Public Debt and Impact on the Economy: The Case of Albania

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Abstract

The purpose of this article is to highlight the effect of public debt on the economy, and whether high budget deficits constitute a real threat to the economy. In general, governments refer to debt in order to cover the budget deficit or to realize the promised objectives and programs. It is not right to say that this or that government performed well or bad, just by referring to the debt figures, but must seeing it in relation to GDP growth, so the continuous increase in debt from one year to year is not a problem if the rates of GDP growth are much higher than the growth rates of the public budget. The government should pay attention of maintaining the balance between the sustainable growth of consumption maximization with the positive public debt, under these conditions we cannot say that today’s debt is tomorrow’s tax as debt and GDP can grow simultaneously. The methodology of this study consists in using the secondary data method, referring to different authors, statistics of state institutions and as well as non-state organizations. The government has impact on the dynamics of the economy in addition to others through its budget deficit and debt policies. Albania has a public debt of about 80% of GDP (according to the latest report of the European Commission), while the economy is growing at a low rate, the government must take action to reduce the percentage of public debt to GDP, and to do that government should try to stabilized GDP growth than intendet to reduce the debt. This is mainly achieved by stimulating the priority sectors of the economy, as well as by increasing the percentage of the expenditure on innovation and encouraging new enterprises, giving importance to the startups as well. The stability of the fiscal system makes it possible among other things to achieve the debt objectives on the other hand the correct use of the debt leads to the efficiency of Public Finances as well as in the efficiency of the country’s economy.

Keywords: Public Debt, Budget Deficit, Consumption, Income Redistribution, Stability, Economic Growth, Gross Domestic Product
1. Introduction

Albania during the years 2010-2020 has a lower economic growth than the previous decade, while it has a public debt at high levels. Public debt is an important macroeconomic indicator with an impact on the economy and that all governments, regardless of the level of economic growth, would use borrowed money inside and outside the country by issuing debt securities, to overcome liquidity difficulties. Currently, our country has a relatively high public debt in relation to GDP, and specifically for the year 2022, this indicator reached 67% of GDP, according to the Ministry of Finance. The orientations of international institutions such as the IMF or other institutions emphasize that Albania, as a candidate country to join the European Union, must reduce the specific weight of public debt to GDP. In addition to the amount of public debt as well as the specific weight in to GDP, it is important to consider public debt, especially from the aspect of its function in the economic development, the borrowed money should effect the economic growth. If the GDP growth rates are higher than those of the public debt, we can say that this situation is positive and that under these conditions this indicator does not constitute a tax for tomorrow. The maximization of consumption with a positive public debt constitutes a condition for the existence of the balanced of sustainable growth of the economy as a whole.

The borrowed funds, are used for problematic or important areas of the national economy such as energy, infrastructure, environmental protection and so on, allows the state to expect that the economic situation is stable, predictable and attractive for further investment.

The size of the debt is related to government expenditures and the ratio of income collected from taxes to total government expenditures. Reagan (1982) stated that the US has a public debt of 3 trillion dollars, not because citizens are not taxed enough, but because public expenditure are higher than it should be.

Albania is characterized by very low rates than its neighbors in terms of fiscal system consolidation, which means a slow reduction of public debt in the medium-term future. Referring to the data of the Ministry of Finance, also cited in the Monitor Magazine, the public debt for 2022 about GDP was 67%, while for 2023 it is expected that the specific rate of public debt about GDP will be 68.8%. In these figures declared by the state bodies, there is a tendency to hide arrears towards third parties as well as the effect of the PPP (Public Private Partnership) programs that the Government is undertaking.

Foreign organizations in our country declare that the Public Debt is in the highest figures and specifically about 80% of the GDP (Referring to the latest European Commission Report), which took into account all obligations to third parties, as well as the effect of PPPs.

2. Research Methodology, Purpose, Objectives and Research Questions

The methodology of this research consist on use of the secondary data method, referring to the scientific literature of different authors, statistics of state institutions, foreign organisations located in Albania as well as non-profit organizations. The most relevant cornerstone scientific literature related to the subject was “Growth in a Time of Debt” (2010) written by Carmen Reinhart and Kenneth Rogoff’s “Growth in a Time of Debt” (2010), which is widely cited from most of scientific researcher. The other important sources of secondary data for realisation of this paper are datasets from the World Bank, International Monetary Fund (IMF), and European Commission. The comparison of the findings from the scientific literature regarding public debt growth and its impact in GDP, as well as the analysis of the progress of this macroeconomic indicator in Albania in relation to the progress of economic development, constitutes the essence of the method used to achieve the goal and realize of the objectives of this research. Importnat data sources to analyse dhe debt and economic growth are provided by Eurostat, World Bank and Statistics Institut of Albania as well as Finance Ministry.

