



## **THE POLITICAL BUDGET CYCLE IN CAPITAL EXPENDITURES AND THE DISCIPLINE OF FISCAL RULES: CASE OF ALBANIA**

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### **Abstract**

*This paper analyses the existence of a political budget cycle in capital expenditure at the general government level in Albania, as well as the effectiveness of fiscal rules in limiting politically driven fiscal actions. The data covering the period 1993 to 2024 were sourced from the Ministry of Finance and the Central Election Commission of Albania. Least Squares (OLS) estimation on EViews 13 is employed to empirically estimate the relationship among electoral cycles, fiscal rules, and capital expenditure trends. Research indicates that although capital expenditure experiences a slight increase before and after elections, it lacks statistical significance, suggesting a slight impact of electoral incentives on long-term investment decisions. Election years are unexpectedly linked to decreased capital spending, likely due to a transition towards short-term expenditures that provide immediate attraction to voters. Furthermore, the research shows that capital spending tends to decrease when assessed using both a dummy variable and the Fiscal Rule Strength Index; nevertheless, the effects are statistically insignificant, probably due to the short period of rule enforcement. The limited impact of election-related capital expenditure indicates a shifting focus towards current spending with immediate electoral attractiveness, which may compromise the efficacy of long-term investments.*

*Keywords: Political budget cycle, Capital expenditure, Fiscal rules, Empirical evidence, Albania*

## INTRODUCTION

The relationship between fiscal policy and election dynamics has been extensively examined, especially in developing and transitional economies. A notable phenomenon in this field is the political budget cycle, characterised by governments modifying fiscal behaviour, particularly public expenditure, in anticipation of elections to improve their prospects for political success. In many countries, including Albania, this manipulation frequently appears as increased public investment in infrastructure and capital projects, which are visible and politically significant (Schuknecht (2000) and Bonfatti & Forni (2019)).

Albania's experience presents an interesting case study. Albania, as a post-communist country evolving into a democratic market economy, has achieved significant advancements in public finance management and budgetary transparency. Nonetheless, electoral incentives persist in influencing capital expenditure patterns. Recent electoral cycles indicate an incentive for government entities to increase capital spending before elections, frequently compromising fiscal discipline and the efficacy of long-term investments. Based on the data, capital expenditure increased by 10 and 11.3 percentage points of GDP in the election years (2017 and 2021, respectively). This conduct corresponds with the opportunistic model of the political budget cycle, wherein incumbents favour immediate political advantages over long-term budgetary sustainability.

To mitigate these fiscal risks, Albania has implemented a series of fiscal rules designed to enhance budgetary discipline. The foremost criterion is the stipulation for a non-negative primary balance, established in the Organic Budget Law. One stipulation of the Organic Budget Law related to our objective is that the annual budget deficit must not surpass the annual capital expenditure sanctioned in the budget law each year. These strategies aim to restrict discretionary budgetary actions and enhance macroeconomic stability.

This paper aims to empirically estimate the impact of the political budget cycle on public capital expenditures in Albania and assess the effectiveness of fiscal rules in limiting politically driven fiscal actions. Our analysis introduces a novel empirical approach in Albania to examine the relationship between public investment and fiscal rules from 1993 to 2024, utilizing the European Commission's Fiscal Rules Strength Index (FRSI).

The paper is structured as follows: Section 2 reviews existing literature on political budget cycles on the public investment side, as well as the impact of fiscal rules on public capital spending. Section 3 outlines the empirical methodology and robustness checks. Section 4 presents the empirical results, meanwhile, the main conclusions and implications are presented in Section 5.

