THE ALBANIAN PUBLIC DEBT IN COMPARISON WITH OTHER COUNTRIES IN THE REGION

Migena Petanaj[1], Veronika Durmishi[2]

[1] University "Ismail Qemali", L. Pavaresia Vlore, Zip code Al – 9401
e-mail: migenapetanaj@hotmail.com

[2] Non-public University "Pavaresia", Bulevardi Vlore-Skele, Vlore, PO Box 4358, Zip code Al-9401
e-mail: veronika.durmishi@unipavaresia.edu.al

Abstract

Public debt is the accumulation of deficits over a certain period. The deficit occurs when the government fails to make a balance between its income and expenditures. Public debt plays a substantial role in the microeconomic system of a given country. Any government, due to various reasons, may face public debt at different extents. There is no country to have escaped public debt; however, different cases call for different solutions. This is one of the reasons why we should learn more about public debt, analyze different situations and draw a comparison between Albania and other countries in the region. Government debt is an integral part of many financial systems. The world practice provides us with many illustrations of public debt as a financing source for government expenditures. The text explains the economic theory related to the elements of public debt, government expenditures, types and efficiency of government expenditures, revenues and eventual financing sources. By means of various statistic and historic data and with the aid of various analytical methods, we shall analyze the characteristics of public debt in some countries, the influence of financial conditions in debt repayment, the investment climate, the consumption structure as well as the development of international collaboration. This work is aimed at analyzing the public debt in Albania and in some countries in the region, the causes of debt such as GDP percentage, the GDP growth rate, the unemployment rate, the amount and content of government income and expenditures, the interest rate on government bonds of external debt etc.

Key words: *public debt, income, government expenditures, budget deficit, economic crisis*

Introduction

Government debt is an integral part of many financial systems. The reason why public debt occurs is that the government policy fails to make a balance between government income and expenditures. However, almost every developing country has faced public debt at a certain point in time. By examining the data available for Albania and by drawing a comparison between Albania and Greece, we shall help in identifying debt problems, as both countries are important participants in international economic relations.

Following the economic crisis (2007 – 2010) many countries got into debt. On one hand there was a decrease of their fiscal income from recession, and on the other, there was an increase of expenditures from the implementation of social policies. The question is: Is it possible for the market to absorb so many debts?

This text provides information on: the total public debt as GDP percentage, the GDP growth rate, the unemployment rate, the amount and content of government income and expenditures, the interest rate on government bonds of external debt etc.

1. Public expenditures

In many countries the government carries out some essential functions that the private sector cannot do. Such functions include: national defense, ensuring territorial integrity, ensuring social welfare, establishing a legal framework, developing industries and infrastructure, etc. Such functions expend public funds. In developing countries, public expenditures policies aim at accelerating economic growth, developing employment opportunities and playing an important role in reducing poverty level and distributing income. In the 19th century the amount of public expenditures among industrialized countries was 8%. During the 20th century such amount started to increase, until, in 1960, the percentage of total government expenditures amounted to 30%. Since then, most countries have continually increased such expenditures. In 2007, the expenditures in the public sector of developed countries were around 73% of GDP. Different countries have different public expenditures; however there is a tendency for them to increase with time. Japan has the greatest debt increase from 167% of GDP in 2007 to 204% of GDP in 2011, France from 70% of GDP in 2007 to 99% of GDP in 2011 and Greece from 103% of GDP in 2007 to 130% in 2011. These numbers are too high compared to the Maastricht Criteria, where the debt limit is 60%.

Government expenditures are classified in three categories:

1. Government consumption
2. Government investments
3. Government transfer payments

Government consumption

The category includes the expenditures made in the private sector aimed at supplying the government with domestic goods and services necessary to fulfill individual or collective needs as wells as encouraging efficient activities in the framework of a given economic sector. Consequently, the government is able to reduce the potential damage to the general economy due to the decline of a particular industry. Usually this happens by preventing job loss in the target industry and other dependent industries, such as: civil and military expenditures, consumption of fix and administrative capital, correctional programs, etc. nowadays, less than half of government expenditures in developed countries go to consumption.

Government investments

Government investments include expenditures that create advantages for the future of a society, such as: the construction of stable assets like highways, underground railways, dams, airports, watering projects, purchase of machineries and appliances used in the industrial sector, other power sources, research expenditures etc. Such expenditures are useful and likely to improve the productive capacity of economy.