The purpose of this paper is to highlight the effect of public debt on the economy, and whether high budget deficits constitute a real threat to the economy.

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3 Mindauges Butkus, Kristina Matuzeviciute (March 2016) “Governmen debt influence on EU countries economic growth: importance of matching Maastricht criterion pg.2” www.ees.uni.opole.pl
5 Fiscal Affairs Department, International Monetary Fund, September 2023 Published in Monitor Magazine https://www.monitor.al.
The objectives of this work are - a) to analyze the specific weight of the public debt in relation to GDP at least for the last 5 years. b) To highlight the impact of public debt on private consumption and redistribution of income. The questions raised and which get answers throughout this paper are: a) Should the internal debt be limited despite the urgent need for funds? b) Does public debt affect a redistribution of income between taxpayers and creditors of the public sector? c) What should be the level of public debt? d) Is today’s debt necessarily a tax for tomorrow?

3. Literature Review

From the review of the scientific literature of many authors, it was noticed that if the increase in debt is accompanied by the generation of the economy, i.e. with an increase in GDP, the debt does not constitute a threat to the country’s economy. Since US government debt as a fraction of GDP reached a trough in the mid-1970s, it has been on a generally upward trajectory. The United States is not alone. Advanced economies as a group have experienced a long-term increase in government debt to GDP, with France and Germany (Pierre 2019)6.

Thus, the two authors Ž. Karazijienė, A Sabonienė in their paper “Economy and Management” (271-279, 2009) point out that government borrowing does not cause damage to the economy if only the opportunities provided by the debt are used optimally7.

It is difficult to find any other argument in the economic field that has been discussed in such contradictory ways than the role of public debt. Already in the middle of the 18th century David Hume (1777) stated that “either the nation must destroy public credit or public credit will destroy the nation”. In strong contrast, Carl Dietzel stated roughly one hundred years later (1855) that “public borrowing is ... the lever for powerful economic progress and thus ... the Archimedean standpoint, that lifts the world off its hinges”.

And another one hundred years later, in the 20th century, the situation is hardly different, since economic and fiscal policy is interchangeably dominated by Keynesian and bymonetarist or neoclassical orientation8.

The government must have pay attention of maintaining the balance between the sustainable growth of consumption maximization with the positive public debt, in these conditions we cannot say that today's debt is tomorrow's tax as debt and GDP can grow simultaneously. This means for different groups of given expenditures, the impacts of alternative financing instruments should be compared with each other. In sum, we can say with Lorenz von Stein (1871) that “a government without debts either asks too much of the presence or does too little for the future”9.

In order to cover the budget deficit, the government generally borrows abroad and within the country, the amount of debt is also related to the income provided through the fiscal system, which means the government to cover the budget deficit uses the incomes provided by fiscal system and the remaining part is financed by debt. To provide balance in public finances, we must choose between taxes and debt10. The government couldn’t inject money into the economy without first taking it out of the economy through taxes or borrowing. Public debt is a macroeconomic indicator that is evident in the almost all the economies of the globe. If the debt is used more carefully and in projects that generate high income in relation to the cost of the debt, then it affects the growth of economic efficiency by stimulating savings in the macro level, reducing tax rates in the long term, while making possible equality between generations. According to Musgrave (1959), the benefits of using public debt are threefold: increasing economic efficiency by reducing tax rates for long-term periods; saving income for working capital as well as achieving equality/neutrality between certain generations (Richard A Musgrave 1959)11. The impact of debt is positive when the rates of return from debt are higher than the cost of debt, while the impact of debt is negative if the rates of return from debt are lower than the cost of debt12. When the

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12 John Y. Campbell Can Gao Ian W.R. Martin (April 2023) “DEBT AND DEFICITS: FISCAL ANALYSIS WITH STATIONARY RATIOS”
government borrows in an emergency situation, it is expected that the cost of the debt will be high and it is likely that the effect will be negative. Today’s debt constitutes a cost for future generations if the economy grows at low rates and the debt at high rates, or to say otherwise if the specific amount of Public Debt in relation to GDP is very high, as it is currently in our country. Despite the global economic growth rebound from 2020 and much higher-than-expected inflation, public debt remained stubbornly high. Fiscal deficits kept public debt levels elevated, as many governments spent more to boost growth and respond to food and energy price spikes even as they ended pandemic-related fiscal support. Global debt appears to have returned to its historical upward trend. Managing debt vulnerabilities should be key.

