

The Budgetary Deficit and the Public Debt in Albania



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The financial global crisis, although beginning as a crisis of the financial markets and institutions, actually has become a crisis of public finances management. The deepening of the budgetary deficit and the growth beyond allowed limits of the public debt on most of the European Countries, impacts directly or indirectly even on the Albanian public finances' performance. The misbalance on the public finances is maybe the most serious internal thread of the Albanian economy. this approach aims at analyzing the status of the budgetary deficit and the public debt in Albania for a period of 13 years.

1. Introduction

1.1 The Budgetary Deficit and Its Progress.

It must be stressed that the budget is very important as a financial instrument through which it is accomplished the redistribution of a great part of the national revenues. There exist many definitions concerning the budget, but according to the "organic law on the budget" in Albania ... "the state's budget is the financial annual program composed of the funds approved by the People's Parliament, where are included all the revenues, loans and other entries and relative expenses to exercise the activities and competences of the High Organs of the State Bodies, of the state administration, the local government and judicial bodies." The state's budget is the principal financial instrument for the implementation of the state's economic and social policies.

On the national accountancy, the budgetary deficit comes as a result when the state's entries are lower than its expenses, thus the budget balance is negative. Moreover, the public administrations (the whole of the other central bodies, of the local government and the social insurance administration) have a public deficit when the public expenses for one year are higher than the public revenues; thus the public finances balance is negative. In the case when the budget entries are higher than the exits, there is a budget surplus, which happens very rarely. More concretely, in mostly of the countries, the public budgets (measured on an annual basis) are built on the deficit.

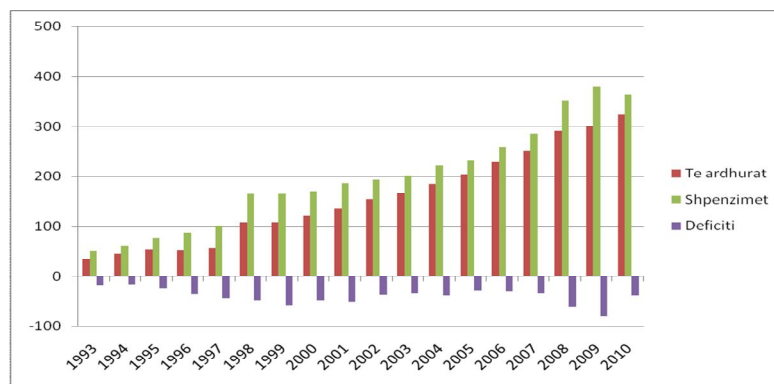


Figure 1.1 Entries, Expenses and Deficit Expressed in Million Leks
(Red – Entries; Green – Expenses; Purple – Deficit)

Source: INSTAT

Between the years 2000 and 2010, the entries have raised on average 9,9%, while the expenses have raised on average 7,5%. On 2001, which was an electoral year, there was a growth of the deficit compared to the year 2000, but after the year 2001 until 2003 it is noticed a decrease of the fiscal deficit as a result of the incomes growth rate higher than the expenses growth rate. This descending tendency was an implementation of the government's fiscal objective to lower the budgetary deficit until the year 2005 in 5,8% of the GDP. A better situation was on 2003 when the deficit descended by 11% compared to the year 2002, especially thanks to the low expenses and the fiscal discipline. The year 2004 returns the deficit growth, but

it continues to be on the measure of 4,9% of the GDP as the previous year. The principal cause was the high growth of expenses on social protection and investments on health and education.

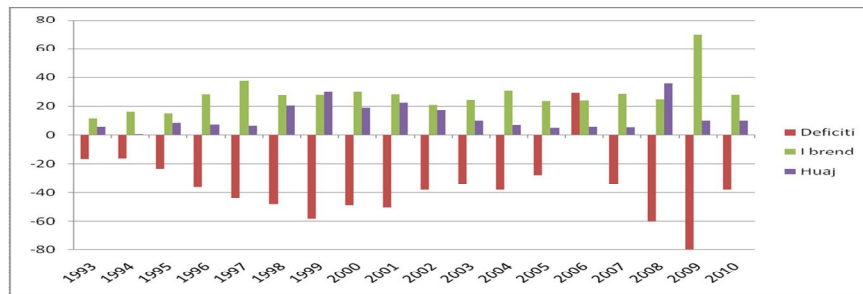


Figure 1.2 Financing of Deficit in Million Leks
(red – deficit; green – inner; purple – external)
Source: INSTAT