Government transfer payments

A transfer payment is a redistribution of income in the market system. Such transfers can be made by any government level in the form of payments either in cash or in kind. These payments are not comprehensive as they do not absorb sources to produce. Examples of such payments are: insurance of unemployed, compensation of veterans and workers, cash assistance to big families and families in need, assistance to students, retired people etc. Government transfer payments in kind include medical assistance and homeless assistance programs. In developed countries most of government expenditures, nowadays, include even transfers. On the eve of World War II, this kind of transfer played a substantial role in increasing the public sector in developed countries. However, we can classify public expenditures in 10 functional categories, which are: general public services, defense service, public order and safety, economic issues, protection of environment, shelter and community, health, culture, religion, education, social assistance. But what is the effect of public expenditures on economic growth? Policy makers and scholars argue that an increase in public expenditures may stimulate income increase in the future. However, there are no easy ways to evaluate the effect on economic growth from maximization of public expenditures.

Some changes in the functions of public expenditures are supported by the political differences in the role a government takes to provide social assistance (insurance of unemployed, retirement funds and disability benefits). Social assistance makes the greatest category of public expenditures. In particular, Korea spends more in economic issues, whereas the United States and Island spend more in health services than in any other government function. There are other factor to influence in the structure and content of budget expenditures. Such factors as financial policy, priorities of social development and methods and plans of implementation have a crucial effect on the way how government distributes its expenditures.

2. Budget deficit and government debt

In some countries, where the proportion of government expenditures in relation to GDP is higher, there are high tax rates. Yet, taxes and expenditures are increasingly becoming incompatible with each other. Therefore, government may suffer deficits and ask for a debt. The primary deficit is defined as the distinction between actual expenditures and government income collected through taxes.

The total deficit is calculated as the difference between government expenditures plus debt interest payment and government income for a certain period of time. Deficits result mainly from war financing, recessions and inefficient fiscal policies.

The economic situation of a country has substantial effects on budget deficit.

First, increase of income level through the application of high taxes. At the same time, government expenditures usually grow during economic decline due to high payments on social programs.

Second, changes in tax rates, levels of social benefits and other government policies may also have a great effect on public debt.

Third, inflation also plays an important role on budget deficit as it diminishes the real value of total debt. Investors wait for high inflation loaded with high interest rate so as to make more expensive public borrowings. Therefore, the actual situation of a given country may cause an increase or decrease of the budget deficit and consequently of the public debt.

The deficit may be structural or cyclic, depending on the economic situation of a country. In structural deficit, the government spends money on investments that are to influence the future of a country. Once the government is sure that such investments will give high long-term returns, it borrows and spends money on them. Therefore, the borrowed money cause structural deficit. This is why structural deficit exists even when an economy operates at full capacity. In structural deficit, things are not included in the balance and the country will suffer deficit no matter how well an economy operates. On the other hand we have cyclic deficit. This kind of deficit occurs only when an economy fails to operate at full capacity due to recession for example. In the case of cyclic deficit, any borrowing made during economic decline will not be repaid unless the economic situation improves. The economy will accumulate public debt over time if the government spends more money than it collects by taxation. A government that makes expenditures by increasing the deficit is likely to increase the amount of public debt. One major component of public debt is external debt. Foreign creditors may be other governments, international organization or monetary funds. Since 2003, the gross external debt of developed economies has significantly increased. In most countries, such increase has been due to the need for high financings in response to the financial crisis of 2007. The high numbers of external debt may be a threat to the general financial stability of a given country.

A very reach and productive country is more likely to suffer and maintain a large public debt than a poor one. Governments with strong economies and good reputation usually borrow securities, government bonds, to collect funds. When individuals, groups of people or other countries buy these bonds, the government promises to pay them for a very high interest rate. Poorer and less reputable governments are likely to receive credit assistance by international financial institutions but with less favorable terms and rates.

Sometimes public debt becomes a decisive factor in the economy of a given country. In cases of payment delay, the economy may enter in a very difficult and complicated situation. That is why such international organizations as International Monetary Fund and World Bank play an essential role in financial controlling, as well as in arranging and providing stability to countries that suffer debt problems.

There is no doubt that someone has to pay for the debt, whether citizens of debtor countries, banks, people of developed industrialized countries, or more likely a combination of three groups. High debt levels have negative effects on economic growth and governments should aim at immediately minimizing such effects. The economic doctrine provides us with two main channels through which government debt might be able to effect the long-term economic growth of a given country.

1. Money collection due to fiscal policy. The theory explains an economic growth in interest rates due to increase of government borrowings in money market.

