Abstract

Albania has managed to maintain a positive economic growth and macroeconomic stability over the past decade, but its high level of public debt, with an increasing trend over the last three years, has been seen as very worrying in the eyes of many domestic and foreign economists.

When it comes to debt, both public and private debt must be taken into account. Private debt analysis takes on particular importance because private debt is associated with financing business projects and increasing consumer demand, which serve economic growth and improve the country's macroeconomic parameters. This paper aims to study the role of public and private debt on economic growth in Albania for the period 2014-2018, as well as the main determinants of these two indicators. The methodology used is based on econometric regression analysis. The results showed that public and private debt has a statistically significant impact on economic growth in Albania. The research question of this paper is: Does private and public debt have an impact on economic growth in Albania?

Keywords: Domestic Economy; Private Debt; Public Debt; Economic Growth; Regression Analysis;
1. Introduction

Sustainable economic growth is of vital importance to all the economies of countries, especially developing countries like Albania, which is facing the challenges of macroeconomic and political stability, reducing unemployment and joining the European Union. Growth is also a motive of any developing country, which aims to control the budget deficit, which has to face many challenges. Also, economic growth is considered as one of the central objectives of macroeconomic stabilization. This is due to the fact that economic growth is closely linked to the standard of living of a country's population. An increase in the standard of living of the growing population necessarily requires an increase in the production of goods and services. An important indicator of the standard of living would be the per capita output of the population. Improving the standard of living of a country's population will be considered when every individual, over time, has more goods and services at his disposal to consume than before.

The theory suggests that the three economically feasible ways for a government to fulfill its obligations and promises to its citizens are taxes, money printing and debt which are transformed into tangible public goods such as infrastructure, schools, hospitals, and so on. But under the main economic problem where: "Resources are constrained by unrestricted needs and desires", a government is faced with a choice of which of the three economic means to choose. A good government chooses to borrow for three main reasons. First, the country can leverage long-term investment opportunities, and for a growing economy it would be inappropriate to tax a current poorer generation to finance investments that would benefit a wealthier generation in the future. Second, it allows for a more efficient way of pursuing countercyclical policies or meeting emergency spending needs. Frequent increases or decreases in taxes can lead to losses in efficiency and generate economic uncertainty. Third, overconfidence in printing money could lead to an increase in money supply, an increase in interest rates, and consequently an increase in inflation, which would hurt domestic or foreign investment.

The financial structure of public debt is the key to guaranteeing fiscal stability due to the high volatility of macroeconomic and financial conditions. In addition, the dynamics of public debt exacerbates the burden of fiscal risk as a source of macroeconomic instability in any country. One of the problems facing the Albanian economy is the problem of non-
performing loans, which has been growing ever since 2008. The high indicator of non-performing loans has shown that some important factors that may have contributed to mitigating this phenomenon have not worked in all the possible areas. Despite the efforts that commercial banks are making with the Central Bank, bad loans are still at a worrying level. The Albanian economy has experienced steady and relatively satisfactory economic growth over the past decade, compared to other countries in the region. The processes of economic transformation and restructuring, as well as the macroeconomic policies pursued in the last ten years, have resulted in higher growth rates in the Eastern European Region. Per capita GDP has increased by about 2.3 times over the period 2010-2016, with an average annual growth of about 6.66%. But despite the high level of economic growth, according to data published by the World Bank, Albania remains one of the poorest countries in Europe, with about 25% of the population living below the poverty line, compared to an average of over $10,000 per year, living in other Balkan countries.

2. Literature review

According to Abbas and Christensen (2007) government debt is important for the very effects it directly or indirectly has on the economy of the country. First, government debt can influence Monetary Policy. A country with a high government debt tends to face high interest rates, and monetary authority may be under pressure to lower these rates through Monetary Policy. This strategy may lower interest rates in the short run, but in the long run there will be unchanged real interest rates and higher inflation and nominal interest rates. The increase of these two indicators will be reflected in the reduction of private investment, and consequently in the reduction of GDP and economic growth (Turnovsky, 1996).

