

MACROECONOMIC POLICY CHOICES FOR GROWTH AND POVERTY REDUCTION

The Case of Albania¹

POLICY BRIEF

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Poverty: Primarily a rural and a mountain-area phenomenon

As it is underlined in the National Strategy for Social and Economic Development (NSSD), which is the Albanian name for Growth and Poverty Reduction Strategy, *the roots of poverty in Albania lie deep in the previous system, but they have also been nourished by developments accompanying the transition process*⁴. In spite of its massive incidence in the previous system, poverty was officially recognized only after 1991. Several surveys related to poverty have been conducted. The first was on the family budget and included only Tirana in 1993-1994. Other surveys followed. Despite their value, they suffer from methodological differences that make comparison of their results difficult. The most comprehensive one is the 2002 Living Standard Measurement Survey (LSMS) in which the calculation of poverty indicators is based on consumption. Because of this it is considered a robust line upon which to base future monitoring of policy impact. Table 1 shows the main indicators of poverty, based on 2002 LSMS.

Table 1. **Poverty indicators in Albania**

	Tirana		Other Urban		Rural		Total	
	Poor	Extreme Poor	Poor	Extreme Poor	Poor	Extreme Poor	Poor	Extreme Poor
Headcount	17.8	2.3	20.1	4.8	29.6	5.2	25.4	4.7
Poverty Gap	3.8	0.6	4.7	0.9	6.6	0.7	5.7	0.8
Poverty Gap squared	1.3	0.22	1.7	0.24	2.1	0.16	1.9	0.19
Mean per capita consumption(New Leks)	9,043		8,468		7,212		7,801	
Gini	0.30		0.28		0.27		0.28	

Source: WB Report, Albania Poverty Assessment, 2003

According to the 2002 LSMS, the poverty headcount for rural areas was 66 per cent higher than in Tirana and 50 per cent higher than in other urban areas. Almost half of people living in the North and North East mountain area (44.5 per cent) are poor and more than a fifth of this group (10.8 per cent) lives in extreme poverty. In the non-income dimensions of poverty, sectoral and regional disparities are more pronounced than those observed through income dimension alone.

⁴ Albania: Growth and Poverty Reduction Strategy Paper, 2001, p.13.

Fighting poverty: a balanced approach is needed

Increasing attention has recently been paid in the economic literature to the relationship between macroeconomic issues and policies and poverty reduction, although poverty is a multidimensional problem and the solution to that problem requires a comprehensive set of well coordinated measures, not only economic but also political, social and cultural. There is a broad consensus in the literature that economic growth is the single most important factor influencing poverty, and macroeconomic stability is essential for high and sustainable rates of growth.

Nevertheless macroeconomic stability *per se* does not ensure high rates of economic growth, not at least for less developed and developing countries, particularly not for transition economies. Economic transition reforms aimed at establishing an efficient market mechanism are a crucial factor for sustained and high rates of economic growth. The Albanian experience, with its ups and downs, clearly shows how critical are transition reforms, particularly structural ones for economic growth and the overall progress of the country.

It is also widely accepted that growth as such is not sufficient for poverty reduction. Policies to improve distribution of income and assets within a society are essential factors for reducing poverty too. In the case of Albania, there are serious regional disparities partly inherited from the past and partly resulting from transition developments. Extensive internal migration is spontaneously taking place from rural and mountain areas to the urban more developed areas, along with the international migration. A consequence is an aggravation of poverty in both the depressed regions and the suburbs of towns and cities where the internal migrants are largely settled. In the former, the provision of public services is becoming very costly. In the latter, emergency measures and funds are needed to improve damaged infrastructure (roads, electricity, provision of drinking water, sewerage), education and health services, the resolution of property conflicts that have arisen, etc. Distribution and regional policies are needed for reducing poverty, although it is clear that such policies are not sufficient. The question raised is: how far can government policies go without damaging the incentives for growth and hence narrowing the base for the means of reducing poverty itself? This is a critical trade-off and a balanced approach is needed.