When a government is in a weak fiscal position, holders of government debt must earn low returns over the long run, or taxes must rise over the long run, or spending must fall over the long run; or some combination of all three possibilities must occur. Timely and appropriate fiscal policy adjustments can reduce debt, but countries in distress will need a more comprehensive approach. Public debt has been soaring in the wake of the recent global financial maelstrom, especially in the epicenter countries. This should not be surprising, given the experience of earlier severe financial crises. Following the 2007-2008 global financial crisis (GFC) and subsequent sovereign debt crisis in Europe, there has been a renewed interest in exploring the relationship between government debt and economic growth.

4. Public Debt in Albania Compared to Countries in the Region

A country’s debt stock is the total public debt issued domestically and abroad that has not yet been repaid. Public debt can be issued domestically and held by residents (domestic debt), or abroad and held by non-residents (external debt). Currently Albania has a relatively high total debt. Referring to Ministry of Finance Data Total Stock of Public Debt was at 67% of GDP at the end of 2022, while reached 74.5% in 2020. Despite the declining trend, this indicator is still far from fiscal principle debt level of 45% of GDP. Referring to the Table No.1 below, the specific weight that has public debt in relation to gross domestic production is different from year to year and is increasing, while the higher percentage is in 2020 of 74.5% of GDP, as well as in 2021 the percentage continues to be high while these two years are characterized by very low economic growth rates, among other things, for the reason of pandemic Covid 19. These stated figures are associated with the tendency of the competent authorities to conceal the backward obligation to the third parties and the effect of the public private partnership programs that the government is undertaking. Whereas foreign organizations in our country declare that public debt is in the highest figures and specifically about 80% of GDP (referring to the latest European Commission report) which consider all liabilities to third parties, as well as the effect of PPP-s. As for the dimension, I think the debt today is higher than government and IMF forecasts, within the interval 73 - 83% of GDP, but it does not appear due to delays in accounting for arrears that exceed 300 million EUR, failure to execute judicial decisions, and especially concession obligations and PPPs which are estimated today to be about 6% of GDP and will only accelerate in the future. If the government stands on its policy for the expansion of PPPs, otherwise known as the EUR 1 billion project, then the Albanian public debt can also approach the 90+% level of GDP.

Table 1: Specific Weight of Public Debt to Gross Domestic Product 2012 - 2022 (in Billion ALL)

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<tr>
<td>Public debt stock</td>
<td>828</td>
<td>885</td>
<td>977</td>
<td>1,042</td>
<td>1,428</td>
<td>1,472</td>
<td>1,551</td>
<td>1,637</td>
<td>1,692</td>
<td>1,890</td>
<td>2,058</td>
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13 Vitor Gaspar, Marcos Poplawski-Ribeiro, Jiae Yoo (September 13, 2023), Work Paper Global Debt Is Returning to its Rising Trend, International Monetary Fund
14 Global Debt Monitor Fiscal Affairs Department International Monetary Fund (September 2023)
16 Adrian Peralta-Alva, Prachi Mishra (April 10, 2023) Paper “How to Tackle Soaring Public Debt”.
18 Jack Salmon (FALL 2021) • The Impact of Public Debt on Economic Growth”CATO JOURNAL
22 Eurostat Euroindicators 23th October 2023 eurostat-mediasupport@ec.europa.eu estat-gov-debt@ec.europa.eu
An unsustainable fiscal system has a negative effect on the realization of debt objectives, because of this it is somewhat difficult in reality to talk about long-term sustainability of the fiscal system. Our country, as a country in prolonged transition, has had and continues to have the volatility of the tax system, which has had negative effects both in the direction of foreign investments in the country as well as in the realization of external and internal borrowing objectives. The impact of COVID-19, the earthquake of 2019, as well as the unstable situation in the Balkans, among others, has been felt in the low rates of economic growth, high inflation, and therefore the well-being of the population has deteriorated. Public debt as a macroeconomic indicator with influence on the economy is currently in high amount, so our country is characterized by high budget deficits, as well as an increasing trend of the budget deficit is observed in the region and beyond this have made public debt an economic and political challenge of global proportions.