2. Increasing risk premium paid by governments that raise debt load. Countries with high debt levels usually face a huge interest premium increase due to the additional increase of debt levels.

The extent at which such channels operate in a given economy depends on the economic structure and the behavior of economic agents.

3. The Equivalence Theorem

The equivalence theorem in economy assumes that people should conform to the budget limitations of a government so as taxation changes might not affect their expenditures. It also assumes that whatever the way government finances its expenditures, by debt or tax increase, deficits have no macroeconomic effect.

For the purpose of collecting money governments may issue bonds or increase taxes. If government expenditures due to borrowings are greater than revenues from taxation, increasing taxes in the future might help to pay the loan. In this way taxation is subject to present or future changes. Rational customers will not spend additional income. They will save them to pay their own or their children’s future taxes. However, there are some critical points in the theory. First, not all customers are rational and most of them might not be able to predict a future tax increase. Second, due to recession, the average consumption trend might decline.

4. Advantages and Disadvantages of Public Debt

Nowadays almost every country faces public deficits no matter how well its economy might operate. The fact shows that deficit is a normal phenomenon. It is difficult to classify debts in good or bad debts unless we have examined its specific characteristics. The most important thing is to identify the deficit extent due to government expenditures increase, for the reason that not all government deficits result form policy decisions. With a slow economic activity and a relatively high tax system, it is more likely that revenues form taxation decrease. If the government is running a deficit due to recession, it certainly needs more money for growing social benefits and projects that will help incenting the economy. If the government is spending more in public infrastructure, education or health, this kind of deficit might be tolerable in the present times and useful in the future ones. However, deficit may be intentional and unacceptable if resulting from the financing of irrational expenditures or the buying of depreciable things that generate no long-term income. Debts aimed at covering such deficits are considered bad debts. A characteristic of bad debt is the high interest rate. Debts aimed at covering good deficits are considered good debts, for the reason that the value of such expenditures might grow and generate long-term revenues to the benefit of the country and society. Market and industry growth stimulate economy and economic development. Furthermore, they stimulate employment and increase revenues from taxes. On the other hand, there is no confirmed risk that inflation might cause inflation or increase existing inflation.

5. An analysis of the public debt

Albania

Debt stock is the total public debt that a nation owes to local or foreign lenders. Public debt may be domestic and owed to local residents (domestic debt) or external and owed to non-residents (external debt).
Based on the data available at Bank of Albania, ministry of Finance and International Monetary Fund, Open Data Albania has carried out a survey on the structure of Albanian debts stock over years. The data are cumulative, i.e. the debt stock for one year includes the total debt emitted up to that year.
The public debt stock for 2010 (at the end of the first quarter) was about 715.5 billion Albanian Lek or 58.5% of GDP, of which 407.4 billion were internal stock (57%) and 308 billion were external debt (43%).
According to IMF, Albania, Serbia and Montenegro have the highest debt percentage in the region, whereas Croatia has the highest revenues in the region.
A country’s economic growth reduces unemployment and increases public investments; however, the solution is not to increase debts but to carry out structural economic reforms.

Public Debt Stock

	2009	2010	2011	2012
Public Debt	682,547	715,517	772,744	828,276
- Central government debt	682,547	715,370	772,526	827,988
- Local government debt	-	147	218	288

