

## Government Spending in Albania: *An Overview*



### Economics

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### Abstract

The paper is intended to study the expenditure of the Albanian government for the period 2005-2015. The analysis follows the actual state of spending in two perspectives: at a general level and by economic function. Quantitative methods are used to forecast the dynamics of expenditure up to 2020 as well as to estimate the effects of the capital expenditure on economic growth. The empirical results show effects on the growth in Albania close to this of the EU-27. The suggestions for reforms in government spending are in line with an increase and improvements in the efficiency. The analysis found that capital expenditure and spending on education are the most appropriate spending items for increase on the road to the EU membership.

Government takes part in economy not only via the taxes levied but also via government spending. At least, the revenues do matter as long as they are earmarked for financing of spending programs. The government purchases generate economic growth. The impact of the expenditure on the growth is direct in difference with this of the revenues which is indirect.

The government expenditure determine the kind of fiscal model a country has. The models we could differentiate are Anglo-Saxon and Euro-continental. In the same time, these models are considered as societal, economic and social models of contemporary world (Nikolov et. al., 2014, p.20).

The first model is determined by a more limited government intrusion into economy while the second one has laxer shares of government spending and more intensive government engagement in the problems of economy and society. Hence, the work of market mechanism could be purified by reductions of government spending and intrusion into economy (Patonov, 2013, p.315).

The share of total government spending of GDP is another important factor in determining the type of fiscal model. There is a specific bound of this share which is 40 percent (Nikolov, 2014, p.21). Thus, redistribution of less than 40 percent testifies to an Anglo-Saxon type of fiscal model. And vice versa, the share of government spending of GDP exceeds 40 percent under Euro-continental model.

In this sense, the paper is intended to study the actual state and dynamics of the government expenditure in Albania. The actual state is also estimated in the context of the EU-28 values of the variables of interest. The impact of government investments on economic growth is also studied via simple liner regression estimates. The period of analysis covers the years from 2005 to 2015.

The data of Eurostat on average values of the EU-28 governments spending prove the literature suggestions. The average share of total government expenditure of GDP for the analyzed period is 48.2 percent. This really high value is caused by the increase in the total government spending as a response to the crises entered over the period. However, these expenditure were financed mainly via government bond issuance.

Looking at the cross-country differences, we can draw interesting conclusions about the government intrusion into economies of the EU member states as well as this of Albania. Denmark is the country with the strongest government intrusion into economy as average share of government expenditure of GDP exceeds 54.95 for the analyzed period. This is an indication of Scandinavian fiscal model, which is a fraction of the Euro-continental one. France, Sweden, Finland, Belgium, Austria, Hungary are other countries redistributing more than one half of their GDP.

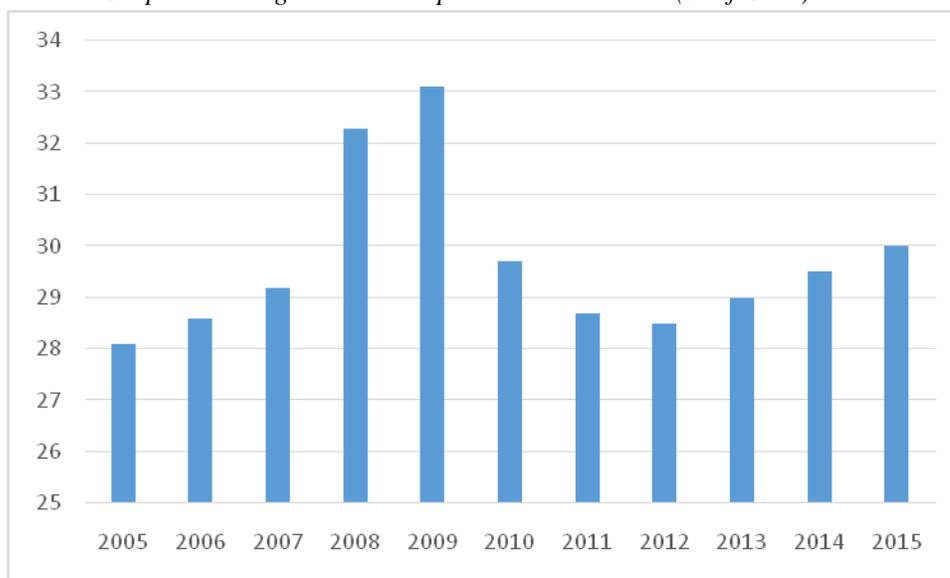
The shares of government spending of GDP between 40 and 50 percent are currently predominant in the EU. There are also countries whose share is below 40 percent. Such a case is seen in new members like Latvia, Romania, Lithuania, Estonia, Slovakia and Bulgaria. The Bulgarian government spends 37.4 percent of GDP,

