BUDGET DEFICIT - ITS IMPACT ON THE ALBANIAN REGIONAL ECONOMY AND SOME FACTORS THAT HAS INFLUENCE

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Abstract

A budget deficit is a financial situation where the government's expenditures exceed its revenues for a specified period, usually a fiscal year. Albania recorded a Government Budget deficit equal to 1.40 percent of the country's Gross Domestic Product in 2023. Government Budget in Albania averaged -5.58 percent of GDP from 1993 until 2023, reaching an all time high of -1.40 percent of GDP in 2023 and a record low of -12.60 percent of GDP in 1997. This deficit must be financed from other sources, often through borrowing. The budget deficit is a common phenomenon in modern economies, but when it is persistent and high, it can create major challenges for a country 's economy. The study of the budget deficit is essential to understand the fiscal health of an economy and to assess its effects on various macroeconomic variables, such as economic growth, inflation, and unemployment. In particular, persistent deficits can lead to a sustainable public debt that can limit a country's ability to finance public services and invest in long-term development. The purpose of this topic is to analyze in depth the budget deficit, the causes that lead to its creation, and the impact it has on a country's economy. This includes an examination of the factors that influence the budget deficit and the strategies that can be used to manage and reduce it. Through case studies, concrete examples from different countries will be examined to illustrate the impacts and possible solutions. In conclusion, this paper aims to provide practical recommendations for policy makers and researchers to improve fiscal management and reduce the negative impacts of the budget deficit. in economics.

Keywords: Budget deficit, financial situation, government's expenditures etc.
JEL Classification: E60, F10, G10, R10

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1. Intorduction

Economists and policy analysts disagree about the impact of fiscal deficits on the economy. Nobel laureate Paul Krugman has suggested that the sluggish recovery from the Great Recession of 2007 to 2009 was attributable to the reluctance of Congress to run deficits to boost the economy.Others argue that budget deficits crowd out private borrowing, manipulate capital structures and interest rates, decrease net exports, and lead to either higher taxes, higher inflation, or both.

A budget deficit is a situation where the government's expenditures exceed its revenues for a given period, usually a fiscal year. This happens when the government spends more than it collects in the form of taxes, fees and other revenues. The budget deficit can be a political instrument to stimulate the economy during periods of economic slowdown, but when it is sustained and high, it can lead to an increase in public debt and create major challenges for economic stability. Fiscal deficits arise whenever a government spends more money than it brings in during the fiscal year. This imbalance is common among global economies. While the budget deficit refers to the negative difference between expenditures and revenues for a specific period, public debt is the accumulation of past deficits. Public debt represents the total amount of money the government owes its creditors, including individuals, financial institutions and other countries. Unlike the budget deficit, which is an annual flow, public debt is a stock that increases every year when the government has a budget deficit and decreases when it has a budget surplus.

1.1 Types of Budget Deficit

- Cyclical Deficit: Caused by fluctuations in the economic cycle. In periods of economic decline, tax revenues tend to fall while spending on social assistance rises. This type of deficit is temporary and is related to the phases of the economic cycle.
- Structural Deficit: Caused by permanent imbalances between income and expenses, which are not related to the economic cycle. The structural deficit is the result of fiscal policies that create a persistent gap between revenues and expenditures, such as tax cuts without a comparable reduction in public spending.

1.2 Causes of the Budget Deficit

- Fiscal Policies and Public Expenditures: Increased government spending on education, health, defense and other public services may contribute to the deficit. Spending on public investment, such as infrastructure and technology, can also increase the deficit if not accompanied by revenue growth.
- Revenue from Taxes and Fees: Lowering taxes and fees to stimulate the economy may result in lower revenue for the government. When the government lowers taxes to stimulate private consumption and investment, this can lead to a fall in fiscal revenues and an increase in the budget deficit.
- Economic Crises and Financial Emergencies: Economic crises, such as recession, can reduce incomes and increase spending on social assistance. During economic crises, unemployment and demand for social services increase, increasing government spending and reducing tax revenues.
- Corruption and Poor Management**: Misuse of public funds and poor financial management can lead to an increase in the deficit. When public funds are used ineffectively or wasted due to corruption, this can result in increased spending and reduced resources available for productive investment.