Speeding up structural reforms, crucial for making effective any policies addressing poverty reduction

As a measure of the scale and effectiveness of market functioning, structural reforms require the success and effectiveness of other policies undertaken by government, including those addressing poverty. The flourishing — and then demolishing — of pyramid schemes in the years 1996-1997, with the resulting destruction of economic, political and social values, were in a synthesized form a testimony of the failure to implement structural reforms seriously. Steps forward were taken later but, as the European Commission reported, “Although some progress was registered in structural reforms, much remains to be done” to create market-friendly institutions and an enabling environment for businesses and investments.

Fostering growth: the single most important policy for poverty reduction

How much growth actually reduces poverty depends on at least two factors: the rate of economic growth itself and the extent of inequality. Considering the *full poverty line*⁵, simple calculations produce an approximate elasticity-of-poverty rate to changes in the poverty line of 2.5. Calculations of the required cumulative growth and the number of years needed to halve the poverty rates (the Millennium Goals target) are then carried out based on an assumed elasticity of -2.5, and also the average elasticity of -1.07⁶, calculated by Epaulard (2003) for developing and transition countries together. Two scenarios are also used for the yearly growth rates at six per cent (which is the target of NSSD for the upcoming three years) and five per cent, to somehow reflect the experience of the year 2002. The results are put together in the Table 2.

⁵ The full poverty line (implying an allowance for necessary food and also basic non-food items) is estimated at 4,891 Lekë per capita per month. (World Bank and INSTAT, 2003).

⁶ -1.07 is the average sample (including developing and transition economies) elasticity in the Epaulard (2003) study.

Table 2. **Percentage of growth and number of years required for halving the poverty rate**⁷

Assumed poverty elasticity to growth	A 6% yearly growth rate scenario		A 5% yearly growth rate scenario	
	Required cumulative growth ⁸	Required number of years ⁹	Required cumulative growth ²²	Required number of years ²³
-2.5	29%	4.3	29%	5.2
-1.07	68%	8.9	68%	10.6

Source: Own calculations, based on 2002 LSMS data.

Considering the whole of the transition period, it can be said that the economic growth in Albania has been rapid but fragile and therefore inconsistent¹⁰. Taking only the period 1998-2002, Albania registered on average a growth rate of 6.8 per cent as compared to 4.7 per cent in the South East Europe region. Albania is the only country in the region that exceeded the 1989 real GDP level since 2000, achieving 114.3 per cent in 2002 and 121 per cent in 2003.

Deserving closer attention by the government are sources of growth particularly important for Albania, such as the increase in total factor productivity, progress in structural reforms and macroeconomic stability; the investment role of remittances, and also sources of fragility related to external position, infrastructure, public expenditure management, etc.

Emigration and the resultant transfers are crucial factors in financing growth, reaching and maintaining macroeconomic stability and alleviating poverty. Policies to support channeling such transfers into development investments should be fostered. Efforts to ease return migration would benefit the country through financial, human and social capital that temporary emigrants bring when they return.

Of crucial importance are increasing further private capital accumulation by facilitating private sector investments (including foreign direct investments) in a business-friendly investment climate (to be improved by pushing ahead with structural reforms, privatization of the remaining large public companies, deepening of trade liberalization, pushing ahead reforms in banking and the financial sector, labour markets, the regulatory environment and the judicial system). Studies also show that increasing public investments in education,

⁷ According to the MDGs.

⁸ The effect of 1% growth to poverty reduction is calculated based on the formula: $\{poverty\ rate\ (\%) - (elasticity * poverty\ rate\ index)\}$.

⁹ Required number of years (n) is calculated based on the formula: $\{\ln(\text{required cumulative growth index}) = n * \ln(\text{yearly average growth rate index})\}$.