which is the lowest value in the EU. Despite the Anglo-Saxon fiscal model of those countries, the economic regulations are far from this model.

The case of Albania is similar to this of the EU new members with an Anglo-Saxon fiscal model. Its average value is 29.8 percent of GDP. Thus, Albanian government spends even less than the EU governments with the smallest amounts of expenditure. Because of this fact Albania's government spending is far from the EU average level.

As seen on Graph 1, the low level of public expenditure in Albania remains relatively constant with a weak tendency to growth. Clearly expressed exclusion were the shares of total government spending of GDP in 2008 and 2009. This eruption is due to the crisis and the attempts for policy reaction. After extreme fall in 2010, a weak growth was recovered after 2013. The last one could be related to the economic recovery of these years. As pointed above, there is a significant gap between the Albanian level and the EU average level. This gap must be overcome on the road to an EU membership of the country.

*Graph 1. Total government expenditure in Albania (% of GDP)*



*Source: Ministry of Finance of Albania*

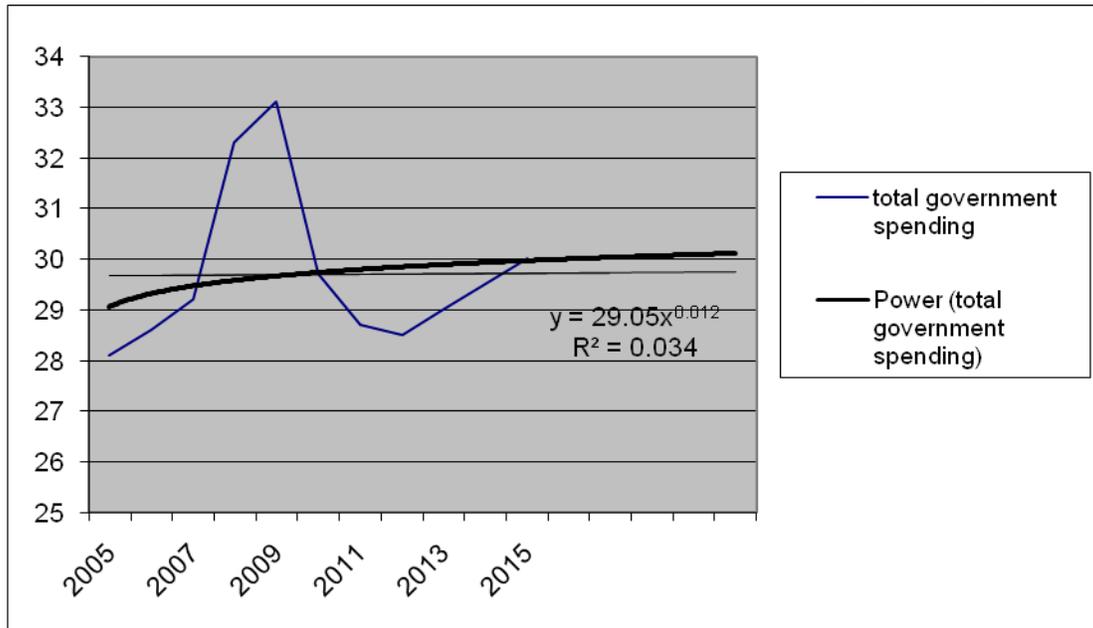
It is important to note that the increase in the government expenditure is achieved in the years of rapid economic expansion. It is expected because the growth of economy enhances the taxable bases available and respectively tax revenues collections. Thus, the increase in the GDP will naturally entail up the government spending as well. Otherwise said, making up for economic being far behind will contribute to an easier making up for the gap in the expenditure. However, the reverse reasoning also is possible.