Chart 1. Albanian budget deficit

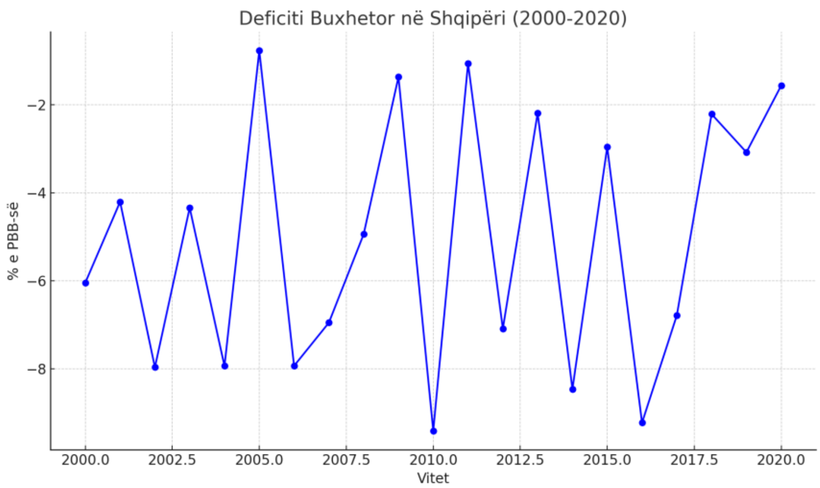
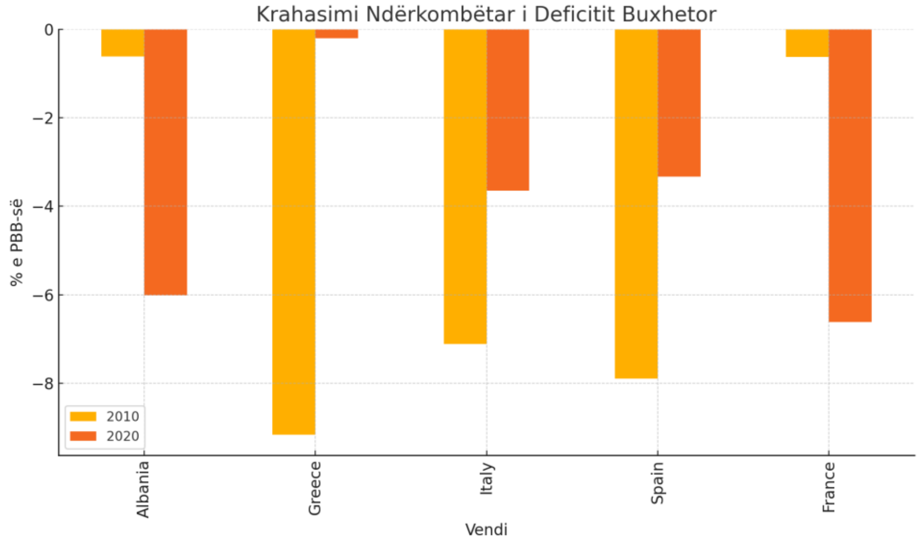


Chart 2. Budget deficit international comparison



2. The Impact of the Budget Deficit on the Economy

Budget revenues saw an annual increase of 19.9 percent at the end of the year, registering a total value of 510 billion alleks [4.1 billion euros], while expenditures reached the level of 596 billion alleks [4.8 billion euros], with an increase of 11.1 per percent compared to 2020. According to data published on the website of the Ministry of Finance, the total tax revenues increased by 19.3 percent compared to 2020, reaching the value of 475.6 billion ALL [3.9 billion euros].While the income from the value added tax reached the level of 161.5 billion lek [1.3 billion euro], with an annual increase of 23.9 percent.