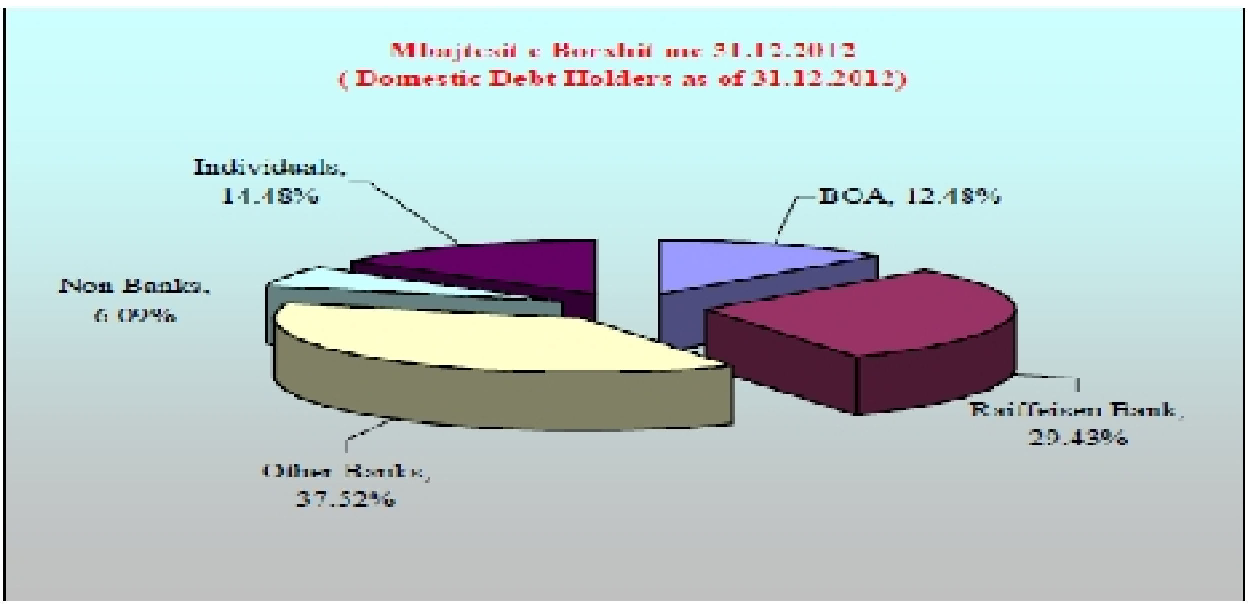
Central Government Debt Stock

	2009	2010	2011	2012
Central government debt, of which	682,547	715,370	772,526	827,988
- Domestic debt	415,028	407,372	438,582	470,358
- External debt	267,519	307,999	333,944	357,629

Source: Ministry of Finance

As it may be noticed in the table, there is an increase in the weight of external debt from 308 billion in 2010 to 357.6 milliard in 2012 and in the weight of domestic debt from 407 billion in 2010 to 470 billion in 2012. In total, the government debt increased from 715 billion in 2010 to 828 billion in 2012. During 2010, in the foreign capital market it was emitted for the first time the Eurobond, for an amount of 300 billion Euro and maturity date 04 November 2005. The annual interest rate over this bond is 7.5% or 22.5 million Euros per year. The revenues resulting from the Eurobond were used to prepay the loan of 2009 and to fulfill the needs for budget financing. The main external debt holders are multilateral institutions (IBRD2, EIB3 etc) and private creditors (foreign banks). Recently the weight of private creditors is increasing.

Although the Eurobond emission raises public debt diversification in Albania being a Eurobond (emitted in foreign currency, and for the repayment of the interest rate and the whole debt in time of maturity, it is necessary to exchange it in Euro currency), the increase of external debt weight in general increases the risk of exchange rate and the debt cost if Euro (or other currencies) strengthens against the local currency, the Albanian all.



LONG-TERM EXTERNAL DEBT
SUMMARIZED DATA

Classification	Up to 31.12.2007	2008	2009	2010	2011	2012	TOTAL
I. CUMULATIVE							
DATA	1,211.16	1,578.56	1,939.10	2,219.49	2,403.67	2,562.02	2,562.02
Net debt	1,691.49	2,070.68	2,466.52	2,939.41	3,161.42	3,439.27	3,439.27
Withdrawals	458.43	534.62	641.62	950.61	1,080.91	1,223.03	1,223.03
Debt payments	241.89	287.77	344.94	603.93	678.32	762.97	762.97
- Principal	216.51	246.85	296.68	346.68	402.59	460.06	460.06
- Interest	667.22	785.59	718.28	765.62	856.05	757.54	757.54
Unwithdrawn signed debt							
II. ANNUAL DATA	125.09	379.19	395.84	472.89	222.01	277.85	1,872.87
Withdrawals	63.68	75.98	107.00	309.00	130.30	142.12	828.31
Debt payments	40.67	45.60	57.17	259.00	74.39	84.65	561.75
- Principal	23.01	30.38	49.83	50.00	55.91	57.47	266.56
- Interest							

The condition for an economy to come out of crisis is to use public funds in three main directions:

1. Guaranteeing and increasing employment
2. Supporting domestic demand
3. Making social policies in favor of poor and at risk categories.

Greece

Greece is a developed country with high and "very high" living standard – in 2010 the 22nd place in the world's human index development ranking. Greece has a budget deficit of 12.7% (the Maastricht limit is 3%). The Greek economy is facing many problems such as the continually increasing unemployment levels, the inefficient administration authorities, the fiscal evasion and the corruption. For example the fiscal evasion cost on the Greek government was over 20 billion $ in 2010. For a long time (almost since the establishment of the Greek state in 1883), Greece has had problems with government debt.