## LITERATURE REVIEW

The political budget cycle theory argues that incumbent governments may manipulate fiscal policy to influence electoral results, frequently by increasing public expenditure or modifying its composition before elections (Rogoff and Sibert (1988), Benito et al. (2012)). Although early work concentrated on aggregate fiscal indicators, contemporary research has examined the specific elements of government expenditure, especially capital expenditures. Capital expenditures, including infrastructure investments, are particularly vulnerable to political manipulation because of their high visibility and capacity to influence voter attitudes. Several empirical evidence indicate that governments tend to increase capital expenditure during election years to secure electoral support (Shameer & Durai (2024), Olejnik (2021), Fukumoto et al. (2020), and Besley et al. (2004)). Bostashvili & Ujhelyi (2019) found that capital investment on roads is 12% higher in election years and 9% higher in the pre-election year under patronage circumstances. Furthermore, according to the findings of Bonfatti & Forni (2019), real capital spending rose by roughly 10–20% on average during pre-election years.

However, despite empirical evidence supporting political budget cycles on the capital expenditure side, Block (2001) concludes that in election years, governments often adjust their expenditures by increasing current expenditures and decreasing investments in long-term public capital projects. This result is confirmed as well by Pierskalla & Sacks (2018), who found a significant drop in capital spending in election years.

Meanwhile, the existence and strength of fiscal rules can profoundly affect this dynamic. Strict fiscal regulations may restrict governments' capacity to undertake opportunistic fiscal expansions, thus alleviating the extent of political budget cycles. Bonfatti & Forni (2019) concluded that municipalities governed by the subnational fiscal rule exhibited a markedly subdued impact, with pre-electoral capital expenditure increasing by only around one-fourth of the amount observed in municipalities not constrained by the rule. Ardanaz et al. (2021) indicated that flexible rules safeguard public investment throughout consolidation periods. Wijsman & Crombez (2021) revealed that more stringent national fiscal rules, as indicated by the European Commission's Fiscal Rules Strength Index, correlate with a reduction in public investment.

## METHODOLOGY

This paper examines the existence of a political budget cycle in capital expenditure at the general government level by employing a quantitative research design. This methodology effectively identifies patterns and causal relationships between electoral cycles and capital expenditures, as well as the impact of fiscal rules on capital expenditures. The analysis

incorporates various data sources for a comprehensive examination, including data sourced from the Ministry of Finance of Albania and from the Central Election Commission of Albania, to accurately correlate fiscal data with electoral events. The data encompasses the period from 1993 to 2024, during which eight parliamentary elections were held respectively in 1996, 1997, 2001, 2005, 2009, 2013, 2017, and 2021.

### Model specification and variables

The model specification was adapted from the model structure established by Nguyen & Tran (2023) and defined as:

$$y_t = \alpha y_{(t-1)} + \beta Z_t + \gamma_1 \text{pre\_elec}_t + \gamma_2 \text{elec}_t + \gamma_3 \text{post\_elec}_t + \varepsilon_t \quad (1)$$

Where:

- $t$  indicates years
- $y_t$  is the dependent variable
- $y_{(t-1)}$  is the lagged value of the dependent variable
- $Z_t$  is the vector of control variables
- $\text{Pre\_elec}_t$ ,  $\text{Elec}_t$ , and  $\text{Post\_elec}_t$  are the electoral cycle dummy variables
- $\beta$  is a vector of parameters to be estimated
- $\varepsilon_t$  is the error component.

The main goal is to identify if capital expenditures rise consistently during pre-election and election years, suggesting opportunistic budgetary behaviour by incumbent officials. The dependent variable of interest is capital expenditures at the general government level as a percentage of GDP. Meanwhile, the independent variables of interest are the dummy variables for the pre-election, election, and post-election years, to account for possible alterations in fiscal behaviour associated with election incentives.