On 2005, it is noted the deficit's biggest decrease since 1997 with 26% as a result of the successful measures to reduce it. The principal emphasis was put on the revenues growth and, above all on the lowering of the expenses. Since 2006 there is a continuous growth of the deficit reaching the maximal range on 2008 with 5,5% of the GDP and on 2009 with 7% of the GDP. These high norms are caused by a growth of the expenses on investments, especially for the funding of the highway Rreshen – Kalimash. The end of the funding was accompanied with the decrease of the deficit for the years to come. The public deficit reached the 3,4% of the GDP on 2012, surpassing the level 3% planned on the initial budget, but, anyhow it stayed lower than on 2011, when it reached the level of 3,5%. The disappointing performances of the incomes collection affect the level of 3,5% of the deficit on the year 2013. Generally, the incomes has performed approximately 7% lesser than 2012 compared to the planning of the initial budget, as the main items of the budget, such as TVSH (VAT) and the revenues from excise have dropped significantly compared to the initial objectives, reflecting a decreasing inner demand. The fluctuations in incomes were compensated only partly by the expenses, where the biggest cuts have affected the capital expenses which dropped by 12% compared to the initial objectives and the same compared to 2011 (the numbers and comments are extracted from the EU progress report for Albania 2013). The budgetary deficit is financed from inner or external sources.

To balance the accounts, the deficit may be compensated through:

- Loans – this displaces the problem in time, it is needed the creditors' conviction and has a supplementary cost as there are interests to be paid.
- Use of previously accumulated reserves from the budgetary surpluses realized during previous years.
- Rise of taxes, supposing they will not suffocate the economic activity, which would bring the decrease of the entries for the public budget. On the other side, the lowering of the taxes built to stimulate the growth of the economic activity would bring the growth of the sum of the fiscal revenues.
- Monetary emission
- Reduction of public expenses

2. The Public Debt

The public debt comprises the sum of the state loans and the matured and unpaid interests until the moment of their calculation. The loans from the government are dictated by the need to ensure the entries sources to cover the budgetary deficit. The public debt is increased every year when the public deficit is exclusively financed by new loans.

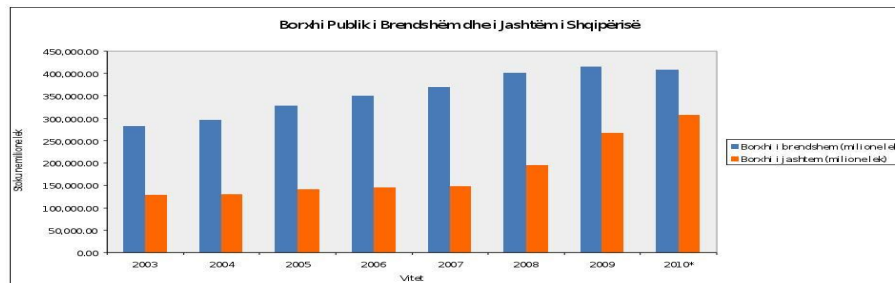


Figure 2.1 The Internal And External Debt In Million Leks Progressive
(Blue – Internal Debt in Million Leks; Red – External Debt in Million Leks)
Source: Mf, Bsh

The public debt until the end of 2009 is composed only of the central government debt. During the year 2010, for the first time, there are included on the public debt stock also the obligations of the local government, which until the end of 2010 are

estimated to be in the limits approved by the Ministry of Finance in the amount of 147 million leks or 0,01% of GDP (the strategy of the public debt 2010-2012).

A country's debt stock is the total of the public debt emitted within and outside the country and which is not liquidated. The public debt can be emitted within the country and is kept by residents (internal debt), or outside the country and it is kept by non-residents (external debt).

For the year 2010, the total debt is 715 milliard leks, from which 407 (56.9%) milliards are internal debt and 308 (43%) milliards are external debt. The stock of the public debt by the end of 2011 was 772.5 milliard leks or 59,4% of the GDP. (The data are extracted from MF). From this total, 438,5 milliards are internal debt (56,7%) and 334 milliards are external debt (43,2%).