Second, government debt can influence the political process that defines Fiscal Policy. Some economists argue that the possibility of borrowing a government reduces the discipline of the budget use process. With the latter it is understood that if a government incurs additional expenditures that are not related to tax revenue, then policymakers and the public are less concerned about whether these expenditures are appropriate. The government's inefficient use of surplus funds in consumer and downtime will translate into a negative effect on economic growth.
Third, government debt makes the economy of a country more vulnerable to an international crisis of confidence. A high government debt puts pressure on the bank’s balance sheet through several different channels. For example, it increases the cost of financing financial institutions after increasing asset risk. Financial institutions, which hold a large share of government debt of countries with "economic stress" that are perceived as risk averse, may have to pay higher interest rates and have difficulty raising funds across the board market. They may also be under potential pressure to raise capital and liquidity. All of these factors lead to an increase in the cost of debt service, which would adversely affect economic growth. Finally, according to Adam and Bevan (2005) financial institutions may face capital outflows and asset replacement. All the factors mentioned above indicate that a high level of government debt affects the decline of the country’s international confidence, would hurt the business climate, and would reduce investment and economic growth. Throughout the theoretical literature, it is highlight that the Classics, who see public debt as a burden on society; the neoclassical view, which views public debt as detrimental to investment and growth; the Ricardian view of state debt as a future tax (Aizenman, Kletzer and Pinto, 2007); Modern economists, who view public debt as a driver of economic growth if funds are used for productive purposes, and the Conventional view that public debt stimulates aggregate demand and growth in the short run and promotes lower capital and national income in the country.

Classical economists built their conviction as they thought that balancing the annual budget with the government was a virtue for the government itself, and a budget deficit was seen as a sign of state bankruptcy. David Ricardo, one of the leading representatives of the Classical School, referred to debt as "... one of the most horrific risks ever invented that could affect a nation" as "... a system that tends to make us less frugal, and blind to our real situation" (Allen et al., 2002). Neoclassical economists, on the other hand, argued that the level of public debt is significant because of the existence of distorting taxes, and the fact that economic agents may not properly predict the effects of future tax changes. In such cases, an increase in debt today would have an effect on the behavior of these agents, which would negatively impact aggregate demand and economic growth (Bernanke, Gertler, Gilchrist, 1996).

In the Ricardian view, state debt was considered equivalent to future taxes (Barro et al., 1995). Considering rational and far-sighted consumers,
the additional value added tax that came from increasing the latter to finance the deficit would be equivalent to the current deficit. Thus, according to Ricardian, a tax deficit financing through taxation would not have net effects on national income in the long run (Clements et al., 2003). Modern economists, on the other hand, took a completely different approach. They were convinced that if state borrowing was carried out for productive purposes, and not for the consumption of goods and services, then they respected this action in every respect. They see government debt as an indispensable tool of a modern economy, especially for developing countries, which depend on these domestic or external loans to accelerate their economic development (Waheed et al., 2006).

An important contribution also comes from the conventional point of view, whereby government debt stimulates aggregate demand and growth in the short run and promotes the reduction of capital and national income over the long run (Eicher and Hull, 2004). In the short run, an increase in public debt will drive up demand for output. Assuming that the government creates a budget deficit by keeping costs constant and reducing tax revenues, this leads to an increase in disposable income of individuals, and perhaps an increase in their well-being. According to the Conventional analysis, it is assumed that the increase in the income and welfare of individuals will increase spending on the consumption of goods, thus increasing the aggregate demand for goods and services (Kumar and Woo, 2010). According to this view, the Keynesian theory operates in the short term, where it is shown solid prices and wages. So, in the short run an increase in aggregate demand would increase national income, meaning there is a positive relationship between public debt and economic growth in the short run (Ilzetzki, 2011).

3. Results

The model is computed by linear regression with a dependent variable and two independent variables for the 2014–2018 time period. The equation representing this model is:

$$PBB_t = \beta_0 + \beta_1 BP_U t + \beta_2 BP_R t + \epsilon_t$$

where unknown parameters to be measured are:

- $\beta_0$ - is constant (are the coefficients of the linear regression)
- $\epsilon_t$ - is the error factor over time $t$
Error is a random variable with normal distribution and expected zero value. It shows the deviations of the observed values from the expected values of the dependent variable calculated by means of the regression equation.

GDP - is the dependent variable during the period t, which expresses Real GDP in millions of lek, despite being expressed in one year time series and three months time series.

BPU\(_t\) - is the independent variable during the period t, which expresses the Public Debt in million ALL and is presented in two time series: one year and three months.

BPR\(_t\) - is the independent variable during the period t, which expresses the Private Debt in millions of lek and is presented in two time series: one year and three months. The following model is also treated with this justification:

\[ PBBt = \beta_0 + \beta_1BPU (\%) t + \beta_2BPR (\%) t + \epsilon t \]

where:

BPU (\%) \( t \) - is the independent variable during period t, expressing Public Debt in percentage to GDP and presented in both time series: one year and three months.

BPR (\%) \( t \) - is the independent variable during period t, expressing Private Debt in percentage to GDP and presented in two time series: one year and three months.

