

Budget deficit, exchange rates and inflation.MSc. Dr. Proces. Alba ALLMUÇA RAMALLARI
MBA. Gentjan RAMALLARI**Abstract**

If we want to look at the history of the finance of a state we should certainly bear in mind where it began to exist until current existing situation.

In our country there is been frequent and fast changes. We went from a centrally planned economy to a democratic society with market economy basis, rushing for a great development, opportunities and cooperation with other countries which had entered earlier in the development path. All these changes and will have a positive or negative impact on the economy.

Issues which will be presented as concern would have a certain negative impact that will not only cause problems for the time being but for the coming years as well.

One may come up with a greater number of concerns but in our study objective, for our economy, we will be looking at the fact of economic development, in particular at the exchange rate and inflation rate of the country. Standing at the impact of exchange rates we take into account the effects of trade on the economy. Where mentioned, exchange rates affect not only trade, but will be a problem in the case of the debt existence. In a developing country a certain level of debt is normal. This is the result of policies encouraging development, as well as a lack of liquidity could this from the negative difference of income and expenditure budget.

Hereby, we will present the effects of inflation stressing here the changes in cash flow, its value as well as that part of imported inflation.

All these elements listed above will be addressed along topic budget deficit, exchange rates and inflation.

Introduction

Starting from a very low economic base in 1991-92, Albania soon entered in the process of the high growth path of GDP and falling inflation, associated with movements toward serious reform for the market. These achievements were threatened, but not forever turned against due to a period of turmoil and almost anarchy in early 1997, which was a period with main problem especially for the economy and the population. Still, this transition period has very large impact in the whole economic life.

Since then, the Albania's economy again enjoyed high annual growth rates and low inflation.

This combination is achieved in an environment where the development of the financial sector is still in an early stage and informal markets are booming. Consequently, the role of monetary policy impact on inflation and growth is naturally limited. However, Albania is being paid more and more attention senior role monetary policy, and especially the costs and benefits of the introduction of instruments. It's important to mention the inflation target regime, the control like an important factor for stabilization policy during transition.

Albania during the real transition.

During this period of transition we have some changes like in the interest rate but that remains in control of the Central bank, the inflation is dropped under control until the banking system will consolidate and the monetary policy start to work with indirect instruments.

In 2000 we have a drop to interest rate, and after this the central bank of Albania began to eliminate almost the direct control to the interest rate. For this we mention that the system of exchange rates is flexible but with some elements by the fixed method. Is more important to have the indirect control and indirect instruments of monetary policy, in the bank market and interest rates.

State Budget

Each individual or family every month plan the expenditures based on amount of money available and all the things they can do during a month. In other words, families, estimates the cost of running it on a budget - income and which you

can spend to eat, live, to wear, to pay rent, to have fun etc..

In the same way, the government is planning expenditures and investments depending on the budget that designs. It schedules rather than its revenues will be spent on various needs state, such as staff salaries administration, pensions, hospitals, education, defense of the country, etc.

Unlike the family budget, state budget is planificated by the government for a certain period called "Fiscal year". The year consists of 12 months and under standards established in our country is the same calendar year, that starts on 1 January and ends on 31 December (in some places this year lies in the period September - October of the next year or March to April of next year).

Particular time

Although the concept is the same, the process of drafting, submission and approval of the state budget for a year is complicated than the preparation of the family or the personal. It is based on the analysis for the development of general economic and complies with long term government policies.

In all situation state balance have two side, income and expenditure with all the elements.

In expenditure side more important are current expenditures, to the social insurance, expenses for health providing, economic aid, reserves in case of natural difficulties, financing local government, etc.

In terms of income among the most prominent elements impact the income tax, customs revenues, non-tax revenue, taxes on vehicle circulation et. The difference between income and expenses is what called surplus - when revenues are higher than the costs or deficit - when costs are higher than revenues. The difference between income and expenditure of the Government in

Albania over the last 10 years is equal to deficits. This is a normal thing for countries in transition. Revenue is not realized because not all taxpayers are correct with the law and avoid obligations to pay; due to difficulties in tax collection; due to social policies that follow country etc., while costs are high due to large share of public investment, etc.

But, deficits are not unusual even for developed countries. United States of America, one of the most developed countries in world, is resulting in a budget deficit for 30 years row, until 1998. Therefore, there is no alarming to think that for other years in Albania, expenses may exceed government revenue. Usually, to evaluate how deep the budget deficit is in a country, it's calculated the ratio of production of a country (Gross Domestic Product). This figure shows how much of the value of total output of the economy occupies deficit the state budget.

To cover the budget deficit, the government borrows internal and external or otherwise allegedly financed from internal and external sources. Domestic borrowing is provided by entities previously defined to include banks, institutions financial and nonfinancial corporations and individuals. Receiving credit government is in the form of government securities or as otherwise called bonds. So, the government issues bonds Treasury with certain values, which are purchased from individuals, bank or other financial institution for a long time previously determined. After this time (or when maturing treasury bills) repurchases government securities and together with the initial price which has sold, it pays an interest holder. This interest is government expense and profit that had purchased treasury bills.

Although it may seem strange, the government is obliged to borrow even when income is the same with costs. This is because it is permanently bound to pay previous debts, even when present does not need to borrow, it spends on debt received in the periods before and settled now.

