% of GDP, in the years to come it grew until it reached 65.5% in 2013 and 71% in 2014.

In these 25 years, major economic changes have taken place, but not always the policies pursued have been the right ones. Changes in government have not been frequent, so the policies implemented from one government to another have not changed significantly.

According to Law No.9665 of 18.12.2006 of our Constitution "On State Borrowing, State Debt and State Loan Guarantees in the Republic of Albania", Article 4 defines (The Official Notebook of the Republic of Albania, 2006, pg.6089): State Debt is the total amount of debt denominated in the national currency, which does not include the financial obligations of municipalities / communes or any other local government authority. The state Debt includes the debts of the Republic of Albania, created before the entry into force of this law. For the purpose of calculating the state debt, when a paid obligation is denominated in a currency other than the national currency, it is estimated at the national currency at the official exchange rate announced by the Bank of Albania at the time of the valuation.

3. Why Does the Government Borrow?

Public debt remains an important instrument of economic policy and can be used efficiently and for effective purposes, but can also cause serious problems. Being an element in the center of economic debate, naturally the question arises: why are governments borrowing?

The answers are some:

1. To finance long-term investment in infrastructure or human capital.
2. To keep current costs without raising taxes during difficult times or facing difficult situations such as natural disasters or wars.
3. To keep current spending without raising taxes (in order to achieve the highest economic growth) by shifting part of the burden to future generations thinking that the future country will be in a more favorable situation for paid.

In all cases, the government should analyze two main moments: first, whether the benefit from spending or investment is greater than the cost of the loan, and secondly, whether it is the best option to get the debt or increase tax.

Referring once again to Law No.9665, Article 7 "Debt Recovery Purpose" stipulates: The Minister of Finance, borrows (Official Gazette of the Republic of Albania, 2006, p.6089):

a. To finance the state budget deficit;
b. To refinance the temporary lack of liquidity;
c. To refinance the state debt previously signed;
d. To pay state guarantees;
e. To pay off the cost of issuing state debt;
f. To cope with the cost of natural disasters and other emergencies;

All countries, despite their development, have created a public deficit and this is a very normal phenomenon. When talking about public debt, we must not neglect the deficit, as it is the main cause of debt formation. It should be analyzed its size and the reasons for increasing government spending. There are not always politicians' decisions, the reason for rising government spending. The tax revenues may decrease when economic activity is slow and taxes are relatively high.

If the cause for the deficit is the recession, most of the money will go to boost social benefits and projects that stimulate the economy. The deficit can be considered more tolerant and beneficial when it is spent more on infrastructure, education and public health, generating long-term income but if accompanied by violations and abuses, causes even more consequences. Debt arising through the accumulation of such deficits is a bad debt and bad debt characteristics are high interest rates.

In the first case when we talk of a deficit that tends to develop, the size of the market or industry usually increases, this leads to stimulating the economy and economic growth. This situation encourages private investors. All of these have an impact on increasing the number of jobs and increasing the tax revenues. On the other hand, the deficit can boost the inflation or create it.

The government has a great responsibility in the way it chooses to pay off the debt and finance the deficit so that the citizens do not get worse.

Public debt is beneficial to a government because its operations are permanently funded. If this debt goes to financing in the manufacturing sector, this would lead to declining unemployment in periods with high unemployment. The disadvantages are that state projects can be overestimated and unjustified also have increased payments due to their postponement.

In such a situation, the need for liquidity is increasing, so that the interest rate on government bonds will increase and the government will be forced to devalue the currency or make a default for the liabilities. When there are major changes that may cause fiscal problems, investors may be afraid to suspend or modify debt service and start selling their investments to the troubled country. Bond prices consequently fall. Banks, which generally hold large amounts of government bonds, lose capital values that cause losses to banks. What is to be mentioned in such situations is that the country that is undergoing this blow has links with other economies and can also cause total demoralization of investors.

To prevent a banking system crisis, often the interconnected countries are forced to buy government bonds that are in trouble. TSEs remain the concrete example. Such actions by the Maastricht Treaty are not permissible, but such countries make it possible to do so only in order not to cause even deeper crises that have come as a result of mismanagement. This causes the borrowing requirement to be high for some countries at the same time, but with underdeveloped financial markets the risk premium is high. It is often concluded by many that high levels of debt and deficit come as a result of the political process. No unintentionally born the EU union to share the burden of risk. If there were single states, interest rates would immediately increase, and this would make the situation even worse, as it would further lower the rates of economic growth. In a community there is also the possibility of sending all pressure to a single bank, such as the ECB. If state institutions function best, they will be a single body even if the monetary system passes difficulties or currents with high inflation.