In the 2021 budget, the Albanian government has predicted economic growth of 8.7 percent and a budget deficit of 120.5 billion lek [977 million euros], or 6.9 percent of the Gross Domestic Product.

2.1 Macroeconomic Effects of the Budget Deficit

- Economic Growth: The budget deficit can have a stimulating effect on economic growth in the short term through an increase in public spending. However, in the long run, sustained deficits can lead to high public debts that can limit economic growth.
- Inflation: Deficit financing through money printing or domestic debt can lead to inflation. Rising inflation can reduce purchasing power and create economic instability.
- Unemployment: A budget deficit can help reduce unemployment in the short term by increasing aggregate demand for goods and services. However, a high public debt can negatively affect the labor market in the long run.

2.2 Effects on the Private Sector and Investments

- Private Sector: A high budget deficit can result in higher interest rates, increasing borrowing costs for the private sector. This can limit private investment and negatively affect economic growth.
- Investments: The government can spend more on public investments to stimulate the economy, but this can result in the "squeezing" of the private sector, where private investments are replaced by public investments, not achieving the desired effect.

2.3 Effects on Financial Markets and Interest Rates

- Financial Markets - The budget deficit can affect the confidence of investors in the financial markets. A high deficit can lead to declining investor confidence and increased demands for higher returns.
- Interest Rates: Financing the deficit through borrowing may result in an increase in interest rates. This could increase debt service costs and limit borrowing for the private sector.

2.4 Graphical Analysis of the Impact of the Budget Deficit on the Economy

Chart 3: Economic Growth and Budget Deficit in Albania (2000-2020)

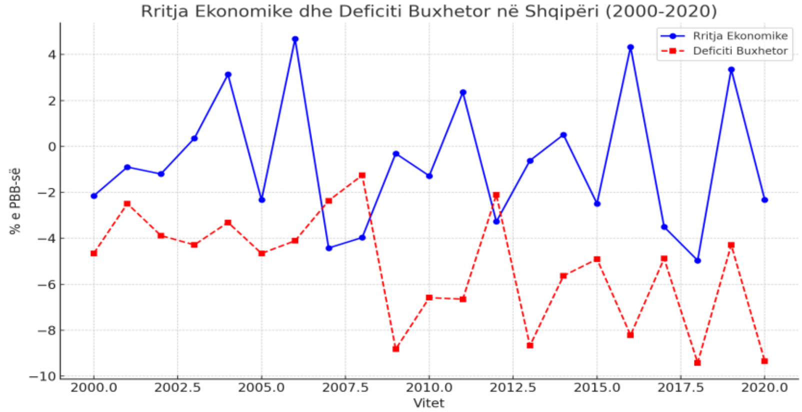
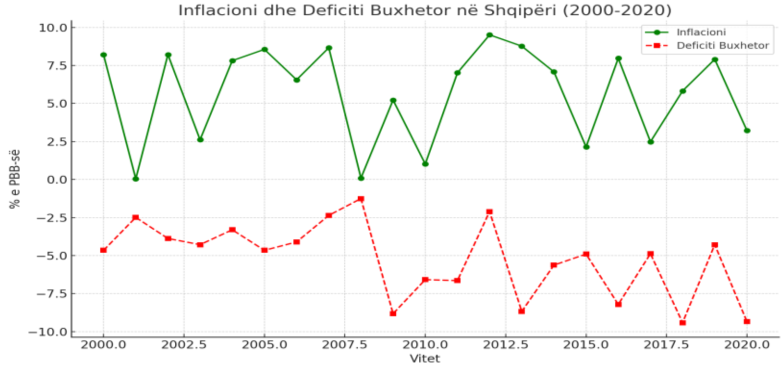


Chart 4: Inflation and Budget Deficit in Albania (2000-2020)



3: Factors Affecting the Budget Deficit

3.1 Political and Institutional Factors

- Political Stability: Political stability or instability can affect the budget deficit. A stable government is better able to implement long-term fiscal policies and manage the deficit. While political instability often leads to excessive spending to satisfy interest groups.
- Fiscal Institutions: Strong fiscal institutions, such as budget rules and independent fiscal councils, can help control the deficit. Weak fiscal institutions often lead to poor management of public finances and increased deficits.

