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THE PUBLIC DEBT IN ALBANIA AND ITS ROLE IN THE ECONOMIC DEVELOPMENT OF THE COUNTRY

Klodian MUÇO*
Catholic University "Our Lady of Good Council", Tirana, Albania
Research Centre on Economics of Transition Countries
** Correspondence: k.muco@unizkm.al*

Abstract: There is a huge debate in the economic literature on the role of public debt in the economic growth of a country. Ricardian economists think that public debt is simply a transfer of taxes over time, and as such it negatively affects the economic growth and well-being of a country. Keynesian economists, but not only, think that public debt that goes to finance innovation, technology, education, and productivity growth, has a positive impact on economic growth and the economic well-being of a country. Based on these facts, this paper evaluated the role of public debt in the economic growth of Albania during the last decade. Descriptive statistical analyzes were used for the realization of this study. The results of this paper suggest that public debt at moderate levels and in certain situations, such as the pandemic, has a positive impact on the country's economic growth. While public debt when it has high management costs or when it is used inefficiently, its costs are higher than the benefits, and its impact on economic growth is negative.

Keywords: public debt, sustainability of debt, economic growth, Albania

1 INTRODUCTION

There is a great debate in the economic literature on determining the impact that public debt has in the economic system of a country (Seater, 1993; Reinhart and Rogoff, 2010; Panizza and Presbitero, 2012; Perotti, 2012; Arellano and Bai, 2016). Today, the public debt is seen as one of the main factors of economic decline, unemployment, inflation, or high interest rates (Blanchard, 2019). On the other hand, the conventional position is that public debt can promote the aggregate demand and economic growth of a country at certain times.

On the other hand, Barro (1979) affirms that debt is a cost for the economy and inhibits economic growth, it is a transfer of taxes in time. This negative correlation is even more pronounced when the debt exceeds a certain ceiling, which according to the research study of Reinhart and Rogoff (2010), is about 90% for developed countries.

With the increase in public debt, of course, the costs of debt management also increase. This increase in debt costs in some cases is higher than the economic growth of a country, therefore the authors in question show that the debt when it is at low levels stimulates growth, while above the ceiling of 90% it becomes a burden for economic growth. The conclusions of the study in question were completely dismissed by Herndon, Ash and Polin (2013). While Guerini et al. (2017) through their study in the USA using the SVAR Approach methodology, reach the conclusion that public debt has a crowding-in effect on investment and private consumption, thus increasing economic growth both in the short and in the medium term. While in the long term, the problem is not the public debt that inhibits growth, but rather the private debt that generates speculative bubbles.

Various studies show that there is no statistical evidence that supports the hypothesis that debt growth can inhibit economic growth in advanced economies. (Perotti, 2012).

Based on the evidence given above, as well as the lack of statistical and empirical studies on the impact of public debt in the economic growth of emerging countries such as Albania, this study will analyze the role of public debt in the economic growth of Albania and the policies of fiscal consolidation. The basic hypothesis of this study is that there is no negative correlation between economic growth and public debt in Albania. As well as fiscal policies are more efficient in countries with a consolidated economy while in the countries like Albania, they habitually bring an enormous increase in public debt. Moreover, the situation becomes more problematic in times of crisis such as the current situation where the Covid-19 pandemic has significantly impacted the economy. And the public debt has increased significantly in all countries of the world and especially in Albania wherein the first 9 months of 2020 public debt has increased by 13.5% reaching 79.5%.

For the realization of this paper, the statistical analysis of different macroeconomic indicators related to economic growth and public debt in Albania was used as methodology.

From the statistical analysis of the data, we see that in the last decade there is a significant increase in public debt, but this increase has not been accompanied by a significant increase in GDP.

On the other hand, the increase in debt in recent years has been accompanied by a reduction in its cost as a result of successful debt negotiation (the government entered the open market, and it bought Eurobonds).

This paper is organized as follows, first, there is a brief introduction, then there is a review of the literature on public debt, after that, we continue with the problems of economic development in Albania. Next, we talk about the evolution of the Albanian public debt and after that, we offer a comparison of Albania with the countries of the region, and finally, we give some conclusions.