Government spending is also related to the business environment. Hence, increased expenditure will lead to improvements in the Albanian business environment. The basic requirement for such a result is the expenditure to be effective. The last mentioning is relevant because government expenditure and government purchases could be subject of abuses and corruption. Therefore, the increase in government spending should be accompanied with measures for improvements of the public sector transparency and a reduction of corruption. This rather is a question of legislative solutions.

We should note that government expenditure also are a precondition required for properly functioning institutions. The last ones should be maximum transparent and safeguarding the property rights. Safeguarding property rights is a critical condition for economic development in post-communist countries and developing countries at all. It also is a key factor for attracting foreign investment.

Taking into account the importance of government spending for the state of public finance as well as for the development of economy, the main reforms recommended are directed to this variable. The reforms of the structure of the spending is also subject of interest. Figure 2 shows forecasts on the dynamics of the share of government spending of GDP for the period 2013 to 2020. The current trend is projected on the developments of this variable.

Graph 2. Forecasted dynamics of the total tax revenues of Albania (% of GDP)



Source: Author's calculations. Ministry of Finance of Albania

As seen, the positive development remains up to 2020. This increase would be a challenge to the budgetary discipline. Balancing budget would imply an increase in the tax revenue collections.

The forecasted dynamics suggest that remaining unchanged the developments of government spending would not lead to a value of this variable which is close to the EU average one. Therefore, the reforms must insist of a flowing increase in the spending. The measures in this line must be linked to the effects of the spending on the growth of economy. Thus, the significant increases should be in expenditure contributing to the growth and development. Measures should be taken for improvements in efficiency and transparency of spending budgetary funds. The better control should not also be missed.

The analysis of the structure of the government expenditure suggests what groups of expenditure should be increased on the road to an EU membership. Table 1 shows the spending items in the Albanian budget for the period 2005-2014. As seen, the current expenditure have a dominant share in total spending. Another interesting mark is in the field of capital expenditure. The ratio of last ones of GDP is close to the widest distributed ratios in the EU member states and even higher than Bulgarian ratios in some years (Munistry of Finance of Bulgaria). Such a structure is usual with respect to the stage of development of Albania. Albanian governments enhanced public investments at this stage of democratic transition in which the economic and politic crises were overmastered. It has been done by the governments of the rest of the Central and Eastern European post-communist countries. Under stability and success of the market oriented reforms, these governments stimulate the economies with large infrastructure projects. They strive to converge the infrastructure of their countries to this of the developed market-economy countries. The infrastructure will thus meet the challenges and necessities of the rapid economic growth caused by the accession to the common market.

Table 1. Albania's Government Expenditure for the period 2005-2014 *z.* (% om BBII)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total government expenditure, including:	28.5	29.3	29.5	32.3	33.1	29.7	29.3	28.4	29.0	29.5
Current expenditure	23.8	23.2	23.2	23.0	24.7	24.6	23.8	23.6	24.2	24.4
Capital expenditure	4.7	5.8	5.9	8.6	8.4	5.5	5.5	4.6	4.8	5.1
Other transfers	0.0	0.3	0.4	0.7	0.0	-0.5	0.0	0.2	0.0	0.0

Source: Ministry of Finance of Albania, Central Bank of Albania; No accurate data for 2015

As pointed above, the investment in infrastructure is a key factor for catalyzing economic development of a country. Yet the infrastructure of Albania is poor. Therefore, this is an item in which the government should intensively invest on the road to the EU membership. This investment influences the economic growth in two ways. First, because government purchases are a component of GDP, it causes an increase in the annual GDP growth rate for the period of spending. Second, there are indirect effects of multiplication. In this sense, a good infrastructure contributes to a cut of expenses of many businesses which make use of elements of the national infrastructure. This multiplicative effect arises in middle- and long-run perspective. Not least, the good national infrastructure is an important factor in attracting foreign investments.