Following the World War Second, it became evident that the Greek government would not be able to repay those loans. Greece was one of the countries that had suffered more than the other West European countries during World War Second as it had experienced hyperinflation during the war. Nonetheless, in the mid seventies, the GDP and percentage of investments to GDP declined due to week economic policies applied by the government. Therefore, the work costs and the oil prices increased.

The Greek industry started to decline shortly before joining European Union. When Greece joined European Community in 1981, all economic barriers were removed. In the light of joining EU membership, Greece made some week performances due to expansionist, fiscal, macroeconomic policies which tripled the debt percentage to GDP, which abandoned the modest figure of 34.55 in 1981 to over 100% in the nineties. When the Maastricht Treaty was signed in 1991, Greece was far away from meeting the required criteria. For instance, the inflation rate of Greece was 19.8% and the government deficit was 11.5% of GDP, almost 4 times higher than limit. The increase of public sector and deficits constrained the Greek government to borrow in many funds. In the end of the eighties and in the early nineties, the Greek government decided to organize a privatization plan to reduce the number of state businesses. Although, the government took a loan of 1.7 billion $ from the EU in 1985, the high debt payments and the low industrialization pace were the reason for the low economic growth during the nineties. Inefficiency in public sector and excessive government expenditures constrained the government to borrow more money. The Greek economy, during the first years of the new millennium, has had one of the fastest growths in Euro Zone. From 2000-2007 it has grown by 4.2% per year. Such pace owed to the infrastructure expenditures related to Olympic Games held in Athens in 2004. This led to loan availability and Greece reached record levels of consumption expenditures. But such growth declined by 2% in 2008 as a consequence of financial world crisis and credit limitation terms. During the second half of the 20th century and the beginnings of the 21st century, a great amount was spent to the reconstruction and strengthening of Greek economy. However, nowadays Greece is one of the few developed member states in the European Union. In 2001, the Greek government was oriented in absorbing foreign investments especially in such projects like highways and underground railways. At the same time, Greece started to take subventions by the EU as a member state. Notwithstanding the financial support, the Greek agriculture and industry sector still remain in a bad economic situation. In 2004, an audit to Greek government finances performed by Eurosat found out that the budget data, which were a reason for inclusion of Greece in Euro Zone, had been misrepresented.

The initial of the financial global crisis in 2008 led to liquidity problems in many countries of Central and East Europe. Nevertheless, the Greek government, initially, managed the crisis very well and it went further by borrowing more money from international financing markets. But recession increased the government deficit due to the raise of expenditures and revenues. After 15 years of subsequent economic growth, Greece entered in recession in 2009. At the end of 2009, the Greek economy had to face high budget deficit and government debt to GDP in the EU. Such high debt levels led to the increase of borrowing costs resulting in a great economic crisis.

In 2010, debt equaled € 54,000,000,000 and investors were uncertain of the repayment capacity. The news that the Greek government had cheated on the statistic data and had tried to hide the real extent of government debt made the investor more suspicious. On 23 April 2010, the Greek government asked officially the IMF and other Euro zone countries for a financial aid. The loan had a relatively high interest rate; however, this interest rate was under the actual rate charged on private investors for the Greek bonds. The initial amount of loan package was € 45,000,000,000. There are many reasons for the present economic crisis. One of them is the unemployment level, from 12.6% in 2009 to 14.2 % in 2011. The following table shows the main features of Greek economy debt and deficit.

Table 1. Main features of Greek economy

Period Measure		1992-2006	2007	2008	2009	2010	2011 (prediction)	2012 (prediction)
Gen. government debt, € million			239 364	262 318	298 706	328 588	349 725	364 503
Gen. government debt,% GDP		97,7	105,4	110,7	127,1	142,8	157,7	166,1
GDP		3,0	4,3	1,0	2,1	4,5	-3,5	1,1

growth, %								
Contribution to GDP growth:	Domestic demand	3.5	4,6	1,0	1,5	7,7	-8,0	-1,8
	Inventories	-0,1	1,7	0,5	-2,3	0,9	-0,5	0,3
	Net Exports	-0,4	-2,0	-0,5	2,0	2,3	5,0	2,8
Gen.govern. balance, %of GDP		-6,5	-6,4	-9,8	-15,4	-10,5	-9,5	-9,3
Unemployment rate		9,9	8,3	7,7	9,5	12,6	15,2	15,3

Source: Eurostat, table made by me

The following table provides us with information about GDP per capita in Greece since 1970. The blue lines present the Greek economy before Greece joined the EU.