3.2 Economic and Structural Factors

- Economic Structure: The structure of the economy, including the diversification of economic sectors, can affect the budget deficit. Economies that depend on a single sector are more vulnerable to economic shocks and are more likely to face budget deficits.
- Rates of Economic Growth: High rates of economic growth usually lead to higher tax revenues and less spending on social assistance, helping to reduce the deficit. On the other hand, slow economic growth may result in an increase in the deficit.

3.3 Demographic and Social Factors

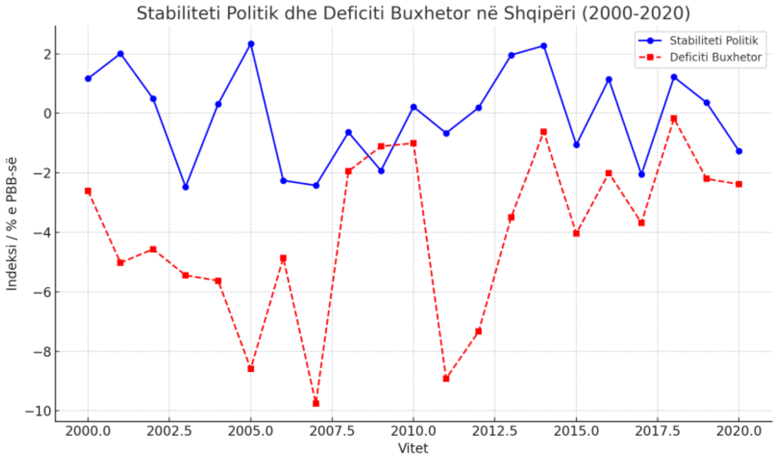
- Population: The demographic structure of the population, such as the percentage of the elderly and the young, can affect the budget deficit. An aging population can increase spending on pensions and health care, increasing the deficit.
- Unemployment rates: High unemployment rates lead to an increase in spending on social assistance and a decrease in tax revenues, influencing the increase in the budget deficit.

3.4 Impact of International Policies and Global Trade

- Trade Agreements: Trade agreements and international economic integration can affect the budget deficit. Trade agreements that increase exports and tax revenue can help reduce the deficit.
- International Aid: Financial aid from international organizations and other countries can help finance the deficit and stabilize the economy.

3.5 Graphical Analysis of Factors Affecting the Budget Deficit

Chart 5: Political Stability and Budget Deficit in Albania (2000-2020)



4: Management and Reduction of the Budget Deficit

4.1 Policies and Strategies for Deficit Reduction

- Fiscal Policies: The implementation of tight fiscal policies, which includes reducing expenses and increasing revenues, is one of the main strategies to reduce the budget deficit.

- Monetary Policies: Increasing interest rates by the central bank to control inflation and stabilize the economy can help manage the deficit. - Structural Reforms: Reforms that improve the efficiency and effectiveness of the public sector, as well as encouraging the development of the sector. private, can help reduce the deficit.

4.2 Increasing Revenue and Improving Tax Collection

- Tax Reform: Improving the tax system to increase revenue collection through expanding the tax base and improving tax collection.

- Fight Against Fiscal Evasion: Strengthening control and enforcement mechanisms to combat fiscal evasion and ensure that all individuals and companies pay their taxes.

4.3 Cuts in Public Expenditure and Efficiency Improvement

- Cuts in Ineffective Expenditures: Identification and elimination of ineffective or unnecessary public expenditures to reduce the budget deficit.

- Efficiency in Public Expenditure: Improving efficiency in the use of public resources to ensure that every coin spent has maximum impact.