¹⁰ The 1997 setback is a testimony.

health, infrastructure and other social services guarantee a sustainable growth and have direct effects on reducing poverty. Fostering growth in labour-intensive sectors, such as agriculture, agro-processing industries, leather and footwear, textiles and garments (the later counting for the bulk of exports), and furniture are expected to have greater effects in poverty alleviation and in macroeconomic stability.

Macroeconomic stability, a ‘pro-poor’ precondition for growth at high rates

In addition to negatively influencing the growth rates, macroeconomic instability poses a heavy burden on the poor. The low single digit inflation rate, a stable exchange rate, and low levels of external debt in relative terms testify to a relatively stable macroeconomic situation in the country.

Nevertheless, the macroeconomic situation in Albania suffers a number of fragilities. Although the current account deficit in Albania is sustainable and no immediate risk for foreign debt and exchange rate exists, the sustainability itself, in medium to long term, seems to be fragile. This conclusion is reinforced if we look closer at the components of the current account. The main contributor in financing imports in the current account is the private remittances, exceeding by almost twice the contribution of exports¹¹. Meanwhile, in medium to long-term, private remittances are expected to decline, as emigrants settle with their families in their host countries.

Not only the small volumes compared to imports, but also the structure of exports, both in terms of commodities and partners of trade¹² is another source of vulnerability. While in the short-to-medium-term the increase of current account deficit sustainability requires close attention to the financing sources in the capital and financial accounts, a stable and long run solution would require the improvement of the trade balance, particularly by promoting exports¹³ and increasing the competitiveness of the economy.

¹¹ See Table A2.

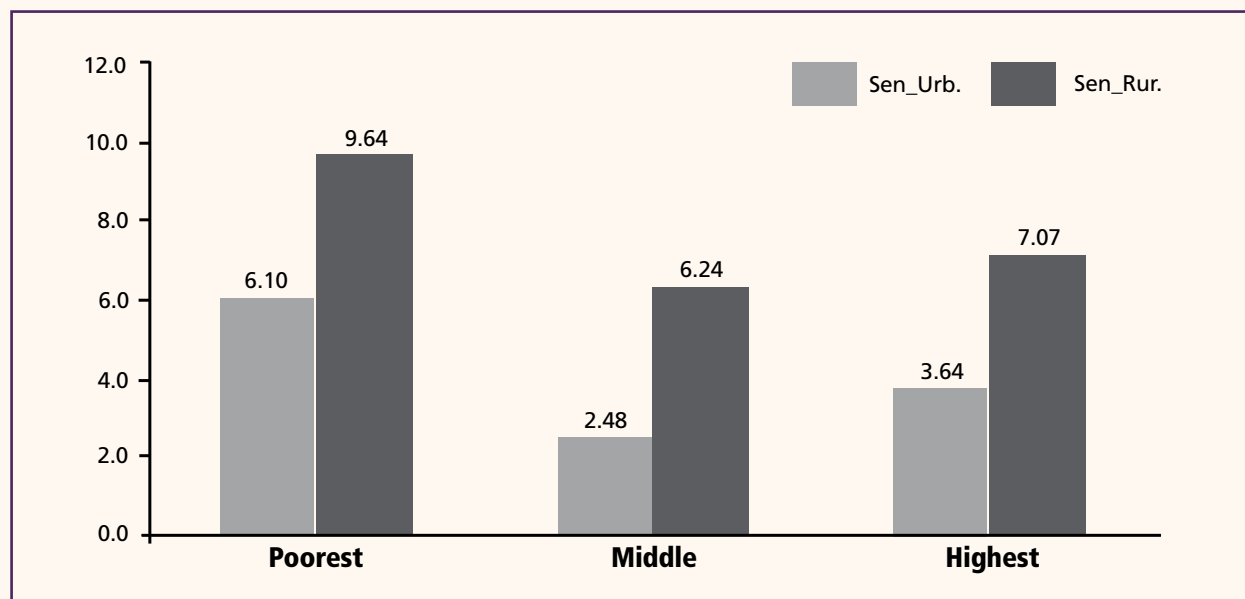
¹² Exports of outward processing goods (textiles and footwear) counts for more than 65% of total exports and around 90% of exports are concentrated Italy (around 75%) and Greece (around 15%). (INSTAT).

