Albania's Fiscal Goals, Budgetary Balance, Government Debt		**Economics**
		Keywords: budgetary deficit, public debt, fiscal rule.

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Abstract

The paper is intended to explore the dynamics of budgetary balance and public debt in Albania for the period 2005-2014. The dynamics of both variables are forecasted up to 2020. A special attention is paid on the link between budgetary deficits and current account deficits. There are favorable conditions to confirm the twin deficit hypothesis. The ratios of budgetary deficit and public debt are within healthy intervals in the studied period. The statistical forecasts suggest maintaining a gradual increase of both variables but not exceeding the healthy bounders.

Fiscal policy of Albania was significantly improved since the beginning of 1990s. Along with important political and economic changes in this decade, the economy attained its sustainable dynamics and sufficient results. This tendency became more apparent after 2000, which results directly from improved macroeconomic policy.

Taking into account the importance of stable public finance for a growth-friendly economic policy, this paper is focused on the fiscal goals of Albania. The main emphasis is placed on the dynamics of budgetary balance and government debt over the period 2005-2014. The developments of both variables will be forecasted up to 2020.

Fiscal policy, of course, is a part of the complex macroeconomic policy. Budgetary deficit got up to its peak in 1997 on the background of the crash of the financial pyramids and Kosovo crisis. In this time, the huge deficits were financed mostly by domestic bank loans. Nevertheless, the deficits began gradually decreasing after 1998 and were dragged down below 5 percent of GDP (See Ministry of Finance of Albania, 2013, p.24).

After a significant decrease at the beginning of 2000, the volume of government spending remains relatively unchanged and floats around 30 percent of GDP. Another important trend appearing after this year is to improved revenue collection. The last trend, combined with spending discipline, contributes to a strong reduction of the budgetary deficits between 1998 and 2009. The deficits were reduced with more than 6 percent of GDP. The improved work of the tax administration and simplifying of the tax system were major causes for a better situation of total government revenue.

The fiscal program performance maintains a weak positive tendency over the period of interest. Sharp increases are seen in the deficit in 2008 and 2009. After this year, the budgetary balance comes back to its usual values. The preliminary data on 2014 show that the decrease in the budgetary balance is nearly 2 percent of GDP. The dynamics of budgetary balance is shown on Graph 1. The annual values of this variable are expressed as ratio to GDP.

It is important to note, the Albanian budgetary deficits of the last few years are close to the mean deficits in the EU-28. The Albanian deficits are not different from these of Croatia and Slovenia – Western Balkan countries which already have EU membership.

The developments of the budgetary balance are also forecasted up to 2020 on Graph 1. The annual data on the deficits are presented as ratio to GDP. As seen, maintaining the actual tend in dynamics of this variable imply a gradual increase until 2020. The forecasts show that the deficit will float between 4.2 and 4.8 percent of GDP. It means the increase in spending will outstrip the increase in revenue. Therefore, this disparity will make challenges for the stability of Albania's public finance in the next few years.

Graph 1. Budgetary Balance in Albania for the period 2005-2020 (% of GDP)

$$y = -0,0517x + 99,587$$
$$R^2 = 0,0115$$
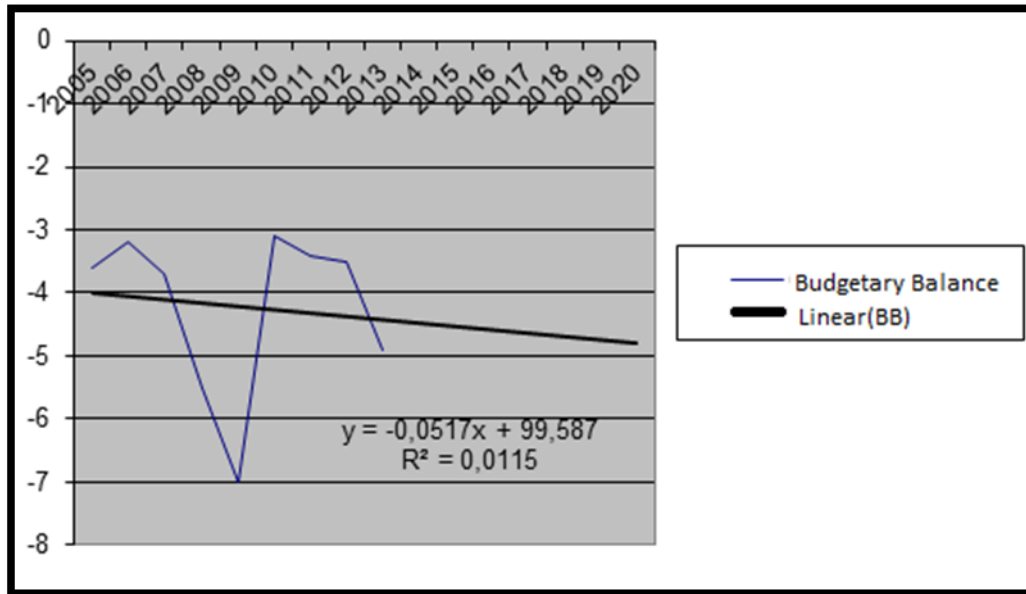
Source: Ministry of Finance of Albania, Central Bank of Albania

In spite of the fact that these values of deficits are consisted with the objective of catching-up development, they are not a good proxy for stability of public finance. They do not give positive signals to foreign investors. Therefore, the governments have to keep maintaining small budgetary deficits (up to 3 percent of GDP). Fiscal consolidation should be attained as a result of increased tax revenues. This line of behavior would be an efficient preparation for the future challenges of the EU membership.