According to the World Bank, the GDP per capita remains in 15,361 $. Historically, from 1960 to 2008, the average Greek GDP per capita has been 9,135 $ with a historical enterprise of 15,361 $ on December 2008 and a low record of 3,419 $ on December 1960.

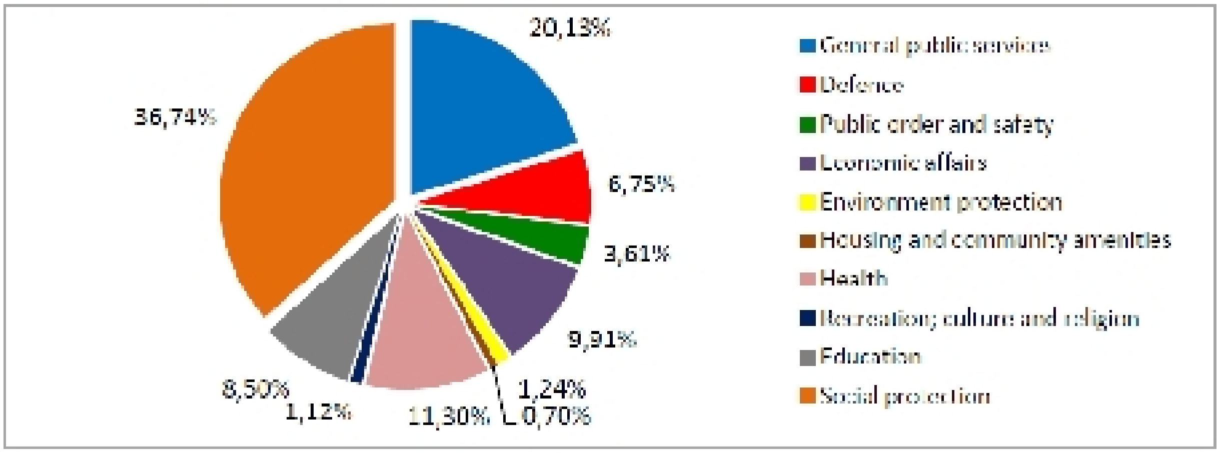
Figure 1. GDP per capita in Greece 1970-2012

Source: IMF

Notwithstanding the EU membership, the Greek GDP per capital has declined as the country has suffered from a week macroeconomic performance. Since 2008, the Greek economy is facing a continuous decline due to financial and economic crisis.

Let us now consider the situation of total Greek government expenditures and income since 1986. Usually the percentage of government expenditures does not exceed 53% of GDP. Such index is similar to the indexes of those countries with a European majority. The maximum value was achieved in 2009, when Greece entered in recession due to economic crisis. The total government expenditures amounted to 52.7% of GDP. The minimum value was achieved in 1989, when the such expenditures amounted to 38.7% of GDP.

Figure 5. General government expenditure by function 2009



Source: OECD Statistics

Most of Greek government expenditures go to social benefits – 41.5% of total expenditures in 2010. Employees' compensation makes the 23.8% of total Greek government expenditures in 2010. And the third greatest component of government expenditures is intermediate consumption, with 11.3% of GDP in 2010.

Conclusions

1. The public debt increase in Albania is mainly due to bad governing rather than global crisis, for the following reasons:
- Lack of access to investment financing
- High corruption
- Inefficiency of state administration. Employment of militants rather than specialist in state administration.
- Instability of fiscal policies.
2. One of the immediate challenges to the Albanian economy is the raise of negative commercial deficit.
3. The economic growth effects unemployment decrease, public investments increase; however the solutions is not to increase debt but to perform economic structural reforms.

References:

1. Ardian Civici " The global or financial crisis?"
2. Agarkova Yuliya "Public debt analysis in selected countries: Greece, Spain and Portugal
3. Mike Artis, Frederick Nixson. The Economics of the European Union: Policy and Analysis. 2ns ed. New York: Oxford University Press Inc. 2007.
4. IMF (2010), Global Financial Stability Report, April 2010, International Monetary Fund.
5. European Commission (2007) "European Economy", Economic paper № 297
6. Annual Reports of the Bank of Albania (www.bankofalbania.org
7. Internet resources:
   - www Ministri of financial.gov.al
   - *http://www.albinvest.gov.al*
   - *http://www.acit.gov.al*
   - *http://www.* instat.gov.al
   - *http://www*.wikipedia.org