Ultimately, we can say that the budget deficit is the main factor in creating public debt and has a sufficient impact on the economy of a country.

4. The Structure of the Albanian Public Debt

The public debt sustainability is important, not being very variable, but maintaining some stability.

It is important to study what part of the debt is financed domestically and from abroad. External public debt remains important not only for its amount, but also due to changes in the role of official creditors, and multilateral ones in particular, as their impact extends beyond the money they provide. They are always strong in managing public debt, and will continue to remain weighty gamblers in the financial markets. In developing countries, most of the loans are made available by international creditors. A country's economic stability is the main factor for the credibility of debt repayment. Over the years, credibility and macroeconomic stability have been increasing.

Multilateral lenders are made up of the International Monetary Fund, the World Bank, regional development type banks: the Research and Development Bank (RDB), which include the Inter-American Bank, the Development Bank and the smaller financial institutions.

All of these financial institutions that we have mentioned have an important role in lending to difficult liquidity situations in the countries. RDB has a specific set of objectives, which also align with the World Bank.

Often, funding from a large multinational corporation is made in the form of concessions. The case of concessions is the most preferred by multinational firms.

It should also be mentioned, the role of bilateral lending through national development agencies, such as the United States Agency for International Development (USAID), United Kingdom Department for International Development (DFID), Wiederaufba Kreditanstalt für Germany (KfW) and Endtwicklungsgesellschaft Deutsche Investitions-und (DEG).

Governments can also receive loans from companies such as export credit agencies such as Hermes (Germany), Compañía Española de Seguros and Créditos a la Exportación (CESCE, Spain), Coface (France), and the Export- Imports to the United States.

In these cases, the currency is the country where the creditor is located or an international currency such as the euro or the dollar.

Much of the external debt has gone to finance the deficit, a part for energy and to finance the transport, the construction, the infrastructure (public investment) etc.

Domestic debt is higher for developing countries because they have not access into the international capital markets. Treasury bills and bonds are the primary means of financing for these countries.

There are the individuals who will buy these financial instruments as debt holders in our country are second-tier banks and individuals. We point out this because in other countries with developed financial markets the debt is taken or held more by insurance companies, investment funds, pension funds or other financial intermediaries. A higher debt level needs a more developed financial markets. Our situation is different because our financial system still has many shortcomings.

Public debt analysis in developing countries is more focused on external debt. Even in Albania we have more internal debt than outsiders, but the latter has been growing ever. However, in recent years, some developing countries have adopted certain policies aimed at reducing the impact of external debt by replacing it with the home country. Generally, it is preferable to create an internal debt thus presenting a lower degree of risk for the state and its finances. However, a debt remains a debt and the policy makers should not feel satisfied with their internal debt.

The focus was on foreign debt for two reasons:

Firstly, the domestic debt only transfers resources within the country, while external debt may increase the access of a country to other resources of funding.

But nowadays, with the growth of financial integration and free movement of capital, the traditional distinction between the external and the internal debt may make no sense (as an external debt we consider all the debts emitted in the international market and as debt internal all debt issued in the domestic market).

Secondly, the central banks in developing countries can't issue the currency to the amount needed to repay the external debt.

In countries with free capital accounts to circulate, the existence of high debt in a foreign currency is an even greater problem for the crisis. In countries like the United States, which, though with a high level of debt, the fact they have it in their currency, does not pose a problem as much as the existence of a foreign currency debt. The element that causes more concern is the fact of maturity for foreign currency, so the changes of the external debt value. But that does not mean that domestic debt is not disturbing, it also has its significance. Through it, the value of the domestic currency can change, and the value of the foreign currency changes as well, as it gives its effect to the foreign exchange rate.

When the government decides to increase the domestic debt, this fact may be attractive to banks, so that they can get the most out of it. This situation would pose a risk to financial stability in the country. The banks would be liquidated and this would cause interest rates to rise. Moreover, by expanding the government bond market, there may be positive externalities for private firm bonds, but there is also the risk that the public sector may take part in the private sector as well.

The international private market has been a major source of financing for economies, which have needed liquidity even earlier. Of course, there are also interventions by the World Bank and the IMF. From the period to the period there are also changes in the borrowing market and necessarily here is generalized the global market.