¹³ In the current situation, import substitution is also important.

More attention should be devoted to regional disparities

Distribution policies are important not only to insulate the poor, but also for macroeconomic stability and economic growth and development. Some regions of the country are seriously affected by poverty. Poverty rates, unemployment, illiteracy, and the frequency of serious diseases are much higher in rural areas, particularly in the North and North East areas of the country. Based on the 2002 LSMS, the prefectures of Kukes, Diber, and Elbasan are the poorest in Albania, while the prefectures of Vlore, Berat, and Fier are among the areas with the highest standard of living (even though they have high levels of urban poverty). The remaining prefectures (excluding Tirana) are grouped in the middle standard of living area/region. The regional values of Sen Index¹⁴ (which is a synthetic indicator of poverty) calculated for the three regions, support this classification. As Graph 1 shows, poverty is present in all three regions, but it is particularly aggravated in rural and the North and North East mountain regions. The poorest region also suffers a more persistent high rate of unemployment compared to the other two regions. As well, it is in an inferior position when the development of private sector is considered. Over the period 1997-2002, 1,607 new firms were created in the poorest region compared to 6,381 in the highest living standard region and 8,364 in the middle living standard region.

Graph 1. **Sen Index for three regions in 2002**



¹⁴ The Sen index measures the poverty that takes in consideration the number of poor people, the lack of their incomes relative to the level of poverty (the revenue gap), and also the rate of inequality in their income distribution (Gini coefficient). In the calculation of Sen Index the municipality of Tirana has been excluded.

What has been the response of policy to regional disparities? The pattern of public expenditure spent on the three regions did not seem to have properly taken into consideration the level of poverty. The relative figures of public expenditure in the period 1997-2002 are higher in the regions with middle and highest standard of living than in the poorest one. The public expenditure index¹⁵ for the poorest region in 2002 was 190 per cent, as compared to 331 per cent for the middle region and 240 per cent in the highest region. (See Table 3).

Table 3. **Public expenditure index by region**

	1997	1998	1999	2000	2001	2002
Poorest Region						
Total Expenditure per head (100%=100)	100%	118%	146%	203%	187%	190%
Total Public Investment per head (100%)	100%	399%	618%	663%	751%	640%
Highest Region						
Total Expenditure per head (100%=100)	90%	110%	137%	159%	232%	240%
Total Public Investment per head (100%)	83%	130%	245%	256%	564%	491%
Middle (excluding Tirana) Region						
Total Expenditure per head (100%=100)	152%	176%	214%	201%	315%	331%
Total Public Investment per head (100%)	160%	267%	412%	368%	667%	675%

To diminish regional disparities in Albania, a careful regional policy agenda has to be designed. Before formulating a regional policy, a study that identifies strengths and weaknesses of each region is needed. Public expenditure policy for poor regions should not simply be income transfers but rather investment in physical and human capital in order to improve their underlying economic performance by increasing their competitiveness. The positive experience with the micro-credit schemes should be enforced and further develop. More institutional and financial support should be given to encourage family businesses, create new firms and grow small ones, and to back partnerships.

In the NSSD, which aims to reduce poverty, priority is given to education, health, infrastructure and governance. The strategy also highlights the importance of attaining macro-economic stability and obtaining an adequate social protection network as pre-conditions to growth and poverty reduction. The transition realized in Albania from the Growth and Poverty Reduction Strategy to NSSD has its positive and negative sides. On the one hand, it is a way to ensure that the strategy itself is made operational. On the other hand, having included every single governmental policy in the strategy, it is quite possible that the focus on poverty reduction has been lost.

¹⁵ The index is calculated by using a base value of 100% for public expenditure level in the poorest region in 1997.

