

Foreign Aid and its Impact on the State Budget
(Case: Albania 2008-2012)



Economics

Keywords: Foreign Aid, Grants, Soft Loans, Budgetary Support, Budgetary Deficit.

Stela Janku

University of Tirana, Faculty of Economy. Albania.

Abstract

Foreign aid comprises a very important element to the social and economic development of the country. It can be offered in various forms, financial, technical as well as donations in kind, namely, it can be allocated to a certain state in the form of grants or soft loans. The right to receive loans has been entitled to the governments, charity organizations, foundations, businesses and individuals. Loans have been considered decisive into aiding and promoting further development to countries suchlike Albania. The role of the foreign aid into the state consolidation process has long been a topic for discussion because of its implications. In spite of the donors' good intentions the loan's positive impact depends greatly on the ways it is managed by the recipient governments which should always apply it to the country's priority sectors. However, it should be utterly accepted that loans are necessary for a state in its initial step towards development and international integration.

For years on end, foreign aid and its effectiveness have been a concern both for the benefitting states and donors. Its impact on developing countries suchlike Albania is very important and has usually been perceived as a positive one, even though many other analyses assert that foreign aid promotes corruption and misuse of funds. Aid from abroad has been considered a great support to the country's economy; therefore, it is very important to use it properly and transparently to most-in-need sectors where its impacts are greater and evident. The foreign aid effectiveness depends on the benefitting country's good governance, too, although understanding factors defining and promoting effective governance still remain undefined, since there are many cases when even though financial assistance from abroad has been provided to great amounts, it has "melted away" into the corruption of the recipient governments, despite the good intention of the donor country. However, it should be admitted that foreign aid, in whatever forms it has been given, constitutes a very important element to the social and economic development of a state. By since the collapse of the communist regime in 1991, Albania has been facing an aggressive market, successive reforms, and measures for modernization of the government, excessive individual freedoms, better living standards and international integration. In these conditions, foreign aid has been an important and supportive element for the country's further development. That is why a great and proper attention has been recently paid to the creation of a cooperation and effective architecture.

Foreign aid can be allocated in two forms: in grants or soft loans received by the official sector whose main objective is to promote the country's economic development and wellbeing. Albania belongs to states which have continuously received both monetary and in-kind aid from foreigners. In the 2008-2012 period, foreign assistance given to Albania amounted to 1.56 billion euros. Initially, grants made up the greatest percentage of the total aid but later on, they declined while the soft loans' percentage has been increasing. The greatest part of the loans have been provided by multiple donors and have been oriented towards sectors suchlike infrastructure, energy, health education and social reforms. In 2008, because of the country's economic growth, Albania was entitled the status of the midlevel revenue countries; consequently, it could no more benefit from the IDA-s zero-interest rates concessionary revenues, but it was qualified for commercial loans by IBRD, making up positive signals to investors and financial markets interconnected to the country's economic future.

Albania has been supported by twenty-two big donors totally founding about 300-350 projects. So this country is ranked among the top-ten European states benefitting from foreign assistance. Likewise any other developing countries, Albania has been endeavoring incessantly to approach foreign aid by identifying priority needs for investment in sectors of precedence promoting country's development. The sector benefitting the most from foreign aid is transport which has also turned into a priority sector.

Foreign aid in priority sectors 2008-2012 (million €)

Sector	2008	2009	2010	2011	2012
Rule of law	31	46.9	24.8	36	24
Economic development	26	32.3	26.8	49	20
Transport	75	67.35	173.8	225.3	105
Energy	33	55	81.4	15.03	7.85
Social Development	25	62	22.5	20.13	36.03
Others	42	62	35.7	35.5	24

Albania has never lacked bilateral or multilateral donors providing any kind of aid, they have even been abundant, but what it has often lacked is the transparency and the information about what the aid has been used for and about the concrete effects yielded. Regarding transparency, the one related to budgetary issues takes special importance. Budget transparency, in terms of both public and donors' access and regarding the timely detailed budgetary information, has turned into a concerning issue for the

international circles, especially for countries like Albania. This kind of transparency has been considered as a key element of governance. For decades on end, donors have provided abundant resources even for funding processes promoting further increase of the budget transparency in developing countries. They have played an active role into the evolvement of the endeavors to improve budgetary management alongside consolidating processes the transparency depends on. Improvement of the budget transparency has also been considered as key factor for increasing internal accountability as well as for promoting the mutual trust culture among borrowing governments and donor agencies.

Foreign aid and transparency should be mutually linked with each-other so that the aids impact is greater. Funding from abroad might be provided to different kinds of projects as well as for budgetary support which, depending on the nature of donors, can be conditional or unconditional. Budget supporting is a method of subsidizing the borrowing country’s budget by transferring the external funding agency resources: transferred funds are managed conform receiver’s budgetary procedures.