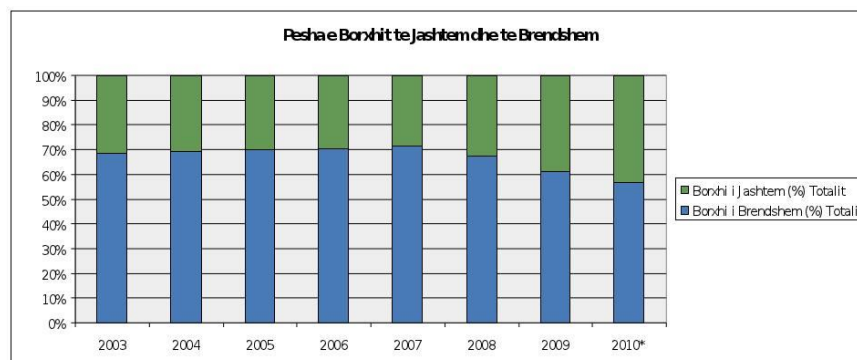


Figure 2.2 The Weight of the Internal and External Debt in %
(Green – External Debt (%) Of Total; Blue – Internal Debt (%) Of Total)

Source: MF, BSH, FMN

The last years it is noted a clear growth of the weight of the external debt versus the internal debt. During the year 2010 was emitted for the first time the Eurobond on the capitals foreign market with the amount of 300 million Euros. The growing tendency of the foreign debt stock it is noted since the year 2007, as a consequence of following a policy of financing with foreign instruments giving the Albanian economy the possibility to profit from the credit in internal currency. Despite the growth in % of the external debt weight, Albania is largely based upon the internal sources of deficit financing. Quite three-fifths of the public debt is internal, but it continues to have a short-terms tendency (quite its half has a duration of one year or less), demanding continuous refinancing.

As for the keepers of the internal debt, the debt is mostly kept by the bank system. The percentage of the treasury bonds bought by the families is growing, but the larger part of the debt continues to be kept by the banks, which may become a problem in case banks decide to lower the stock of the public loan and also exposes banks to the sovereign risk. Generally, the relatively high and growing public debt and its short-terms character are a concern as they represent a source of macro-finance danger, especially after repealing of the debt's legal roof.

Table 2.1 Keepers of the Internal Debt in %

Source: MF

Keepers of the internal debt	2008	2009	2010
Bank of Albania	17,75	17,66	15,40
Raiffeissen Bank	36,88	34,57	33,94
Other Banks	34,58	34,33	35,37
Non-Banking Institutions	2,46	2,68	3,21
Individuals	8,33	10,76	12,08

Table 2.2 Keepers of the External Debt in %

Source: MF

Keepers of the external debt	2008	2009	2010
Multilateral institutions	61,46	54,01	52,67
Governments	15,80	14,92	15,58
Private creditors	17,39	25,68	27,43
Others	5,35	5,40	4,32

The principal keepers of the external debt are the multilateral institutions and the private creditors (foreign banks). During the last two years, the weight of the private creditors has grown. For the year 2011, at the first place as the principal financier

of the Albanian Government is the World Bank with 800 million Euros used to finance priority projects of the infrastructure or social development. The private creditors occupy the second place with approximately 721 million Euros where are included all other banks and financial institutions with which the Albanian Government has signed private financing agreements. The buyers of Eurobond occupy the third place in the line of the keepers of the foreign debt with 298 million Euros (*data extracted from MF*).

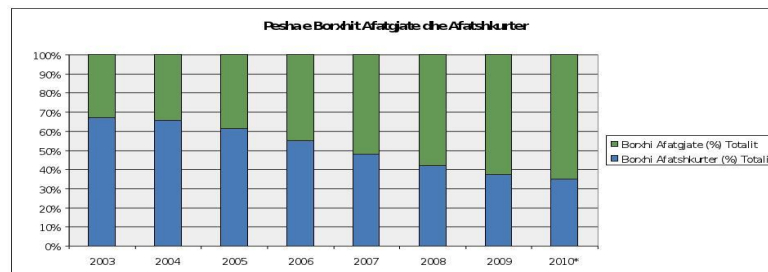


Figure 2.3 The Weight of the Short and Long-terms debt in %
(Green – The Long-Term Debt (%) Of The Total; Blue – The Short-Term Debt (%) Of The Total)
Source: MF

During the last years it is noted a growth of the long-term debt's weight versus the short-terms debt and this is part of the MF's strategy on the public debt. The short-term debt is composed of the treasury bonds, while the long-term debt consists mostly of two and five-years obligations. On 2007 there were emitted for the first time even the seven-year bonds. The internal debt is almost all of short-terms and the average maturation is approximately 0,8 years which means that it should be refinanced within a year. Meanwhile, the long-term debt is more than long-terms as there are included soft loans taken until the year 2005, with an average maturation of 11 years. The Eurobond emitted on 2010 has 5-year maturation. The growth of the long-term debt lowers the need for refinancing, but on the other side it increases the costs, as the long-term debt means the payment of higher interests than the short-terms debt because of the lower liquidity.

