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# Fuelling political fiscal cycles by opportunistic privatization in transition economies: The case of Albania<sup>☆</sup>

Endrit Lami<sup>a,b</sup>, Drini Imami<sup>c,d,\*</sup>, Holger Kächelein<sup>e,f</sup><sup>a</sup> Ministry of Finance, Albania<sup>b</sup> Budapest University of Technology and Economics (BME), Hungary<sup>c</sup> Faculty of Economics and Agribusiness, Agriculture University of Tirana, Albania<sup>d</sup> CERGE-EI, Prague, Czech Republic<sup>e</sup> Bavarian Virtual University (Virtuelle Hochschule Bayern–vhb), Germany<sup>f</sup> Southeast Europe Centre for Economic Development (SECED), Tirana, Albania

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## ABSTRACT

This paper provides insight into the widely studied phenomenon of political business cycles by analyzing the impact of elections on the privatization of public assets in transition economies. The hypothesis of this article is that incumbents opportunistically schedule privatizations to take place close to the next elections in order to finance higher public expenditures, aiming to please voters and increase the chances of being re-elected, particularly when their ability to borrow is constrained by high public debt. We consider the case of Albania, which is a transition and small open economy with a relatively high public debt. We find significant increases of income from privatization before elections. Despite often being trumpeted in the context of structural reforms, the intentional privatization of public assets in times of election is most likely a sub-optimal choice for the public interest. Studying the impact of elections on the privatization of public assets could be of interest to other transition economies facing fiscal constraints.

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## 1. Introduction

Sometimes it is called “Election year economics”: The long-run interests of incumbents are largely dominated by immediate re-election concerns. There is a common perception that the economic performance before elections to a large extent determines the likelihood of re-election for the incumbent and the other way around (Tibbitts, 1931). Hence, economic factors influence political factors, but political factors may also influence economic ones—governments may use all means at their disposal, including economic policy instruments, to enhance their chances of re-election.

Over the last decades, there has been plenty of research into the use of fiscal and monetary instruments controlled by incumbents to stimulate economic performance before elections. The government may behave opportunistically and inefficiently prior to elections, engaging in expansionary economic policies to increase output and decrease unemployment in order to please voters. This incumbents’ behavior often induces political budget cycles and maybe also political business

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\* Corresponding author.

E-mail addresses: [endrit.lami@financa.gov.al](mailto:endrit.lami@financa.gov.al) (E. Lami), [dimami@ubt.edu.al](mailto:dimami@ubt.edu.al), [drinimami@yahoo.com](mailto:drinimami@yahoo.com) (D. Imami), [kaechlein@seced-web.org](mailto:kaechlein@seced-web.org) (H. Kächelein).

cycles (PBC). The PBC model of Nordhaus (1975) paved the way for many subsequent empirical and theoretical studies and publications and remains a point of reference. While initially the focus of PBC-related empirical research was on developed countries, over the last decade there has been a growing interest in research on PBC in developing and/or transition countries, whose institutions, economies and societies differ significantly from the developed ones. As shown by Brender and Drazen (2005) and Shi and Svensson (2006), new democracies are particularly vulnerable to political budget cycles. While Alt and Lassen (2006) show the relevance of transparency, Brender and Drazen (2005) also emphasize the lack of experience that voters in new democracies have regarding the existence of political fiscal cycles. Treisman and Gimpelson (2001) provided evidence on the existence of PBC in Russia, as did Asutay (2004) for the case of Turkey, while Lami and Imami (2014) found evidence of political fiscal cycles in Hungary, to name a few. Meanwhile, Hallenberg and Souza (2002) argue for the existence of PBC in EU accession countries related to both fiscal and monetary policies, with the latter being more common in countries with central banks with low levels of independence.

Recently, there has been a growing research interest in PBC and other related phenomena that could be typical for other transition economies in Albania. Imami and Lami (2006) found evidence of election-related influence on several fiscal policy instruments, with a clear expansion of some of the main items in the budget expenditures before elections (e.g. capital expenditures and compensation of employees). Sometimes incumbents use means other than instruments of economic policies. Kächelein et al. (2011) show how publicly supplied goods (the supply of electricity) in Albania has been opportunistically manipulated by incumbents for electoral gains. However, despite their opportunistic behavior, the incumbents might not be able to affect the final outcomes the way they intended. Lami et al. (2014) pick the case of Albania to argue why, particularly in new democracies, although incumbents try to engineer economic expansion before elections (higher output and lower unemployment), they might not succeed due to the expectation-related behavior of private economic agents, which offsets the transmission of opportunistic fiscal policies into macroeconomic outcomes.

One of the sources of financing the state budget in transition countries, characterized by a massive privatization process on the one hand and by limited market financing means on the other, may be income from privatization. The higher the budget expenditures and deficits, the higher the financing needs. In this context, our hypothesis is that the incumbent may engage more intensively in privatizations before elections, aiming at increasing public revenues to sustain increased expenditures, in line with the political budget cycles theory and evidence. Hence, this paper focuses less on the existence of political budget cycles or political business cycles per se, but rather on incumbents' potential use of public assets to finance such election-related cycles through privatization. After some clear cases of completely inefficient privatizations in Albania – most notably the electricity distribution company and the oil refinery company, both with a strategic status as well as monopolistic power – the implications on public welfare are immense should this hypothesis hold, as privatizations are neither implemented according to what could be optimal nor to the maximum benefit of society.

In the next section, we provide an overview of the privatization process in Albania and explain the background of the hypothesis of this paper. Section three explains the methods, data and procedures. Section four presents the main findings and Section five concludes.

## 2. Election-related cycles in income from privatization

### 2.1. Overview of the privatization process in Albania

Albania began the transition from a planned to a free market economy in the early 1990s. All large and small enterprises as well as all land were owned by the state before transition. Therefore, private ownership, including land reform and state enterprise privatization, was a top priority for economic reform during early transition.

Large-scale privatization started in 1992 as part of a program guided by the IMF and the World Bank. The Ministry of Privatization and the National Agency of Privatization were responsible for supplying, projecting and implementing procedures for the documentation of enterprises and the organization of auctions. In the early 1990s, compensation bonds and privatization vouchers were issued, which were distributed to the whole adult population of Albania. These were used to buy shares in the commercial companies to be privatized. The Bank of Albania was responsible for issuing vouchers according to the requirements set by the Ministry of Finance. From their introduction, the value of the vouchers dropped continuously. During the social unrest of 1997 their real value went down to 1.6% of their face value, while there was very limited trade of such vouchers (Mema and Novrus, 2001). The use of vouchers was not successful—during the privatization process only a small share (21.25%) of the distributed vouchers was used (Mema and Sallaku, 2003).

Despite the weak use of the voucher system, privatization proceeded fast and the economy was largely in private hands by 1996.<sup>1</sup> While privatization halted during the unrest of 1997, it resumed again in the following years. Based on the EBRD index, small-scale privatization basically ended in 1995, though large-scale privatization persisted at a moderate level until the end of the last century.<sup>2</sup>

During the 2000s, the banking sector was privatized entirely (currently all secondary level banks are in private hands). The landline company, a monopoly at that time (Albtelecom), the Albanian electricity distributor (OSSH), and the only oil

<sup>1</sup> MIGA—Privatization in Albania, 2002 (MIGA, 2002).

<sup>2</sup> EBRD—Transition report 2004, p.92; 2005, p. 96 (EBRD, 2004, 2005).

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