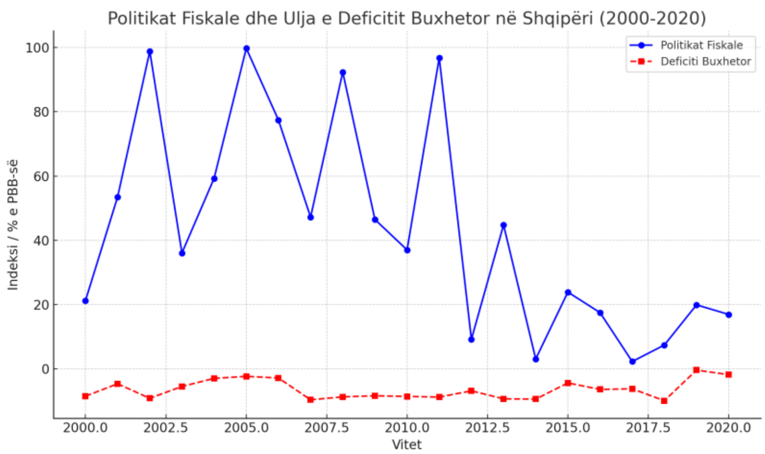
4.4 Debt Restructuring and International Aid

- Debt Restructuring: Negotiating better debt terms with creditors, including lowering interest rates, extending maturities and reducing principal.

- International Aid: Benefit from financial and technical assistance from international organizations and other countries to help manage the deficit and stabilize the economy.

4.5 Graphical Analysis of Budgetary Deficit Management and Reduction

Chart 6: Fiscal Policies and Budget Deficit Reduction in Albania (2000-2020)



5: Case Studies and Case Analysis

5.1 In-depth Study of Some Countries with High Budget Deficits

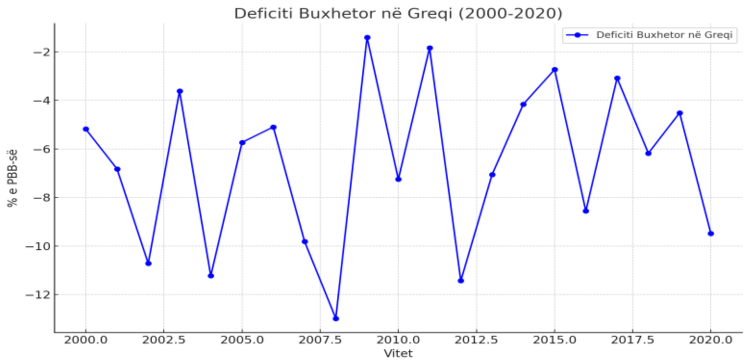
- The case of Greece: Greece is one of the countries that has experienced a deep fiscal crisis. The main causes of Greece's budget deficit include poor financial management, high fiscal evasion, and increased public spending without corresponding revenue growth.
- The case of Italy: Italy has also experienced a high budget deficit for many years. The causes include a high public debt, slow economic growth and a complicated and inefficient fiscal system.
- The case of Spain: Spain experienced a high increase in the budget deficit during the global financial crisis. The main causes include a sharp drop in tax revenues and an increase in spending due to economic stimulus packages.

5.2 Measures Taken and Their Results

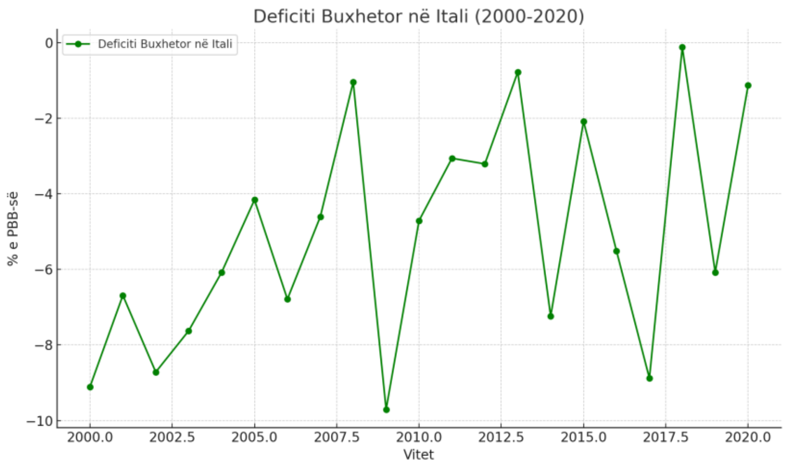
- Greece: In order to manage its fiscal crisis, Greece has undertaken some severe austerity measures, including cutting public spending and raising taxes. However, these measures have led to economic recession and increased unemployment.
- Italy: Italy has undertaken structural reforms to improve the efficiency of the public sector and reduce the budget deficit. These include reforms in the tax system and the labor market.
- Spain: Spain has taken measures to increase tax revenues and reduce public spending. These measures have helped stabilize the economy and reduce the budget deficit.

