SPEAKER 1: Hello, and welcome to the Harvard Center for International development's weekly podcast. Since 2013, the Center for International Development has been collaborating with the government of Albania to identify binding constraints to economic growth and create policy solutions to solve them. CID's Growth Lab and Building State Capability programs have used the tools of growth diagnostics and problem driven iterative adaptation or PDIA to help drive economic growth in the country.

CID researchers Ermal Frasheri and Tim McNaught have seen firsthand how theory informs policy and how insights from public policymaking, in turn, enrich our theoretical frameworks. Today, on CID speaker series podcast, Jason Keene, student at the Harvard Kennedy School, interviews Ermal and Tim, who give an overarching perspective of CID's project in Albania.

JASON KEENE: Thanks very much Ermal and Tim for joining us today. This is a very lively discussion, and I wanted to kick it off by asking, so the CID works in a number of different countries around the world. Why Albania? How did this idea ultimately get involved there?

ERMAL FRASHERI: So CID is one of the Results Center is based on the Kennedy School. Its main focus of work is to understand growth and how countries move from lower to higher productivity. It has two different approaches to work.

On the one hand, it has a very strong core research group that looks into understand it from an academic perspective or the growth dynamics. While on the other hand, it couple that with a strong presence in different countries, in different geographies.

So that combination of theory with public policy works for the better because that way, theory informs public policy, but also on the other hand, public policy insights and the research that we do here at the center.

So the Center has three main programs. There is the evidence for policy design, then there is the growth lab, which is where I am. And then there is the Building State Capability where a Tim is at. And so in Albania, we started working in 2013.

I should mention that Albania is one of the places where we work for the Growth Lab, in particular works in other geographies such as in Argentina, in Colombia, Venezuela, Mexico, Jordan, and Sri Lanka, in Panama, where I worked as well.

TIM MCNAUGHT: Yeah, just adding on to Ermal, I work with the Building State Capability program here at CID. We work with several different countries using an approach called problem driven iterative adaptation, where we work with teams of civil servants to solve problems that are pressing for our country, problems that matter.

And in Albania, this work started around 2013, 2014, and we were working jointly with the Growth Lab to identify sectors to establish these, what we call, black belt teams.

JASON KEENE: So rewinding a little bit. What did Albania look like in 2013 and what were the most pressing challenges that you guys and your counterparts had identified going into the project?

ERMAL FRASHERI: As Tim was explaining, the approach to work the Building State Capability program takes-- at the Growth Lab, we look into what are the binding constraints to growth. So the first question that we ask when we go to a particular country is to understand what prevents or what hampers that country's growth.

So it's like a doctor going to a patient, then understanding what is happening, right? So in that exercise, we aim to identify the so-called binding constraints to growth. Countries face a number of constraints in order to attain growth, starting from transportation, education, sometimes, problems with good governance, administrative capacities, and so forth.

Well, the main question there is to not simply look into what could be a problem, but what is the binding constraint? So what constraints the most growth? So that, in turn, that country or the government could formulate or implement public policies that address or that aim to solve that particular constraint.

All right, so the first exercise that we do whenever we go to a country, in order to understand growth, is to do diagnostic exercise. So in Albania, in 2013, the country was facing a situation that slowly aggregated over time. So in 2013, Albania was facing the spillover effects from the Euro crisis while at the same time, its economic growth model had shown signs of collapse.

So until 2013, the model was based on construction. It was based on infrastructure spending, mainly through borrowing, but also it relied on remittances. Now all these three forms or sources of growth in Albania were experiencing decline and in some areas, even collapse.

So in particular, in the construction sector, that sector was about to become imploded. And as a result, that also had created issues with arrears that the government had accumulated vis-a-vis private sector, and also, in turn, private sector had accumulated vis-a-vis one another.

So the situation with construction had also exacerbated not only the situation with public finances by increasing the fiscal deficit, but also had impact in the banking situation because banks were experiencing a high number of non-performing loans.

On top of that, remittances were declining. As I said earlier, Albania was also facing the spillover effects from the Euro crisis. And on top of that, there was an ongoing electricity crisis that was becoming severe. So there was a problem between the distributor and the generator companies.

The distributor also was experiencing difficulties in collecting payments from customers. And in turn, the government had to bail these two companies out every single time they encountered a financial problem. And so, the situation for public finances was less than rosy, so to speak of.

And so, that was the first constraint that had to be addressed in order to turn Albania back towards this economic growth and to change the economic growth in the first place.