The impact of the fiscal rule will also be examined, in which we will use the fiscal rule as a dummy variable and the Fiscal Rule Strength Index for Albania. The subsequent specification model incorporates the interaction between the political budget cycle variables (pre\_election, election, and post\_election) and the variables fiscal rule and fiscal rule strength index as regressors, which was adapted from the model established by Benito et al. (2012).

$$y_t = \alpha y_{(t-1)} + \beta Z_t + \gamma_1 \text{pre\_elec}_t + \gamma_2 \text{elec}_t + \gamma_3 \text{post\_elec}_t + \gamma_4 \text{FR}_t + \gamma_5 \text{pre\_elec}_t * \text{FR}_t + \gamma_6 \text{elec}_t * \text{FR}_t + \gamma_7 \text{post\_elec}_t * \text{FR}_t + \varepsilon_t \quad (2)$$

$$y_t = \alpha y_{(t-1)} + \beta Z_t + \gamma_1 \text{pre\_elec}_t + \gamma_2 \text{elec}_t + \gamma_3 \text{post\_elec}_t + \gamma_4 \text{FRSI}_t + \gamma_5 \text{pre\_elec}_t * \text{FRSI}_t + \gamma_6 \text{elec}_t * \text{FRSI}_t + \gamma_7 \text{post\_elec}_t * \text{FRSI}_t + \varepsilon_t \quad (3)$$

The Fiscal Rules Strength Index is developed by the European Commission's Directorate-General for Economic and Financial Affairs. It quantifies the robustness of fiscal rules in EU member states by evaluating them across five key criteria: legal base, binding nature, monitoring bodies, correction mechanisms, and resilience to shocks, thereby providing a comprehensive, time-varying measure of each country's fiscal rule strength. Meanwhile, Jovanovic et al. (2024) measured this index for the Western Balkan Countries. Our paper employed the aggregate FRSI, including the debt and the budget-balance fiscal rule. Table 1 shows descriptive statistics of the variables.

Table 1: Descriptive statistics

Variables	Description	Mean	St.Dev	Max	Min
Cap.exp	The share of capital expenditure to GDP	5.66	1.40	8.70	2.80
Pre-elec	The dummy variable which equals 1 for the year before an election and 0 otherwise	0.28	0.46	1.00	0.00
Elec	The dummy variable which equals 1 for election years and 0 otherwise	0.25	0.44	1.00	0.00
Post-elec	The dummy variable which equals 1 for the year after an election and 0 otherwise	0.28	0.46	1.00	0.00
FR	The dummy variable which equals 1 for fiscal rules in place and 0 otherwise	0.28	0.46	1.00	0.00
FRSI	The fiscal rule strength index measured by evaluating five key criteria.	1.74	2.82	6.17	0.00
PD	The ratio of general government debt to GDP.	56.56	17.74	74.50	4.80
GDPG	The annual GDP growth rate	4.83	4.51	13.32	-10.92
FB	The ratio of fiscal balance to GDP	-5.43	3.14	-0.70	-12.60

### Estimations and robustness checks

This paper employed Least Squares (OS) estimation utilising EViews 13 to examine the specified econometric model. We performed a series of diagnostic assessments to guarantee the integrity and accuracy of the results. The Jarque-Bera test was employed to evaluate the normality of the residuals, whereas the Augmented Dickey-Fuller (ADF) test investigated the stationarity of the time series data. The Ramsey RESET test was employed to identify any model misspecification. The Breusch-Pagan-Godfrey and White tests assessed heteroskedasticity, while the Breusch-Godfrey LM test was performed to detect autocorrelation in the residuals. These diagnostic procedures are essential for verifying the assumptions that underpin LS regression and for confirming the dependability of the econometric results.

## ANALYSIS AND DISCUSSION

This section outlines the results derived from the time-series analysis of the political budget cycle concerning capital expenditure at the general government level. The analysis aims to determine if capital expenditure demonstrates systematic variations during election timing, consistent with the idea of opportunistic fiscal behaviour by incumbent governments.