The 2023 Budget Law determines the budget expenditures for public debt interests at 61 billion ALL, including the contingency of 4.9 billion ALL for debt risks for 2023. The increase in interest rates from central banks directly affects the increase in the cost of domestic public debt and external, increasing the indicator of budget interest expenses to the stock of public debt to 4.3% in 2023, from 2.9% in 2022, as well as the indicator of budgeted debt services (principal plus interest) to the stock of the public debt to 6.5% in 2023, from 3.8% in 2022. Expenditures for the public debt interests may increase to 10-11% of total budget expenditures in the period 2023-2025, from 6% in 2021, burdening public expenditures more every year.

According to the latest report of the European Commission for the candidate countries, in 2023 our country is expected to have a level of public debt of 73.9% of the Gross Domestic Product (GDP), which is estimated to be the highest in the region, surpassing and Montenegro, which until now held the record. Public debt in North Macedonia as of June 2022, when the latest statistics were published, reached 7.2 billion euros and is 55.4% of GDP, according to official data from the Ministry of Finance. In terms of the percentage of public debt in GDP, Serbia has somewhat lower public debt compared to North Macedonia. Serbia's public debt at the end of June this year was 31.3 billion euros, which is 53.2 percent of GDP. Of the countries in the region, Montenegro has the highest public debt in GDP ratio, which is 83.27% of GDP, while Kosovo has the lowest public debt of 33.34% of GDP. Montenegro forecast to reduce public debt in 2023, to 71.7% of GDP, reducing it at a faster pace than Albania. Meanwhile, other states in the region are in a more comfortable position, as they have lower debts, such as Kosovo 22% of GDP, Bosnia Herzegovina 35%, Serbia 54% and North Macedonia 58%, according to expectations for 2023 published by the European Commission. In order to improve the economic situation in the country, the World Bank suggests to intervene in improving the climate of doing business in the country, to work towards a stable and reliable fiscal system since our country is characterized by a frequent change of fiscal policies which negatively affects not only foreign investments, but also the business climate as a whole.

5. Conclusions and Recommendations

Public debt is an important macroeconomic indicator affects the economy, the debt will be accompanied by sustainable economic growth if it is used for the purpose of expanding the economy by investing in innovation, technology, and for the purpose of entrepreneurship. The impact of debt is positive when the rates of return from debt are higher than the cost of debt. The impact of the debt is negative if the rates of return from the debt are lower than the cost of the debt. Today's debt constitutes a cost for future generations if the economy grows at low rates and the debt at high rates, or to say otherwise if the specific amount of public debt in relation to GDP is very high, as it is currently in our country. The amount of the debt is related to government spending and how much of this spending can be financed by revenue collected from taxes and fees. Therefore, apart from others, it is important that we cannot say that there is a fixed limit regarding the specific weight of public debt in relation to GDP, but we can say that if this debt is used in a productive way it constitutes an added value for the country economy. Currently, the public debt of our country has a relatively high specific weight in relation to GDP, and the orientation of international organizations is to reduce the debt. The public debt somehow affects the redistribution of income through the interests that the creditors benefit from, and that today's debt is not necessarily tomorrow's tax. Internal debt, especially the debt taken by individuals, affects actual consumption, since individuals, in conditions where the financial market offers them the possibility of high profit from interest, make a decision to postpone consumption by investing savings in the financial market.
It is noted that there is no synchronization between the public debt figures published by international organizations such as the IMF or the World Bank and those published by the Ministry of Finance.

According to our opinion there is no fixed mandatory figure of how much public debt should be in relation to GDP, but it might be lower than 50% of GDP. According to the economics experts recommendation and international institutions this indicator should be about 45% of GDP. It is not a condition to reduce the debt, but to aim at the sustainable growth of the Gross Domestic Product, this means that the borrowed money should be used for capital investments in those sectors of the economy that are priority and have a haer impact on the GDP.

The debt should be oriented towards the important sectors, which have an impact on the country's economy and therefore on the increase in the well-being of the citizens, the debt should be mainly invested in technology, innovation, in the expansion of the business, in the increase of human capital, etc.

The debt should be used for capital investments and not for current expenditures, and these investments should be made in the priority sector of the economy.

References