JASON KEENE: OK, so it sounds like a lot of these issues are macroeconomic in nature. How do you then solve that? And what is the first step in your process?

TIM MCNAUGHT: Exactly. So as Ermal mentioned, Albania, at the time, was facing large fiscal deficits, around 7% of the GDP. There's a lot of high debt. So first, the country brought in the IMF to help bring in a program to offer some lending that got the fiscal situation under control.

But that meant that the country needed to find another source of economic growth, and they thought that this would need to be led by exports. And so, we were looking at exports. And at the time, one of the main exports was this garment industry called the fason industry, which represented around 30% of exports at the time. And it wasn't growing as fast as it could be growing.

So Building State Capability program met with the government and established a Black Belt Team focusing on this fason industry. And essentially, the team was around six to eight people, went out and started talking to companies and made a huge list of all the problems that they're facing-- more than 30 problems that were facing the sector, and then started identifying solutions to address these problems.

And so in a relatively short period of time, the team then developed a package of measures to actually address these problems. And so, it was a very quick way to start improving the sector. And in that year, they saw a jump in the exports. And so that was one way to keep that economic growth going.

ERMAL FRASHERI: Yeah, as Tim was saying, after we first diagnosed what is constraining growth, and so back in 2013, the macroeconomic situation was a binding constraint. So once that situation was addressed through the intervention of the IMF and the World Bank with some the government of Albania was able to enter into very favorable agreements.

And also, the situation in the energy sector, in particular, with the electricity, companies was also addressed. Now the next question was how do you move away from the defined constraints towards building a growth narrative or a growth strategy?

And this is where the new model dimension comes in because how we see countries develop is that they develop through stable and diversified exports and exports that move from lower towards higher complexity. So in the case of Albania, that meant that a growth had to be export-led.

And once we say that growth has to be export-led, then the next question is what are the sectors that harbor the greatest potential for increase in exports? And the fason was one of such sectors or areas where economic operators were able to or had connections with foreign

markets, and they were able to bring in so many foreign exchange, which was the time.

Then also, they had the potential to increase their productivity because this is another function of growth. So when we look into growth, we don't necessarily look into increasing profits for particular actors, but we are looking to increase in productivity for the sector.

JASON KEENE: What were some of the binding constraints to productivity in the sector? For example, how did you navigate the process by which you identify those and then leverage the government counterparts to actually deliver the service that some of these businesses might not have been receiving?

ERMAL FRASHERI: So we're going to speak about different sectors here. So we can speak about say, the fasons, but also other areas. And they defined it in Albania. So for instance, when it comes to the growth engines in Albania, so we've looked into or we worked in tourism. We worked in agriculture. We worked in the energy as I mentioned earlier, in manufacturing. So especially manufacturing, we worked in the fasons and the special economic zones.

And the situation in which one of the sectors is very different from one another. So what experienced the financial sector didn't necessarily mean that the same constraints were also in others. For instance, in the [? special goal ?] zones, the main problem that we identified over there was that the institutional framework was not suited in order to serve and in order to create zones and also develop them. So this is like where our focus was-- to create the institutional framework that would enable the government of Albania to set up economic zones for development and turn them into areas that didn't have the same problems as the rest of the territory had in Albania, but also areas where the government could experiment with bringing in new economic activities that in turn will create or lead towards more diverse growth.

So that was the problem that we identified back then, so a lack of an institutional framework. And the second is that the government did not have the inter-institutional capacities and skills in order to set up and run an economic zone. So the work focused on addressing those two constraints back then. But in fasons, there were others.

TIM MCNAUGHT: Yes. So when the team was talking to the companies, all these consultations, they actually came up with 50 reasons why the firms weren't hiring more people or exporting more. And they ended up sorting these into multiple different clusters, many of the problems related to taxes, business finance, infrastructure, trade support. But they weren't always just like fiscal incentives that were needed. Some of them were very specific problems.

For example, for this sector, a lot of times, garment sector bringing in leather from Italy. And they were charged the customs based off of the weight of the leather. And often, if it would rain, the leather would get wet, and they were charged a lot more of the customs. And so they were able to-- I mean, this is a very specific problem. So they were able to address that problem. And so that made it a lot cheaper

for customs and made them able to export and produce more. So these are kind of the specific problems that you get into instead of taking an approach like trying to just improve general doing-business indicators in a country.