Thus, the government cannot repay all its loans within one year after the time of their settlement coincides with different periods. Therefore, unlike income, spending and the budget deficit, measured in periods of one year fiscal, government debt includes all outstanding loans yet by the government over the years. In these conditions, successive governments have the duty to pay for the matured debt. For this reason governments can't create a debt every time they want, because they can't spent everything they want to. Is important to calculate the cost of the debt and analyze the profits by the use of this amount.

This is important because can affect the whole economy, can affect the value of money in the market and for this the interest rate. All this implicate the economic situation, especially in an open economy with international trade base.

One part of the debt is an internal debt, but how is it created?

This is important. We say that a country for developing needs investments and for sow needs savings. In the time that we can see that a country is developing now is not true that the saving in state currency are rising because the real fact is that we are in an open economy and the money can come from outside. This especially in a freely circulation of capital.

Developing countries, like Albania, have used external debt as a mechanism to fill the gap created between national savings and desired investment level and to meet gap created by the import-export. This debt is added to the total resources economy for a certain period of time and provides a level of higher expenditure than that can be met only with internal resources. This is applied by external sources benefit when the country has low. This can contribute to economic growth and poverty reduction in

country. If they spread so inefficient, the cost of the foreign borrowing can lead to problems in the form of macroeconomic management levels even unsupported and in external debt service.

Facts shows that we have savings in our country, but peoples want to have bonds, because are without any risk and they don't prefer doing investment green filed.

Given that the public is the main lender and, as mentioned debts will be payee by the successive governments, government policies on borrowing will be considered the public opinion too.

How can they pay the amount of debt, how is changed the money value etc, are important questions which wants a direct answer. The inflation still is a problem in this case, especially when we don't have a stabilized product, and stabilized currency in international market.

During recent years, the central bank has taken into account the movement of the declaration of inflation limit within which it intends to operate in inflation target (Inflation Targeting).

Such a policy allows flexibility when faced domestic real shock (aggregate demand) and external. In addition, the regime inflation target uses a forward looking approach, which allows central bank to avoid policies that are contrary to the objective. Creating a policy that has o long term of view is likely to have a stabilizing effect in the financial markets. The Czech Republic was the first country in transition, which began adopt this alternative for monetary policy. Is not important only the actual period, but the successive too.

This strategy can be attractive also for Albania. Existing regime freely floating exchange rate facilitates the replacement of monetary control with the inflation target, which is now present in our country. It can also help to strengthen the central bank independence. However, there are several reasons why Albania can still not be ready to fully adopt such a policy.

Exchange rates in Albania

The Financial situation of firms in industries and services has a considerable recession during the second half of 2008 and till in 2013. As well as in the construction sector the financial situation is worsened during the second half. The individual financial situation shows a decrease in savings and a greater risk in personal loans. Deterioration occurs even in enterprising, businesses and families. This reflects the decline in demand for goods, investment,

declined due to smaller opportunities for funding and promotes the need for an adaptation of savings and spending pattern. If this process will be strong, there is a risk that he may encourage a forcible spiral. Until 2012 a best part for the income in Albania was by remittances. In 2007 were assessed of mass 12-13 % of GDP. As a result of the crisis in the developed countries of Europe, the flux of these remittances has decreased so significantly and this adversely affected the value of the income of Albanian families. In this way the currency flows in economic agents will become rarer, bringing a relative reduction of the country's domestic market currency. In this case, the maintenance of exchange rate levels would require a decrease in demand for currency, mainly in the form of imports reduction.

Conclusions

In our country the fact is that we have changes from one period to another. Trying to have a significant development, government can create a huge amount of expenditures which directly and indirectly affect money market. In our case we have budget deficit and the main part is created by government investments in infrastructure. For this budget deficit is created the public debt in our country and the solutions of all this is privatizing all state propriety. This can affect the economic situation and the economic stabilization. The circulation of money can be lower in case of difficulties or crises.

Being a country which has international trade, this fact is not insignificant. We depend by mane other in the market, this because the lower supply for goods and services. The changes in the money value can create problem to the trade balance and the balance of payment. We cannot present the possibility for foreign trade with a weak currency and the necessity for products and for inputs. During the transition the value of the Albania Lek is changed often, sometimes the decrease was very deep and with higher costs. Recently the value is appreciated and depreciated. For the changes in Albanian Lek currency the consumers sometimes prefer work and have a low in foreign currency like is Euro or US Dollar.

We have a free capital circulation, foreign investments and all these are depended by fiscal and monetary policies. With the circulation of money and the need to have an economic stability the main aim is to have price stability, an control in inflation rate. This is the duty of the Central Bank. During these years it has some changes in the policy like the decreasing of the interest rates and try to appreciate the value of Lek with instrument, but a collaboration betwin fiscal policy and monetary policy can affect more in the price level and in the money value.

References

Mankiw, N.Gregory, David Romer and David N. Weil (1992), A Contribution to the Empirics of

Economic Growth, *Quarterly Journal of Economics*, 107, pp. 407-438.

Rao, B. Bhaskara (2007), Estimating Short and Long-Run Relationships: A Guide for the Applied

Economist, *Applied Economics*,
Reports by Bank of Albania 2012

Manasse, P., 1996, "Are Taxes Too Low?" *Journal of Economic Dynamics and Control*,

Vol. 20 (6-7),