5.3 Graphical Analysis of Case Studies

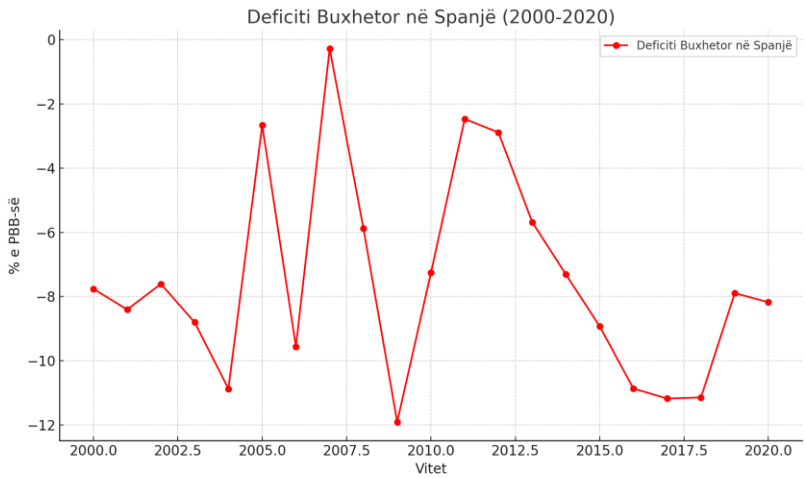
Graph 1: Budget deficit in Greece (2000-2020)



Graph 2: Budget deficit in Italy (2000-2020)



Graph 3: Budget Deficit in Spain (2000-2020)



6. Conclusions and Recommendations

6.1 Summary of Key Findings

- Definition and Causes of Budget Deficit: Budget deficit is a situation where government expenditures exceed revenues for a certain period. The main causes include fiscal and monetary policies, economic crises, corruption and poor financial management.
- Impact on the Economy: The budget deficit has significant impacts on the economy, including economic growth, inflation, unemployment and interest rates. The impact is significant in the private sector and financial markets.
- Factors Affecting the Deficit: Political, economic, demographic and international factors have an important role in determining the level of the budget deficit. - Management Strategies: Fiscal and monetary policies, structural reforms, increasing revenues and improving the collection of taxes are some of the main strategies for managing and reducing the budget deficit.

6.2 Recommendations for Policymakers

- Improvement of Fiscal Management: Implementation of sustainable fiscal policies and improvement of public finance management to reduce the budget deficit in the long term.
- Structural Reforms: Promoting reforms that improve the efficiency and effectiveness of the public sector, as well as promoting the development of the private sector.
- Improvement of Tax Systems: Increase in income through expansion of the tax base and improvement of tax collection. Fighting tax evasion and improving transparency and accountability.
- Political and Institutional Stability: Ensuring a stable political environment and strengthening fiscal institutions to ensure an effective management of public finances.

6.3 Recommendations for Future Researchers

- Further Empirical Studies: Conducting empirical studies to analyze the long-term impact of the budget deficit on the economy and to identify the main factors that influence the efficiency of deficit management policies.
- International Comparative Analysis: The study of different international cases to understand the best practices and to identify the most effective strategies for managing the budget deficit.
- Development of Econometric Models: Development of econometric models to predict the various impacts of the budget deficit and to help formulate effective policies.

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