JASON KEENE: In the presentation, you really talked about this idea that there were these barriers in between different ministries that needed to kind of be knocked down. Can you maybe give an example of cross-collaboration within the government-- why that might not have been happening before? Have you got that to kickstart more of a collaborative process within the government?

TIM MCNAUGHT: Sure. So the doing-business indicators are usually more-- have to do with laws. And it's easier to change a law, but then actually implementing it is a different story. And when we were getting into addressing these problems, you find the team faced different problems.

For example, if you were trying to deal with a different ministry and you have to speak with them, there are bureaucratic structures where you have to write a formal letter to the minister. And then that goes to the deputy minister, and that goes down to who you need to speak to. And it can be very inefficient and slow, and sometimes it doesn't work.

And so usually when we work with teams, we say, OK, why don't you try this? And then we meet with them and say, OK, did it work? And if not, what can we do?

And so essentially, with this team, if the letter wasn't working, then they could maybe send an email. If the email is not working, then make a phone call. And basically, the team was finding ways to overcome these bureaucratic structures and to create these connections. And what we find is that these relationships are what's really important with public policy, because they also are sustainable over time. If you're going to start working in another sector in the future, these are the relationships that will make it easier to start making real changes.

ERMAL FRASHERI: Absolutely. And just to build on that, the problem with doing business indicators is that they lump together solutions, but all the solutions want or are in want of a problem. So it's not just about addressing laws. Sometimes you need to address laws. But it's about going to a government with a laundry list of reforms-- 20, 30 reforms in all areas. And there is no particular evidence that will suggest that addressing all these reforms simultaneously will lead towards greater growth.

And to even go further, government only has so much bandwidth. So it's impossible for government to adopt and enact 20 reforms at the same time-- and if you also want the government to actually implement those reforms. And so the problem with the business indicators is that they don't understand or they don't look into what is ailing a particular sector. So rather go into a country with a blanket list of demands and reforms, doesn't really address what's hurting or what's ailing. Rather, those are lists and reforms that are tried elsewhere, but that don't really make sense in a different context.

And so the approach ought to be different. One doesn't have to go to a

country with a laundry list of requests, but rather, one goes to a country to understand what is hampering growth in a particular area, and then formulate solutions which are tailored to addressing those problems. So this is where the approach here differs a lot from the classical doing-business indicator approach that, say, for instance, World Bank takes.

JASON KEENE: So this project started about six years ago. How have things progressed, and what does the current outlook for the future over the next five or six years look like? And what would you like to see changed and implemented on a going-forward basis?

ERMAL FRASHERI: So when we first went to Albania, the main issue that the country was facing at the time was that it was going towards macroeconomic collapse. And thankfully, that situation, due to the work that the government did, was able to be reversed. And now the country has a stable and healthy macroeconomic situation with a very positive outlook for the future. So it was a situation that was addressed. And so the country was able to stabilize its macroeconomic situation without the need to go into recession. The debt-to-GDP ratio is on a downward path, the growth rates have been very healthy at 4.2% as of last year, and the country is building more experiences and building more capacities, as well.

So there are definitely challenges going forward, in particular when it comes to the government building capacities to identify, prepare, and execute the investment projects using and better making use of state-owned assets, but also being better-positioned to mobilize private capital. There are challenges in the way of not formulating solutions in the form of tax incentives, but really addressing the core of the problem, which often is not because of the way public finances are structured. So keeping the public finances stable is very important in that context.

And this goes back to the way how we have worked in Albania over the years, right? So we haven't just provided recommendations to the government, or research, but we actually-- we've worked with the government to implement those recommendations or advice. So the focus has been towards action, not simply towards preparing analysis.

TIM MCNAUGHT: What's encouraging for us is we saw that this experience with the [INAUDIBLE] team with fason industry was seen as a success. And the government's continuing to use this approach in new sectors. We're currently working with a team on a completely different sector right now using a very similar approach.

As far as looking into the future, we've worked with several teams in the country, and they've really developed a lot of capabilities. And what we would like to see is that they continue to feel empowered to solve these problems by themselves. And I think with the tools they've gained, with the experience they've gained, they really do have the ability to solve these problems, and think that they have a very bright future if they are able to continue working together to solve these problems.

JASON KEENE: Great. Thanks, Tim. Thanks, Ermal. It was great chatting with you guys, and best of luck with the future of the project.

ERMAL FRASHERI: Thank you.

TIM MCNAUGHT: Thank you very much.

SPEAKER: If you want to learn more about CID's research and events, please visit cid.harvard.edu. See you next week.