2 LITERATURE REVIEW

Different views have defined public debt and its effects on the economies of countries in different ways. There is a wide debate in the economic literature on the effects of public debt on the economic growth of a country.

According to the theory of debt neutrality, which is founded on Ricardian equivalence, public debt has no effects on aggregate demand in the long term (Buchanan, 1958; Meade, 1958; Modigliani, 1961; Elmendorf & Mankiw, 1999). Barro (1979) saw debt simply as a tax transfer in time without economic effects on economic growth.

Other studies arrive at different conclusions regarding the role of public debt in the economic growth of a country.

Reinhart and Rogoff (2010) in their study of developed countries show that there is a negative interaction between debt and economic growth. This correlation shows up when the debt ratio exceeds 90% of GDP. Reinhart and Rogoff in the study in question say that this correlation may be a causal correlation between high debt and low economic growth.

Herndon, Ash, and Pollin (2013) identified errors in the estimate of average economic growth by Reinhart and Rogoff (2010). They not only criticize the maximum limit of Harvard economists, but also of the study.

Panizza and Prebsbitero (2013) in their study on the relationship between debt and economic growth in developed economies, arrive at a conclusion that there is causality, heterogeneity and that this correlation is such where an increase of 30 percentage points in debt correlates negatively with a decrease of 0.5 percentage points in economic growth. While in the other study of 2014, Panizza and Presbitero reach the conclusion that public debt has growing negative effects in economic growth of Japan and Greece country. The same result is reached by Schclarek (2004) in his study in a group of developed and industrial countries.

Patillo, Poirson and Ricci (2002) reach the same result in their study of 93 developing countries. According to the authors in question, external debt has a negative impact on economic growth in developing countries after a certain level of debt, this level is calculated over 35-40%.

Minea and Parent (2012) in their study agree with a part of Reinhart and Rogoff's study, that there is a level of public debt where its effect on growth goes from positive to negative, but that the assessment of this level is very difficult to find accurately. A similar result is reached by Banglan and Yldas (2013).

Guerini et al. (2017) in their study with SVAR Approach, totally contradict the above results, they say that public debt has a crowding effect on consumption and private investments. Crowding occurs when the increase in public spending (even with debt) leads to an increase in real GDP, which stimulates the growth of private spending and investment thanks to the multiplier effect. The multiplier effect is the reason why even Stiglitz (2012) supports economic stimulation through public debt.

For developing countries such as Albania, different empirical studies have concluded that for developed countries, high debt levels have negative effects on the economic growth (Pattillo et al., 2004; Kumar and Woo, 2010). However, it has not been empirically proven where a ceiling limit should be placed.

The IMF considers 45% to be the optimum limit of public debt to GDP ratio for developing countries, whereas 60% is the maximum limit.

3 PROBLEMS OF ECONOMIC DEVELOPMENT IN ALBANIA

Although almost 3 decades have passed since the change of the system, Albania is still facing problems regarding the economic growth of the country.

Unemployment remains one of the main problems. Unemployment means economic and social costs, loss of income for individuals, which consequently leads to a loss of tax revenue, an increase in expenditure, a decrease in GDP, and various social problems. If we look at the statistics, the unemployment rate has been decreasing by a slightly significant percentage from 2016 to 2019, but we note that it is Albanian youth between 15-29 years which has suffered the largest decrease, approximately 7%.

Although the figures look positive, it is another factor that has made possible the reduction in the unemployment rate for this age and this factor does not constitute a positive aspect for our country, emigration.

Albania, like other countries in South-Eastern Europe, is facing problems from the emigration of people. Emigration is a global phenomenon, but unlike other countries, today, after three decades, Albania is experiencing a new wave of emigration and the population is being reduced significantly. Referring to INSTAT data (2022), if in 1990 the average age of the population was 21.4 years, in 2021 the average age was 37.8 years.

Only in the last 10 years, about 500 thousand Albanians have left the country. This is putting the pension scheme in difficulty, where if in 1990 we had about 4 employed persons for 1 pension beneficiary, today Albania has 1.4 employed persons for one pension beneficiary, while in 2030 according to current projections we will have 1.1 employed persons for one pension beneficiary. (INSTAT, 2022).