Econometric studies have proven that capital expenditure are the most appropriate for urging on the economic growth. Hubenov and Boshnakov (2010) found the elasticity of GDP with respect to the capital expenditure is 1.13 for the EU-27. This coefficient is higher for the EU-15 and has a value of 1.24 (Hubenov, 2010, p.15). Hence, the elasticity of the Albanian GDP with respect to the government investment should be estimated.

Table 2. Capital expenditure and GDP growth rate for the period 2005-2014

Dependent variable: GDP			
Observations: 20			
Variable	Coefficient	t-statistic	p-value
Constant	0.249	0.081	0.934
Investment	1.104	2.408	0.027
R squared	0.266	F-statistic	5.762

Source: Ministry of Finance of Albania, Central Bank of Albania, No accurate data for 2015

Table 2 shows a few econometric estimates on the relationship between capital spending and the annual GDP growth rate in Albania. The estimation consist of six-month observations for the period 2005-2014. There are no accurate data for 2015. As seen, the elasticity of the growth of the Albanian economy with respect to government investment has a coefficient of 1.10. This value is close to this one estimated for the EU-27 (Hubenov and Boshnakov, 2010). Albania's coefficient shows empirically the effect of multiplication of capital expenditure, i.e. a one-percent increase in the investment will cause an increase in the annual GDP growth rate of more than one percent.

Table 3 shows the government expenditure differentiated by economic function. The presentation follows a widely accepted international classification. The main spending items of Albania's budget are the functions of general public services, economic affairs, health care, education, social protection.

The expenditure of first function are not directly related to a catching-up economic growth, but they are a precondition of qualitative government institutions. Therefore, they should be maximum effective. Parallel to, quantitative criteria for an estimation of the effects of government spending, qualitative criteria should also be approved for performance efficiency.

The expenditure on education are an important item consistent with the purpose of intensive economic growth. It is impossible to develop a modern economy of knowledge without an increase in the spending on education and science. The system of education in Albania should be fully reformed in order to be adequate to the challenges of the EU membership and needs of a modern economy for skilled workers. It would be rather a subject of other kind of research. The high level of skills and qualification of the persons offering labor is a key factor for attracting foreign investments. The government can influence this factor through an increase in the spending and improvements the efficiency of each dollar of expenditure. It is important to note that Albania's ratio of the spending on education is close to Bulgaria's one, which is one of the lowest in the European Union (see BGNES, 2014).

*Table 3. Albania's Government Expenditure by Economic Function (% of GDP)*

Type of Expenditure/Year	2007	2008	2009	2010	2011	2012	2013	2014
General public services	5.12	5.19	5.81	5.64	5.83	5.44	5.59	5.90
Defence	0.83	0.79	0.89	1.14	1.04	1.09	0.87	1.01
Public order and safety	1.34	1.25	1.37	1.50	1.60	1.57	1.45	1.52
Economic affairs	3.41	5.44	7.86	4.15	4.14	3.28	4.14	4.20
Environmental protection	0.01	0.01	0.02	0.03	0.05	0.03	0.04	0.04
Housing and community amenities	0.93	0.91	1.34	1.58	1.71	1.50	1.80	1.76
Health	2.02	2.06	2.41	2.51	2.58	2.64	2.53	2.54
Recreation, culture and religion	0.27	0.28	0.33	0.31	0.34	0.32	0.30	0.32
Education	2.66	2.90	3.21	3.25	3.09	3.22	3.23	3.25
Social protection	7.40	7.01	7.79	7.97	8.17	8.47	9.09	9.02
Other expenses	0.06	0.57	0.07	0.00	0.00	0.00	0.00	0.00

*Source: Central Bank of Albania, No accurate data for 2015*

The European integration of the Western Balkan countries and improvements of the military situation in the region give possibility for a reduction of the spending on military defense. However, the expenditure on public order and safety should not be reduced.

At the end, we can mark some concluding remarks. Albania's government expenditure are too low in European perspective. The reforms on the road to the EU membership imply a significant increase in the spending because Albania's governments have to establish precondition for a catch-up economic growth. The most appropriate items for increases are capital expenditure and spending on education. These items are most consistent with the rapid growth objective. The effects of the first item in Albania is close to this of the EU-27. There still is a lot to be done in the field of science and education.

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