When it comes to the global market, the conditions are very favorable for the development of the borrowing market and for low values, the loans are numerous. These global factors include bringing interest rates to large advanced economies and also unexpected stoppages in capital inflows caused by seldom occurring events. What matters, however, is that opinions about these trends, which pose borrowing opportunities for the purpose of financing public debts, seem to be optimistic, but that need to be kept under control.

In addition to the importance of external and internal debt, it is worth analyzing the role of monetary and fiscal policy as well. These policies have a great weight not only on the level of debt and its decline, but also on the future and overcoming of this debt and its consequences to future generations. The combination of the two would be the most ideal solution in order not to have a large amount of emissions that bring down interest rates, inflation, or large tax increases. Implementing only one of the macroeconomic policies would not be the best way.

The same conclusion was reached by the deputy governors of emerging economies at the meetings held in 2012 in Basel. According to them, to overcome the global crisis is a key policy co-operation. Although fiscal policy provides a faster solution, it would be better if combined with issuing local currency bonds.

In our country, fiscal policy with the aim of financing the debt is not very efficient because of the fact that in our country there is a high rate of evasion and because this type of policy directly affects individuals and their savings. Although evasion and informality are being fought for some time and especially in the last two or three years, there is still a lot to do. On the other hand, we think it is better to get debt, since tax increases directly affect us, while debt payments are divided into generations. But even the latter is something we disagree, so the situation is complicated. It is easy for us to blame the state for the level of debt and, in fact, is rarely the result of excessive or unmanaged government expenditures, electoral campaigns etc.

As far as the monetary policy is concerned, it is better when long-term instruments are launched, as short-term ones can cause inflation.

It would be best if the monetary system and fiscal policy acted in such a way as to predict that any fiscal change is offset by inflation and that there is no decline in the economic growth and in the consumption reduction.

Based on this theory developed by Sims (1994) and Sargent e Wallace (1981), they also introduced some other analyzes, which have to do with the timely limitation of the budget. It is required to respect this restriction, in order to establish compatibility between the two policies.

If both monetary and fiscal authorities will not be in interoperability and the Central Bank would increase the money supply then we will have a drop in interest rates. On the other hand, fiscal policy would continue with excessive deficits, then there would be a change in the level of government spending, hence the change in AD, which would bring about a change in the price level and directly changes in the level of inflation.

In a monetary union, this justification gains another dimension that a single monetary authority has to do with some fiscal policy authorities. It should be noted that overcoming expenditure by one or several member states leads to a heterogeneous inflationary union model, which presents problems, and above all, in a single country when it is developing. In such a situation, it is difficult to carry out good governance of government spending, which causes a change in the level of debt. This difficulty is caused because it is not known what kind of monetary policy will accompany fiscal policy. Here's another problem: finding a timely monetary policy, but sustainability remains a key element. The sustainability is a constraint on government and its budget, where it is required that current spending on goods and services plus the actual debt cost is equal to tax revenue plus the newly established debt.

Another form of debt is the privatization, but it is not a solution that can last forever, as the public assets are not infinite, not all proceeds secured by privatization go to debt repayment and the state loses benefits which could be provided by these activities. The privatizations began in 1992 and revenues were small and in the years 2000-2010 secured large revenues from privatizations. Another instrument used was concessions.

5. Conclusions

The role of public debt on economic growth is quite a topic important, which should be taken into account by policymakers in Albania.

The public debt is important as it may affect the Monetary Policy, the political process, the international level of trust in the country, the capital outflows and asset substitution.

The main factors that have contributed positively to the economic growth in Albania over these years are: shifting the workforce from low productivity to high productivity, prudent fiscal and monetary policies, sustainability of the macroeconomic situation, and steady growth of investment.

The main factors that have led to public debt growth are the growth of the deficit and the increase in public investment.

The external debt has risen faster than the domestic one since 2007, and this is a concern for financial stability in the country, because such a composite state debt carries a higher exposure to changes in world financial markets and the exchange rate.

The budget deficit was one of the main causes that affected directly the growth of public debt, while it was fully funded by the latter. Policy makers should not choose to reduce government spending as their best option to reduce the budget deficit, but they should choose to raise tax revenues. The best way to do this is to apply controls and inclusive sanctions to anyone who avoids paying taxes. Also the use of tax money should be made transparent to the general public, because transparency enhances confidence, and the latter will increase the awareness of taxpayers that their money is being used for their benefit. Also, the investments in infrastructure are indispensable for creating new businesses and for the movement of citizens. An efficient use of borrowed funds has a colossal effect on the Albanian economy and the well-being of the citizens.

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