The departure of people is leading to a decrease in the number of students in schools, leading to the creation of collective classes in the peripheral areas, this makes the quality of teaching and learning drop significantly. The exodus of young people is significantly increasing wages, but without increasing productivity.

The departure of educated people is making the investment in human capital made in Albania go to the developed countries, benefiting the developed countries, and creating in the Albanian reality a lack of doctors, nurses, engineers, etc. (Muco, 2020, Muco, 2022).

Another problem is related to foreign investment in our country. Foreign direct investment (FDI) in Albania fell to 7.6% of GDP after the completion of the investment phase of large energy and gas transmission projects (WBM). The Netherlands was the largest foreign investor in Albania in the first quarter of 2019, according to data on FDI flows published by the Bank of Albania.

This country invested € 77 million in the first quarter, down 11.4% compared to the same period a year ago, but if we consider the first quarter of 2020, the inflows invested by the Netherlands in our country is € 95 million. Switzerland is no longer the main investor. Inflows from this country, which is the main source of TAP gas pipeline investments, were € 67 million in the first quarter of 2019, down 37% compared to the same period last year, and € 45 million for the first quarter of 2020, down 22% compared to the previous year.

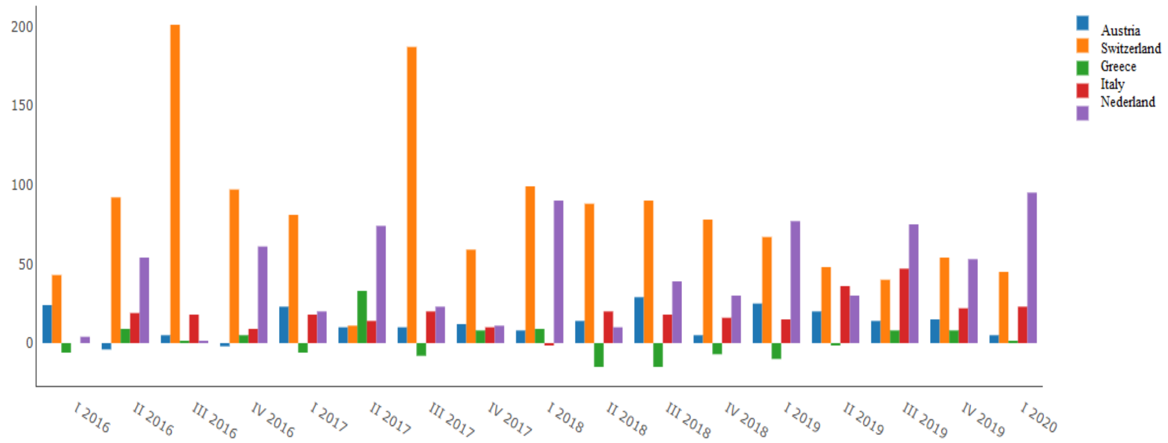


Figure 1. Quarterly inflow of foreign investments

Source: Bank of Albania, 2020

The third-largest investor in the country for the first quarter of 2019 was Austria, with € 25 million, followed by Turkey with € 19 million. But Italy became the third-largest investor in the country.

But Albania ranks very low in terms of investment. Foreign investors still face unresolved problems related to corruption, property registration, institutional red tape, justice reform, protracted economic crisis, etc., which cause them to lose confidence. The fact that they are leaving Albania is costing the Albanian economy dearly.

The government should make continuous efforts to address the abovementioned problems for foreign investors to remain optimistic that Albania will be able to be competitive among the other countries of the Balkans.

4 THE EVOLUTION OF DEBT OVER THE YEARS IN ALBANIA

With the repeal of the last paragraph of Article 58 (which determined the 60% limit of public debt in the Republic of Albania) of Law no. 9936, dated 26.6.2008 "On the management of the budget system in the Republic of Albania", approved on 7.12.2012, the Albanian public debt began an upward trajectory, passing to 64% in 2014 to reach around 69% in 2016. After this year until 2019, the debt trajectory had a downward trend, passing in 2019 to about 66% of GDP with a 2% decrease compared to 2018. To increase again in 2020 due to the pandemic, where it reached the maximum level with almost 80% of GDP.