Table 2: Empirical results (EViews 13 output)

Variables	Dependent variable				
	Capexp (1)	Capexp (2)	Capexp (3)	Capexp (4)	Capexp (5)
Capexp (-1)	0.322** (0.14)	0.320** (0.15)	0.302* (0.16)	0.343** (0.16)	0.307* (0.17)
Pre-elec	0.215 (0.52)	0.222 (0.54)	0.369 (0.6)	0.108 (0.65)	0.224 (0.67)
Elec	-0.143 (0.52)	-0.137 (0.53)	-0.113 (0.54)	-0.047 (0.66)	0.08 (0.68)
Post-elec	0.157 (0.53)	0.159 (0.54)	0.14 (0.55)	0.536 (0.68)	0.516 (0.68)
FR		-0.036 (0.53)		0.321 (0.95)	
FRSI			-0.128 (0.22)		-0.174 (0.3)
FRSI (-1)			0.13 (0.21)		0.223 (0.25)
GDPG	0.212*** (0.05)	0.211*** (0.05)	0.206*** (0.05)	0.237*** (0.06)	0.238*** (0.06)
PD	0.035** (0.01)	0.035** (0.01)	0.037** (0.01)	0.034* (0.01)	0.037* (0.01)
FD	-0.461*** (0.13)	-0.458*** (0.14)	-0.421** (0.15)	-0.481*** (0.15)	-0.416** (0.17)
FD (-1)	0.373** (0.13)	0.373** (0.14)	0.331* (0.16)	0.413** (0.15)	0.342* (0.17)
Pre-elec*FR				0.121 (1.19)	
Elec*FR				-0.39 (1.35)	
Post-elec*FR				-1.21 (1.32)	

Pre- elec*FRSI					0.088 (0.21)	Table 2...
Elec*FRSI					-0.09 (0.22)	
Post- elec*FRSI					-0.188 (0.21)	
Observations	31	31	31	31	31	
R <sup>2</sup>	0.58	0.58	0.59	0.61	0.62	
Adjusted R <sup>2</sup>	0.43	0.4	0.38	0.35	0.34	
F Statistic	3.89	3.3	2.9	2.4	2.2	
p-value	0.005	0.01	0.01	0.04	0.06	
p-value (Durbin- Watson)	1.88	1.87	1.9	2.03	2.1	
Significance: *p<0.1; **p<0.05; ***p<0.01						

As presented in Table 2, the coefficients of the lagged dependent variable are positive and statistically significant in all regressions, signifying fiscal policy inertia and the continuity of fiscal behaviour over time. The inclusion recognises that present fiscal decisions are shaped by historical policy actions, emphasising the dynamic patterns of fiscal management. Including capital expenditure with a one-period lag enhances the capture of serial correlation, hence strengthening the model specification.

In accordance with the literature, the paper reveals that the coefficients for capital spending in both pre-election and post-election years are positive, indicating an incentive for politicians to increase capital expenditures during these periods. Capital expenditure increases by around 0.215 and 0.157 percentage points of GDP in pre-election and post-election years, respectively. Nonetheless, these increases lack statistical significance and hence do not provide robust empirical evidence for a political budget cycle. Conversely, election years correlate with a reduction in capital spending, suggesting that capital investment is not employed as a fiscal stimulus to garner voter approval, although this finding is also statistically insignificant. This result may be attributed to the long-term nature of capital expenditures, which often result in delayed benefits that are not immediately visible to voters during election cycles, thereby reducing their attractiveness as effective electoral tools. Furthermore, governments may prioritise current expenditures such as subsidies and salaries, which provide immediate voter satisfaction and thereby enhance electoral motivations. This inclination further reduces the probability of heightened capital expenditure during election years. Moreover, overarching

macroeconomic factors—such as GDP growth, inflation, and interest rates—can significantly impact capital expenditure decisions, potentially eclipsing the effects of political budget cycles.

In this paper, we have examined both the fiscal rule as a dummy variable indicating the existence of fiscal rules and the Fiscal Rule Strength Index quantifying their robustness. Following existing literature, fiscal rules correlate with a decline in capital expenditure, with estimated reductions of 0.036 and 0.128 percentage points of GDP, respectively. Although the fiscal rule strength index indicates a more substantial impact, neither outcome is statistically significant, as supported by the literature (Larch & Van Der Wielen (2024)). The insignificance may be attributed to the limited time-frame implementation of fiscal rules covering only the last two electoral cycles.