Even though the Eurobond emitting increases the diversification of Albania's public debt, as being emitted in Euro, to pay the interest and the debt when it will be matured, it is necessary the exchange in Euro. Therefore, the growth of the external debt's weight generally increases the risk of the exchange rates and the debt's cost if Euro (or other currencies) becomes stronger than the Albanian Lek. Therefore, the internal debt gives the economy more stability and sustainability, since it does not have the effects of the exchange rates. The stalemate resides in the internal debt's structure which is based upon the type of short-term payments with 58% and only 42% in long-term payments and concentrated on less investors, especially banks. This situation increases the risk of refinancing and the cost of the public debt. To breathe freely, the government's pockets must be built upon long-term payments; otherwise it must borrow only to pay the old debts.

The Cost of the Public Debt

The debt taken from a country to finance a part of its expenses, being capitals or current, is accompanied by the rise of the obligation of paying the interests, often known as the debt's cost. A very important indicator to judge over the debt and the capacity to pay its cost from the borrowing country is the debt's cost per capita. It is calculated as a report of the sum of interests to be paid on one determined year with the population of this year.

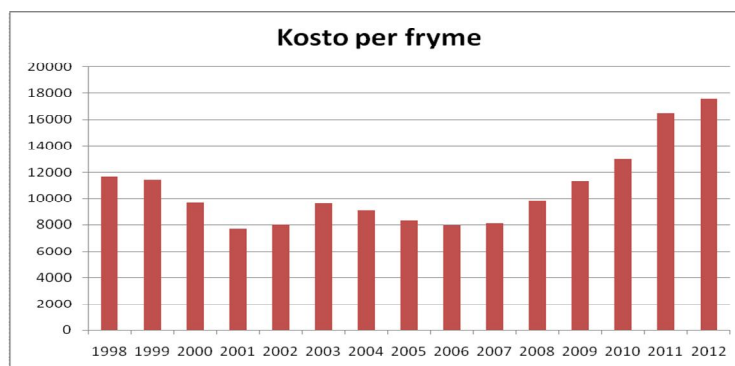


Figure 2.4 Cost Of The Public Debt Per Capita
Source: MF; BSH; INSTAT

During the years 1998-2010, the rates of population change were low, for this reason the main cause of the fluctuation of the debt's cost per capita was the interests' expenditure. During the years 1998-2001, there is a continuous decrease of the debt's cost per capita, from 11,724 lek on 7,710 lek on 2001 or 34% less. During the years 2002-2007, there is a debt's cost per capita fluctuating more or less on the same values, excluding the year 2003 when the debt's cost per capita increased by

approximately 20% compared to the previous year. During the years 2008-2012 it is noticed a continuous increase of the debt's cost per capita which during the years 2008-2009 was caused by the increase of the debt's stock. As it can be seen on the graphic, until 2010 the progress of the debt's cost per capita is explained mostly by the increase or decrease of the debt's cost, while the population becomes the determining factor for this indicator only on the year 2011. The decrease of the population number, used for calculations, according to the census preliminary results, affects the high figure of the debt's cost per capita on 2011.

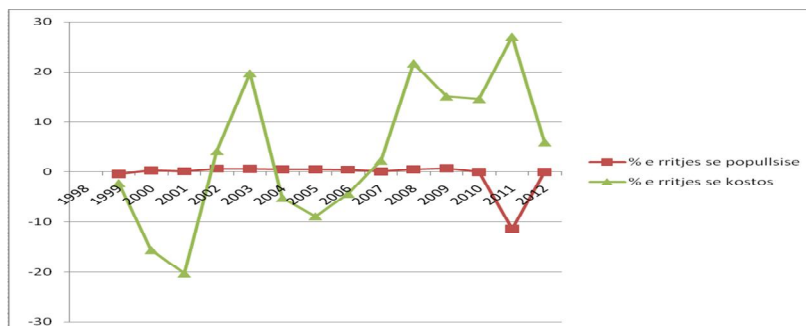


Figure 2.5 % of The Population Increase and % of the Debt's Cost Increase
(Red - % of the population growth; green - % of cost growth)
Source: MF; BSH; INSTAT

3. Is it a Concern the High Level of the Public Debt in Albania?

The public debt and its role on the stability of the public finances and the economic growth is part of a wider world debate, especially after the year 2010, when it seems the financial crisis is under control; but the most worrying remains the imbalance of the public finances as a consequence of the public debt increase. Investments and bigger public interventions that helped fighting the financial crisis, now are becoming an obstacle to encourage the economic growth and revive the most important productive sections of the European and world economies.