The main factors that have influenced the reduction in the debt level to GDP ratio have been, fiscal consolidation, an economic growth rate higher than the debt growth rate, and the appreciation of the local currency about to other currencies that make up the debt portfolio (AMF).

The public debt was ALL 1.11 trillion and the largest part of this debt belongs to the internal public one 35.37%, while the external government debt stock was 30.48% (Ministry of Finance 2020).

In 2019, the government orientation was towards long-term debt instruments.

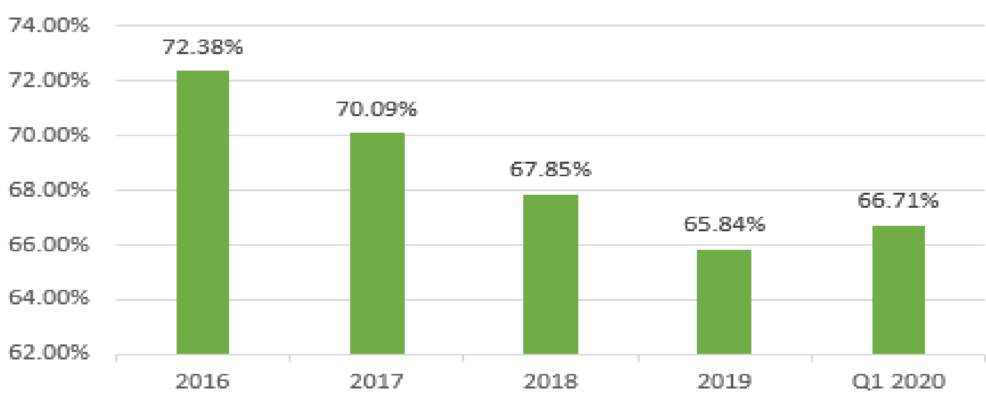


Figure 2. Central government debt to GDP (%) structure

Source: Ministry of Finance, 2020

Regarding the internal public debt stock, it consists of short-term and long-term instruments, as well as guaranteed debt. Currently, the government has started using a series of instruments to reduce the risk of internal public debt. Promoting 7- and 15-year bonds against short-term instruments. At the end of 2022, the Prime Minister of Albania together with the Minister of Finance will undertake a promotional policy for the purchase of bonds by citizens as a very good long-term investment.

Borrowing through short-term instruments has mainly served to manage short-term liquidity needs, while deficit financing was made possible mainly through long-term instruments. In the domestic market, in short-term instruments, we see a further decline in auctions in 6-month Treasury bills, whereas 12-month treasury bills have continued to remain at the same levels.

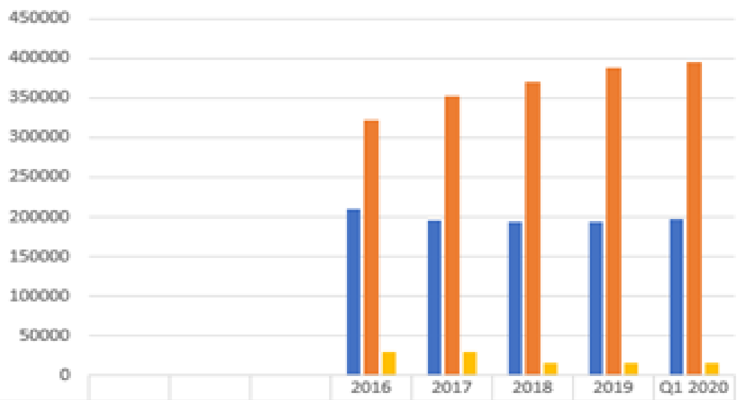
There is a marked increase in long-term instruments compared to 2018, in the issuance of 10-year, 5-year, and 3-year bonds, whereas there is a decline in the issuance of 2-year bonds compared to a year ago. In long-term instruments, the debt stock is estimated to be ALL 388 billion, while a year ago it was ALL 370 billion.

Seen from the point of view of the currency in which this debt of the domestic market is, it turns out that there is ALL 582 billion (Albanian Monitor, 2022) in lek.