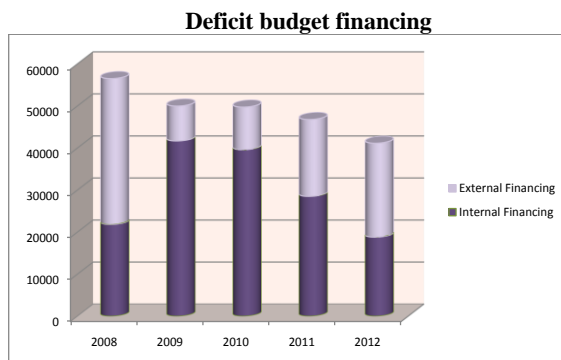
Budget support is a financial assistance which cannot be allocated to special projects. It is a special way of providing aid, although it constitutes a substantial change to other forms of allocations since funds are channeled via the government’s own financial system, i.e. being directly apportioned to the Ministry of Finances public expenditure budget. However, recipient governments should consider the fact that budgetary support bears its own risks, since it may lead to the donors’ high level interventions into the country’s budgeting processes. Consequently, there can be a diminution into the scale of flexibility regarding the allocation of resources which, later on, might undermine the stimuli for further improvement of the public expenditure effectiveness.

Moreover the system might become vulnerable toward the “foreign aid shocks” in case donors decide to withdraw their funds. In Albania, foreign aid for budgetary support has not reached very high levels, since greater attention has been paid to funding big projects with greater impact in the country’s economy. For the analyzed period, 2008-2012, Albania’s budgetary deficit has been increasing. Commencing from 2006, the deficit increase has been continual, reaching its maximal value, to 5.5% of the country’s GDP in 2008 and to 7.7% of the GDP in 2009, due to the fiscal policies expansionist nature. These are the highest deficit norms ever experienced by the Albanian finances. The reason behind this increase is simple; public spending has been higher than revenues, even though an IMF report defines Albania as a country having the lowest public spending as compared to other regional countries suchlike Montenegro, Serbia and Bosnia-Herzegovina. The causes for the growth of expenditure and decline of revenues are manifold but the most crucial is the increase of governmental spending and imports, decreases of exports etc. However, in the case of Albania’s last 5-years, the main cause behind budgetary budget is the increase of the governmental investments.

How will this deficit be financed?

To finance the budgetary deficit the governments use funds from loans, in order to cover governmental spending which could not be financed by revenues. Divided by the origin of funds, the financing could be internal or external. Consequently, the question about the role of the foreign aid in financing the budgetary deficit might be raised. Foreign aid is an important element for reducing budgetary deficit, although it should be emphasized that it reduces the deficit solely in the instant the aid transferring is accomplished, therefore, in this moment a part of the aid goes to cover the budget deficit whereas the rest goes to fund the project the aid has been allocated for. It helps to narrow the gap created in the public budget giving the recipient government the possibility to spend more money on public affairs than it would have been able to spend basing solely on the revenues from taxation and other borrowings. In the case of Albania as well, foreign aid has been a crucial element contributing to the reduction of the budgetary deficit in the moment it has been received. There is an important point to be made to this regard: the percentage of the foreign funding for the budgetary deficit involves funds received from foreign aid, i.e. the soft credits as well as funding from high-interest rate loans.

As it has been clearly shown by the chart, the greatest amount of the foreign aid allocated to Albania was in 2008, a considerable part of which went to fund the budgetary deficit while initially allocated to fund the Albania-Kosovo Highway, (“Rruga e Kombit”). Meanwhile, the least amount allocated by international donors was in the 2009-2011 period, making up the lowest level of foreign aid to the country, compared to previous years.



What others consequences brings foreign aid except lowering budgetary deficit?

Obviously foreign aid reduces budgetary deficit but, on the other side, it has ulterior implications since obtaining foreign aid means increasing the country's public debt.

Therefore, as far as the aid increases borrowing, it turns into a debt-creating means, whose future implications will compromise the liquidation of the loan interests and contribute to the further increase of the public debt. In case of Albania the situation becomes even more problematic, because of the very high level of public debt during 2011-2012, compelling the Albanian government to change the public debt limit, by raising it to 62% of the GDP in 2012.

Certainly, such situation is not favorable at all for Albania since paying of such amount of public debt back would require greater portions of revenues to go to liquidating its principal and interests, bringing chain problems to the country's public finances.

This reasoning makes us conclude what was said at the beginning; increasing foreign aid effectiveness in the country requires, first of all, good governance of its resources by the government.

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