In economics, special attention is paid on the relationship between budgetary deficits and the deficit of the current account of the balance of payments. This phenomenon is popular as twin deficit. This phenomenon has two conceptual explanations – via Keynesian approach and via the relation of savings and investments (Varol Iyidogan, 2013, p.36). Under the Keynesian approach, the expansionist fiscal policy worsens the state of the current account of the balance of payments as a result of increased income (Varol Iyidogan, 2013, p.36). Thus, the more the expansion, the less pure work of the market mechanism is (Patonov, 2013, p.315).

Graph 2. Current Account of Albania's Balance of Payments (percent of GDP)
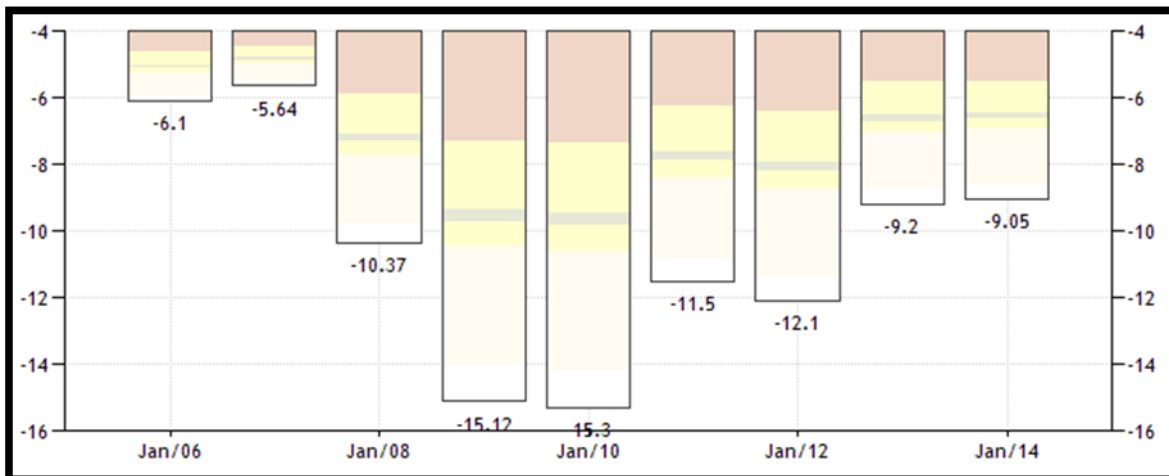
Source: Tradingeconomics

A set of studies test the twin deficit hypothesis. Regression evidence is often found on small open economies. Albanian also has a small open emerging-market economy. An empirical study on the sample of Central and Eastern European countries confirmed the twin deficit hypothesis for all the countries, excluding Bulgaria and Estonia (Ganchev et. al., 2012). Albanian conditions are closer to those of the CEE countries rather than those of Bulgaria and Estonia because of the lack of fixed exchange rate. Therefore, it is possible an econometric study to confirm the twin deficit hypothesis for Albania. Similar sustentations are being suggested by the data on the current account of Albania's balance of payments in Graph 2. As seen, there are deficits of the current account from 2006 to 2014. The highest values of negative balance have been registered in 2008, 2009, and 2010 with a peak in 2009. Graph 1 showed the budgetary deficits also are highest in these years as the peak is in 2009 too. Therefore, we could agree that the twin deficit hypothesis was confirmed in Albania. However, this conclusion is not definitive because it was not supported by an econometric methodology.

In most of the economies, the taxes are used to soften fundamental shortcomings of overall fiscal policy, budgetary deficits, and cycle-friendliness. It is important to note, the importance of tax revenue as a policy instrument is increased in terms of small open economy because revenue multiplier is stronger than the spending one (Muir & Weber, 2013).

The practice has proven fiscal rules can improve the fiscal performance (Debrun, et. al., 2007). However, these rules do not change the fundamental engagement of the governments to abide fiscal discipline (Wyplosz, 2005).

It is important to note Albania's fiscal policy of last decade is very prudent. It could be seen from the overall reduction of the ratio of government debt to GDP before 2008 (See Ministry of Finance of Albania, 2013, p.24). However, the growth in the borrowings of the government to finance large infrastructure projects and slowing down of the economic growth break the good tendency after this year. The ratio of the debt to GDP is expected to keep high values (World Bank, 2014, p.37), that makes Albania vulnerable for negative shocks (International Monetary Fund, 2009). Thus, maintaining of acceptable of the ratio must be a prior fiscal goal.