Among domestic debt holders, the data show that 62.22% is held by the banking sector, slightly increasing its share compared to 2018, when it held 61.25% of the debt. Individuals` debt holders represent only 13.41% of domestic debt, while a year ago they held 15.15%. Non-bank financial institutions also have a bigger share.

The trend of securities' interest rate was declining in 2019 as well because of pursuing monetary easing policy with a base interest rate of the lek at an all-time low of 1%. Data from the Ministry of Finance show that the interest rate on 10-year bonds was 5.39% while in 2018 it was 6.811%.

Rates were also lower on 7-year, 5-year bonds, and so forth on each of the instruments. The low-interest-rate explains also why people have shown little interest in participating in government securities auctions. (Albanian Monitor)



	2016	2017	2018	2019	Q1 2020
Short term instrument	209,409	195,047	194,545	193,739	197,489
Long term instrument	321,426	351,892	370,548	388,396	395,479
Short term debt	30,286	30,117	15,218	15,154	15,496

Figure 3. Central government debt stock and guaranteed debt.

Source: Ministry of Finance, 2020

Regarding the external debt of Albania, the government in recent years has gone to the European debt markets several times. The current value of the Eurobond according to the Ministry of Finance (December 2022) is about 1.8 billion euros, which is about 15% of the total public debt of Albania.

In the following months, a request is expected again in the foreign market to receive another 500 million euros. This debt goes mainly to finance strategic investments and to support the reforms undertaken by the government. Taking the Eurobond has a positive impact on reducing public debt costs, especially when interest rates in international markets have been very low.

Issuance of Eurobond of € 500 million in 2018, which was accompanied by the buyback of the existing Eurobond of € 200 million, enabled it not only to address its liquidity needs in 2018 and 2019 but also the active management of debt liabilities to keep refinancing and interest rate risk under control in the short and medium-term. About 49.2% of the government debt portfolio continues to be comprised of ALL, followed by the Euro and USD.

The external debt portfolio continues to be over 65% in Euros. Thanks to a significant strengthening of the local currency ALL and the devaluation of the euro in recent months, it has led to a significant decrease in debt costs. So, Albania is benefiting more recently from the strengthening of the local currency in relation to foreign currencies, since almost one-half of the country's public debt is in foreign currency.

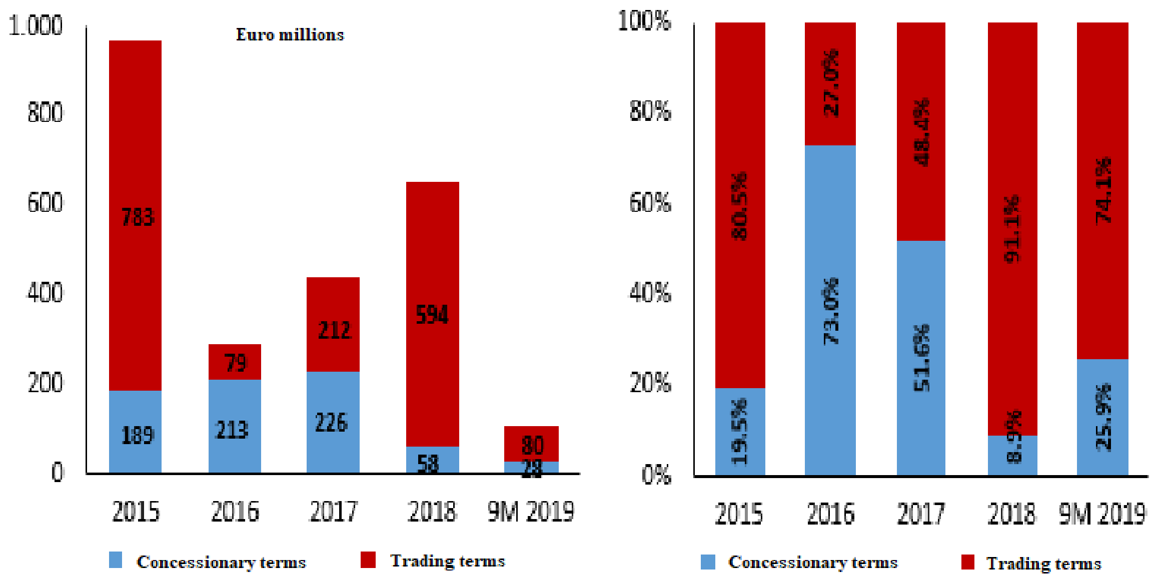


Figure 4: Public debt by liabilities

Source: Ministry of Finance, 2020

The improvement in the cost-risk ratio in recent years in Albania has derived not only because of good management but also because of market conditions and macroeconomic factors of the country as it could be:

- Until the end of 2021, the base interest rate was very close to zero in the European Union, Albania and beyond. This made the domestic public debt as well as the foreign one to have very low interest rates.
- The great availability of liquidity in the market made it easy even for countries like Albania to finance their projects with debt at low interest rates (the last Eurobond was obtained at only 3.75%).
- High demand for 5-, 7- and 15-year bonds with fixed and satisfactory interest rates;
- The strengthening of the local currency, especially in the last two years, in relation to the Euro and the Dollar.

Today, the problem is the significant increase in interest rates both in the international markets as well as in the domestic market, where 7-year bonds are given at almost 7.8% today, while 2-year bonds at the end of December 2022 were traded at 5.89%. Also, another problem remains the fact that the external public debt has a low maturity rate, this forces us to go to the international markets again to refinance the old debt.

The indicators that evaluate this risk have progressed towards strategic objectives of Albania. The reduction in the weight of short-term instruments has led to an improvement in the risk of refinancing domestic debt.

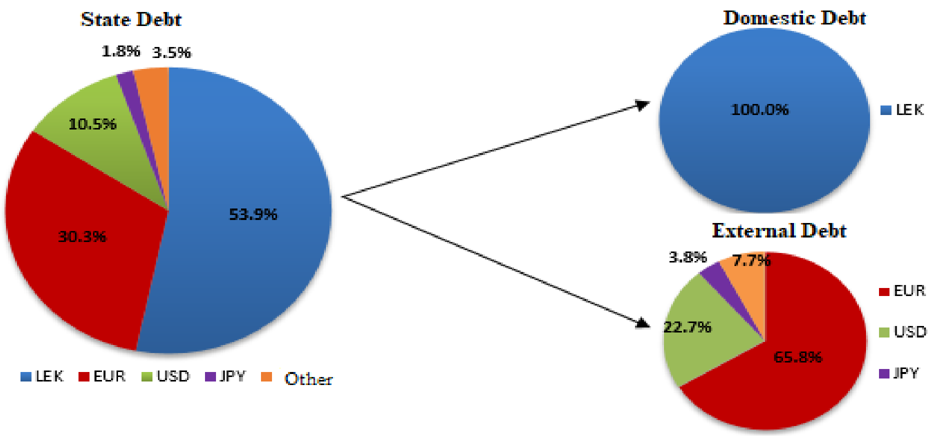


Figure 5: Debt by currency

Source: Ministry of Finance, 2020

5 COMPARED DEBT OVER THE YEARS IN THE REGION

Although during the above analysis the debt in our country for the period 2016-2019 seems to decrease as a percentage of GDP, compared to the countries in the region, the figures are worrying.

If we consider the figures from the World Bank report (WBR) on public and guaranteed debt as a percentage of GDP and calculate a simple average for approximately the last 3 years, we see that Albania and Montenegro rank first with a debt level on average about 69.87% and 74.63% of GDP.

Then comes Serbia with a debt level averaging about 55% of GDP, Macedonia with 46% of GDP, Bosnia & Herzegovina with 36% of GDP, and Kosovo with about 16.9% of GDP.

Different views have defined public debt and its effects on the economies of countries in different ways.

Referring to Blanchard's study (2012) or conventional analysis, if public debt goes to finance projects that generate well-being for individuals. The latter will use this additional income, or this increase in well-being to consume more goods and services, stimulating aggregate demand and private investments. This will lead to an increase in national income and an increase in the country's GDP.

Unlike the conventional ones, the classics see public debt as something negative for society and think that a budget deficit is a sign of state bankruptcy.