Columns 5 and 6 demonstrate the interaction between electoral cycle variables and fiscal rules. The impact of election timing on capital expenditure in the absence of fiscal rules is represented by the coefficients of the election cycle dummy variables. Conversely, the impact when fiscal rules are in force is denoted by the aggregate of these coefficients and the relevant interaction variables. The data reveal that the interaction coefficients are positive in pre-election years and negative in election and post-election years. In pre-election years, fiscal rules correlate with a rise in capital spending of 0.229 percentage points of GDP ( $0.108 + 0.121$ ), while in election years and post-election years, capital expenditures decrease by 0.437 percentage points ( $-0.047 - 0.39$ ) and 0.674 percentage points ( $0.536 - 1.21$ ), respectively. The findings indicate that the interaction between fiscal rules and electoral schedules, specifically in the case of the Fiscal Rule Strength Index variable, could mitigate the impact of the political budget cycle, despite the effect lacking statistical significance.

Regarding the control variables, economic growth demonstrates a positive and statistically significant effect on capital expenditure across all estimations, consistent with theoretical expectations (Bhatta (2023), Landowska et al. (2025)). Likewise, public debt exerts a positive and significant impact, indicating the role of borrowing in funding capital investment (Blanchard & Giavazzi (2004), Marmullaku et al. (2021), Bal (2014)). In contrast, the fiscal deficit has a negative and statistically significant impact on capital expenditure, indicating that pressures for fiscal reduction may limit investment (Cabezon et al. (2015)).

## CONCLUSIONS AND RECOMMENDATIONS

This paper investigates whether a political budget cycle exists in capital expenditures at the general government level in Albania. It assesses the effectiveness of fiscal rules in limiting politically driven fiscal actions. The paper relies on comprehensive data from the Ministry of Finance and the Central Election Commission of Albania, covering the period from 1993 to

2024, which includes eight parliamentary elections. Least Squares (OS) estimation using EViews 13 was employed to estimate the impact of control and explanatory variables.

The paper indicates that capital expenditures typically rise by 0.215 and 0.157 percentage points of GDP in the pre- and post-election years, respectively. Nonetheless, these increases lack statistical significance, indicating limited empirical evidence for a political budget cycle. Notably, capital expenditure experiences a slight decrease during election years, although without statistical significance. This may indicate the delayed benefit of capital projects, making them less attractive as electoral instruments. Governments may prioritise current expenditures, such as salaries or subsidies, to achieve a more immediate effect on voters. Moreover, macroeconomic factors, such as GDP growth, seem to affect capital expenditure decisions, potentially overshadowing electoral incentives.

The research additionally investigates the impact of fiscal rules, both as a dummy variable and via a Fiscal Rule Strength Index. Although both measures correlate with reductions in capital expenditure, these impacts are statistically insignificant, probably attributable to the short implementation time of these rules. The interaction between fiscal rules and election scheduling indicates an increase in capital expenditures in pre-election years when rules are in place but declines markedly during and after the elections.

The limited impact of election-related capital expenditure indicates a potential transition towards current spending with immediate electoral attractiveness, which may compromise the long-term efficacy of public investment; therefore, assessing the efficiency and structure of expenditures is crucial. The findings also contest the universality of political budget cycles and underscore the necessity for more comprehensive, longitudinal, and comparative data to enhance the understanding of the underlying fiscal dynamics.

Considering the weak and statistically insignificant relationship between the political budget cycle and capital expenditures, policymakers should enhance the transparency and effectiveness of public investment rather than supposing systematic pre-election spending increases. Emphasis must be directed towards monitoring current spending, which may be more vulnerable to manipulation in elections. Enhancing the enforcement mechanisms and durability of fiscal rules could improve their credibility and efficacy in mitigating opportunistic fiscal behaviour.

Further research should extend the dataset to take into account potential long-term changes in political budget cycles. A detailed analysis of expenditure composition, distinguishing between capital and current expenditures, may reveal more nuanced aspects of electoral influence. Furthermore, examining the institutional and political circumstances that influence the efficacy of fiscal rules could lead to substantial insight into the conditions under which these frameworks either succeed or fail.

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