The governments are limited to implement the last recommendation because of the difficulties in finding an optimal ratio of debt to GDP. The Maastricht criterion for debt of 60 percent could be accepted as a starting point. Empirical studies put an emphasis on the impact of the debt on economic growth. They found debt of 60-90 percent of GDP leads to a weak slowing down of the growth and there is an apparent slowing down after 90 percent of GDP (Reinhart & Rogoff, 2010, p.576). The slowing down debt of 60-90 percent exerts is more apparent in terms of emerging markets. At first glance, accepting 90 percent as a healthy above boundary of public indebtedness is the most appropriate policy recommendation for the Albanian governments.

Possible solution would be laying down a spending rule. In such a case, the rule should be combined with a mechanism of reverse link. Thus the unfavorable tendencies could be corrected, if weak revenue collection (Ljungman, 2008). Taking into account the low amount of tax revenues in European context, poor infrastructure, the high share of population in poverty, the need of catching-up development, rule implying an expenditure reduction or constraining the increase in spending would not be a good choice for Albania.

As a whole, there are fully technical reasons which make the fiscal rules to be not good solution for Albania's government debt. Many countries lay down fiscal rules in a special law. Albania currently needs an institutional framework for elaborating and using fiscal rules. In this regard, difficulties could be expected in attaining political consensus regarding rules. Therefore, initially the levels of public indebtedness should have a form of political engagements being incorporated in the annual budget laws. Possible shortcoming of such an agreement could be the lack of succession. The political engagement for stable public finance is a fundamental precondition for successful fiscal management.

The management of the aggregation of debt is an alternative approach. Increase in the debt is expected in middle and long term because of the process of catching up. Thus the ratio of the debt to GDP could be reduced without a nominal reduction of the debt. The ratio could be lowered if the nominal growth of the debt is lower than the nominal growth of GDP (Macdonald, 2003). This approach is more appropriate for Albania's

conditions because make governments more flexible in debt management and entails less requirements to primary balance.

Graph 3. Public Debt of Albania for the period 2005-2020 (% of GDP)
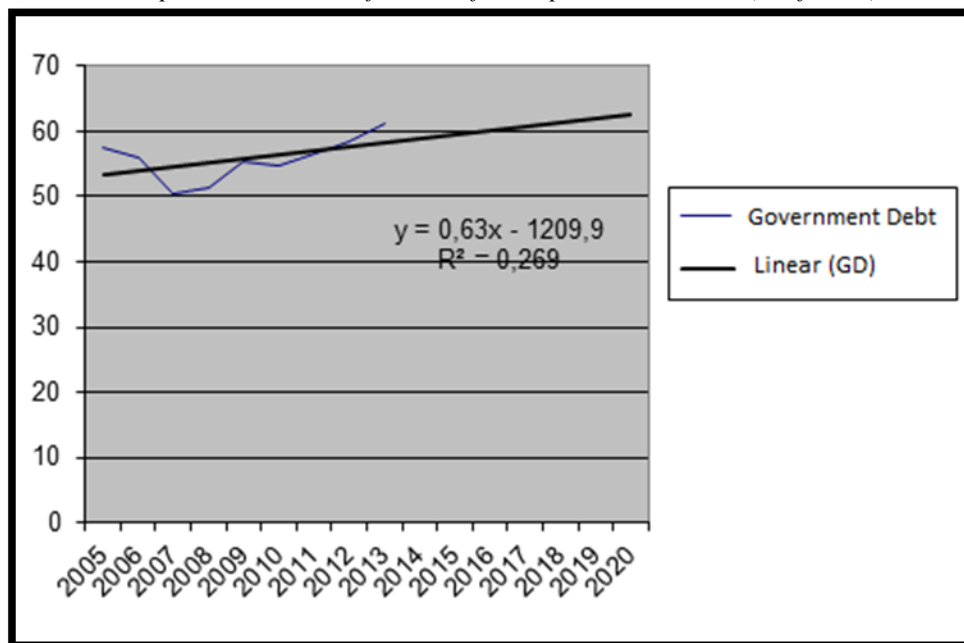
Source: Ministry of Finance of Albania, Central Bank of Albania

As seen from Graph 3, the Albanian ratio of the debt to GDP did not exceed the healthy bounder of the Maastricht criterion over the period of 2005-2014. There is a small increase in this ratio registered in 2013 and 2014. This is a positive feature of macroeconomic governance as well as unused potential for increase in the public indebtedness. Maintaining those ratios and even a little increase is consistent with the objective of catching-up development. Therefore, the governments can finance large infrastructure projects without endangering overall public finance stability and economic growth exceeding 90 percent of GDP.

The expectations for a gradual growth of the government debt are a usual continuity of the current developments of the debt. As seen from graph 3, the simple statistical forecasts on the dynamics of the debt confirms the growth expected up to 2020. Thus, the public indebtedness will follow the already formed tendency to increase. However, the increase is forecasted to overcome the healthy bounder of 60 percent towards the last years of the period but far less than 90 percent.

In conclusion we can point out that there are favorable conditions to confirm the twin deficit hypothesis. The ratios of budgetary deficit and public debt are within healthy intervals in the studied period. The statistical forecasts suggest maintaining a gradual increase of both variables but not exceeding the healthy bounders.

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