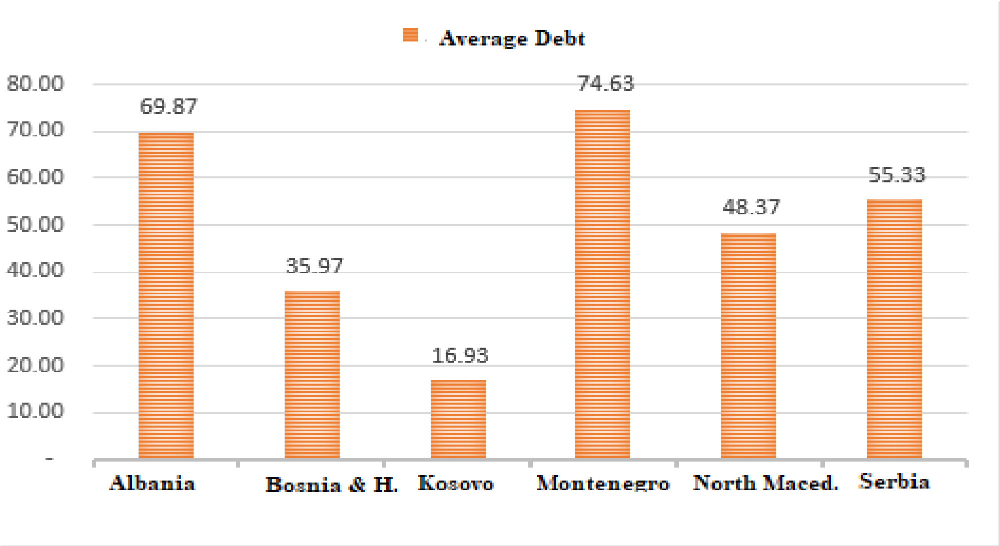


Figure 6: Public and guaranteed debt (percentage of GDP)

Source: World Bank, 2020

6 CONCLUSIONS

This research study aimed to evaluate the role of public debt on the economic growth of Albania.

Referring to the economic literature regarding the impact of public debt in economic growth, it can be concluded that there are different views about the correlation sign of public debt and economic growth, as well as the existence of a level of public debt above which public debt becomes an obstacle for the economic development of a country.

So, it can be affirmed that all researchers agree on the fact that public debt has management costs, which comes because of interests, where Albania had average interest costs of around 3.53% during 2021.

The increase in public debt or the increase in interest rates encourages countries to bring more and more financing for debt interest payments, draining resources that could be invested in different sectors of the economy of a given country with the aim of growth and economic development of the country. As for the costs of the debt, they are affected not only by the interest rate but also by the currency in which the public debt is taken, since the strengthening of the local currency can help to ease the cost of the debt if the one in foreign currency is dominant.

From the statistical analysis it emerges that economic growth during the last decades in Albania has been mainly stimulated by debt.

During the last decades in Albania, the public debt has gone up to about 4.5 billion dollars, while the growth of GDP in nominal value has been about 3.8 billion dollars. In 2022, economic growth in nominal value is estimated at around 827 million euros, while the increase in public debt was around 845 million euros. Of course, the effects of public debt on economic growth come with a 2–4-year delay, from the 12-year analysis it can be said that in Albania, public debt is not very efficient in stimulating the country's economic growth.

Debt negotiations in recent years have been with a very low interest rate, but from the beginning of 2023, an almost two-fold increase in debt costs is expected, for this reason it can be said that the period of quantitative easing has ended, costs of debt is increasing and its impact on economic growth will be reduced or on the contrary it can have negative impact on economic growth.

Also considering the situation of economic performance of the country, fiscal revenues, the level of public debt, and the policies pursued in Albania, I can say that in recent years, whenever governments have tried to intervene in fiscal policies and reduce the budget to some extent, there was no improvement in the management of public finances or an increase in fiscal revenues because of good fiscal management. The increase in the cost of the debt that is expected in the future may endanger the public finances of Albania. For this reason, for countries like Albania, it is suggested to maintain a level of public debt in control, which according to the IMF should be below the 60% level. Consequently, the reduction of public debt in Albania is necessary to have public finances under control and to have sustainable economic growth.

Thus, to conclude, we can say that in Albania the debt needs to go more towards technological improvement and towards an increase in the quality of human capital than infrastructure. This would certainly increase GDP significantly and reduce the public debt-GDP ratio.

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