The macro-economic stability, as a foundation of the stable economic growth, is receiving more importance than ever. This stability is being evaluated by investors and banks with stricter standards than ever. The key danger for the macro-economic stability of Albania is the stock of the public debt being evaluated with more than 800 milliard leks on 2012 and during the year 2013 it is estimated to have reached the figure 883,849 million leks or 65% of the GDP. These figures have become known by the government's report on the Economic and Fiscal Program 2014-2016. But, if we consider the government's arrears, the stock of the public debt goes to 70,4% of the GDP.

This rise of the debt level may be accompanied by some difficult situations:

1. In case there is some hard batting on the budget (unexpected energy import), there exists the big risk to overpass it. The increase of the debt level to the GDP may be considered by the markets as a sign of lack of macro-economic stability and react negatively making harder to support the economic growth.
2. As seen above, the greatest part of the public debt is short-term and financed mostly by banks and its refinancing every year represents a growing danger. In case the government increases the level of the intern loans, this diminishes the possibility to credit the private sector because of the so-called "removal of capital".
3. On the conditions when a great part of the internal debt is on short-terms instrument, this will increase the interest rate on the internal market which would lead to a possible rise of the public debt.
4. The increase of the external loan, besides the positive side, has also the exchange rates risk which, on the conditions of domestic currency depreciation increases the public debt.
5. This decision goes contrary to the recommendations of the IMF and all the developments happening in Euro zone undertaking concrete actions to reduce the debt and not to increase it. Now, almost every country of the Euro zone is adapting the "golden fiscal or budgetary rule" according to which, the principal public finances parameters, thus even the debt limit, are defined by law in the constitution and can be changed only by qualified majority.

It is true that in Albania the public debt figures are not in the alarming levels of the European countries suffering from the debt crisis but, the slowdown of the economic growth, the problems with the management of the energetic system, the slow growth of the economic loans, the existence of the high informal unemployment, the exports narrow base, the decline in remittances, etc. makes a concern of the Albanian debt. Besides these factors affecting negatively the public debt level, during our analysis we must consider another important thing. The thing playing the principal role on a country's public finances and their stability is not just the public debt level, but"The possibility to finance it ... the ability to return the debt together with the interests, its concrete use in economy and the expected effects on the economic growth...." (A. Civici, 2012). So, what's important, is the way his debt will be used and the effects on the economic growth. The risk of the debt roof increasing will be minimized if it will be used for financing with quick and visible effects on the economic growth, on decreasing the unemployment, etc. by being used only for public investment financing and not for current expenses. A positive impact on the debt level would have the use of the revenues from Albpetrol privatization to pay a part of Albania's external debt.

During a slow economic growth, it is not suggested to take coercive measures but, to favor the economic growth, it is necessary, through administrative measures and policies, to limit the government expenses, especially the current expenses and to increase the public revenues, decreasing in this way the budgetary deficit and bringing it to the agreed level of 3% of the GDP and the public debt to the level of 60% of the GDP, holding the EU criteria.

4. Conclusions

To keep under control the budgetary deficit, it is important to make realistic predictions on the revenues and expenses planning. Usually, the Albanian government makes a very optimistic prediction of the economic growth and the revenues to justify a high expenses program. The fiscal consolidation is the short-term and mid-term priority to improve the economic performance and to lower the risk of a high level of public debt. Lower deficits will promote the loans for the private sector with lower norms of interest and also the economic growth.

Besides the deficit, the public debt also must be well-managed, because its high levels may conduct to a high uncertainty, deformed taxes in the future and reduced investments, having thus an impact on the economic growth. Concerning the public debt, the debate must not be concentrated much on its level in relation to the GDP, than on its management. The use, especially of the external debt only for investments, their effectiveness, the expected effects on the economic growth, the growth on % of the long-term debt's weight versus the short-terms one would lower its risk; on the contrary the public debt's high level would be really a concern.

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