Based on the literature reviewed and what it is believed, these hypotheses have been formulated to be tested by the model:

H1: Public debt affects economic growth. A high level of debt leads to a decline in economic growth rates and a low level of debt leads to an increase in economic growth rates.

H2: Low level of Private Debt and curbing its rates do not stimulate economic growth

H3: Public Debt Affects Real Gross Domestic Product. Debt accumulation leads to reduced investment

Time series were initially treated in more abstract way by analyzing them on an annual basis and therefore became a separate annual database, where all variables were expressed over a 5 year period, from 2014 to 2018. Also, disagreeing only with the results and the analysis with annual data, to test the hypothesis in a qualitative way the shorter time period was
taken for analysis, creating yet another database with the same variables expressed in time series three, monthly throughout this period. The analysis is constructed using linear regression rules comparing the sigma coefficient with the limit value of 0.05. If this coefficient is greater than this value for the 95% confidence interval, then it is said that the two variables compared are not significantly related to each other, so the independent variable has no effect on the dependent variables. On the other hand, with the same degree of confidence, if the sigma coefficient is less than 0.05, then it is shown a significant relation, where the changes on the dependent variable have a significant effect on the independent variables.

4. Conclusions and Recommendations

At the end of this paper, after an econometric and statistical analysis, to look at the impact of Public Debt and Private Debt on GDP, the following conclusions are reached:

- Like most countries, Albania is experiencing a debt crisis since 2008, which has worsened. Economic growth in 2018 was 4.45% higher than in 2017 with an increase of 0.61%, which is considered the highest in the region.

- A determining factor in economic growth is foreign investment, which has undergone significant changes in recent years. FDI in Albania increased in 2014-2015, but decreased in 2016 and increased again in 2017-2018. Empirical literature has shown that in many studies there is a nonlinear concave relationship (in the form of an inverted U). Many empirical studies have found that high levels of government debt have a negative effect on economic growth in developing countries (Reinhart and Rogoff, 2010). While other empirical studies have found a positive role of public debt on economic growth (Serven, 2007). These results may have been due to the different empirical methods used, different contexts, different time periods, or other factors that it is not analyzed in this research.

Private capital has a positive relationship with the economic growth of a country or region (Sheikh M. et al., 2010). In the empirical literature, some studies show that private capital can stimulate economic growth by encouraging technological development and industry innovation, job creation, and better corporate governance. The private sector is recognized as a partner in the country's
economic development, as a provider of income, jobs, goods and services, to improve people's lives. Some of the priorities that make the private sector important: 1- The private sector contributes to the growth of national income as the largest employer and creator of new jobs. 2- The private sector provides basic services in infrastructure, education, health and finance that are important to improve people's lives. 3- The private sector and private sector employees are the largest contributors to tax revenue and support for government operations. From the econometric analysis it is concluded that 79.2% of the real GDP variability can be explained by the impact of Public Debt.

- From the analysis it is concluded that public debt affects economic growth. A high level of debt leads to lower economic growth rates and a low level of debt leads to higher economic growth rates. Private debt has a significant impact on real GDP, 86% of the real GDP variability can be explained by the impact of Private Debt.

- From the analysis on the impact of Private and Public Debt on Real GDP, it is noted that Private Debt has a higher impact than Public Debt, 86% and 79.2%, respectively.

At the conclusion of this paper it is recommend that:

1. For businesses in need of bank capital, the government should intervene with legal mechanisms to avoid this business inequality.

2. The Bank of Albania should develop monetary policies to encourage commercial banks to increase their lending activity to both businesses and households, as private borrowing functions as a contract between businesses, households and banks for relatively long periods.

3. Initially, the Bank of Albania and the entire banking system should work intensively to reduce the interest rate on business loans.

4. In times of global crisis, which has also affected our country, it is proposed to the Government the creation of public funds investment funds to assist entrepreneurship, especially small and medium-sized businesses.

5. A study of the literature showed that: A decisive factor in economic growth is foreign investment, which has undergone significant changes in recent years. Regarding FDI it is recommended:

- The local government, in cooperation with the local and foreign business community, should develop a more comprehensive and
specific strategy for promoting foreign investment, as an important factor in the economic growth of the region.
- The promotion and development of joint venture projects in the private sector and the application of concessionary schemes will significantly increase the level of foreign investment.
- In the context of foreign investment promotion, the training and qualification of a specialized workforce is a must in order to better respond to labor market demands.
- Improving the business climate, increasing transparency, ease of doing business and increasing the level of service provided by public administration to assist domestic and foreign investors, would boost investment in the economy.

List of References