Analysis on the Impact of Public Debt on Economic Growth
Case of Republic of Kosovo

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Since the half of the last century the importance of public debt as an instrument of economic policy, is increasing more and more. Public debt as a form of financing for meeting the needs of state, besides being present in developed industrial countries, it is used a lot in developing countries or countries in transition. This is because these countries face with a lot of economic and social problems and they use public debt as one of the forms to overcome these difficulties, with a tendency of economic growth, financial stability and raising the standard and economic welfare of society.

All states apart from the public revenue collection as a source for coverage of public expenditure, they also need other financial resources, because very often most countries cannot collect sufficient budgetary revenues to meet all the budget expenditures. Therefore, this is one reason why the public debt is created.

Among economists there are always debates and dilemma about how much optimum percentage of public debt should be so that it will not affect the obstruction of a country’s economic development. But in order this not to happen then there must be proper management of the public debt in order for it to be destined for appropriate projects which will contribute to the economic growth and development.

The Republic of Kosovo like other countries is burdened with public debt. Regarding the history of debt it is known that Kosovo had a public debt
inherited from the time of former Yugoslavia amounting to 220.6 million euros. Kosovo got this fund on behalf of the debt from the World Bank. Eventually, in 2009 Kosovo managed to begin to apply the services for processing the external debt, which according to the agreement, the debt must be returned to the World Bank until 2031. In Kosovo even the internal debt started to function, which began to be realized through the issuing of bonds. So in January 2012 the first bond auction was held.

Sustainable economic growth is essential for a country’s economic system, especially in developing countries or those in transition, such as the Republic of Kosovo. Economic growth, among other things, will also affect the creation of new jobs for the population who are able to work, so that through employment to improve the standard of living and economic welfare of the population. An optimal growth leads to stability of macroeconomic objectives. According to what the Law for Public Debt in Kosovo says, the limit of the public debt should not exceed the level of 40 percent of Gross Domestic Product (GDP) and in the end of 2015 it turned out to be 28.50% (Annual Report 2015, CBK, p. 31) of the GDP.

Therefore, this study aims to analyze the impact of the public debt on economic growth of the Republic of Kosovo from the period when the public debt as a form of financing started to be applied up to the end of 2015, as well as the factors that affect the determination of these two indicators.

Keywords: economic growth, public debt, finance, economic policy

Public debt in the Republic of Kosovo

Kosovo is focused on stabilizing the social-political and economic development pillars trying reinforcement in positive growth of GDP, balance of trade and payments, industry and other branches of economy, employment, savings and investment in the fiscal sector, etc. Like in all other countries of the world even in Kosovo the public debt functions and is processed in the same way. Unlike other countries, Kosovo has a history of public debt which is more specific, since Kosovo has public debt inherited from the time of former Yugoslavia (The Program of State debt 2014-2017, Ministry of Finance, Republic of Kosovo, p. 10, n.d.). So, during the period
when Kosovo was part of the autonomous federation of Yugoslavia, it took funds from the World Bank on behalf of the public debt, now this amount is worth 385 million euro (Annual Report 2009, CBK, p. 32.). After the last war in Kosovo in 1999, the economy was devastated and the institutions were dysfunctional, but from year to year things began to change and the country’s economy began to recover. So in 2009 in Kosovo the services for public debt (external) started to be provided. In the last quarter of 2009 a part of payment of the public debt in the amount of 43.8 million euros (Annual Report 2009, CBK, p. 32.) was paid to the World Bank, for which no payment for the interest was required. In the same period of the year, Kosovo was exempted from the payment of another part of the debt in the amount of 89.1 million euro, of which, 84.1 million euros were donated by the United States, while 5.0 million was a donation from the European Commission (Annual Report 2009, CBK, p. 32.). The remainder of the public debt is 252.1 million euro or 6.4 percent of GDP (Annual Report 2009, CBK, p. 32.). And then it was decided about the implementation of existing agreement from the past that the remaining debt shall be returned to the World Bank in installments twice a year until 2031.

In 2012, Kosovo was in a good situation to get external borrowing from international financial mechanisms. Positive changes in fiscal policies during the second half of 2011 have put Kosovo’s economy on a solid macroeconomic basis, which led to institutions such as the International Monetary Fund (IMF), the International Development Association (IDA) and the World Bank (WB) supporting Kosovo with funds to improve the economy. So, Kosovo has achieved compliance to the agreement "Stand By" with the IMF, also received funds from the International Development Association (IDA). Besides, the IMF, IDA and even the World Bank-provided funds that were envisaged to be used for the benefit of its citizens and economic development of Kosovo.

Also in 2012 for the first time in Kosovo’s economy the domestic public debt also began to be applied. This marks a milestone in the money market in Kosovo because the first product that was sold was issuing bonds. So in the first months of 2012 the first bond auction took place in the country. These auctions on the basis of planning began to be held every month and where bonds with nominal value 10 million euros were issued, with maturity of 91 days. (Annual Report 2009, CBK, p. 35). Based on the development policy of the public debt in Kosovo, it is seen that the overall
public debt stock as that of the external and internal in the end of fiscal year 2015 was 748.9 million euro or 28.50% (Annual Report 2015, CBK, p. 31) presented as a percentage of Gross Domestic Product (GDP). On the basis of these data it can be noticed that Kosovo’s state debt is within sustainable levels and that there are conditions and opportunities that public debt can grow even more in order to create funds for infrastructure development and economic growth in general.

With a tendency of development and strengthening of economic activity in the country, accompanied always with positive economic growth from year to year and if we consider the path of development of public debt over the years we can say that the low level of debt reflects high accountability because with the conditions that are offered to us today it is not too difficult to get into debt. In our case, if we compare the public debt to GDP then we notice that the public debt has a very, very low percentage in relation to GDP, this situation shows accountability and macroeconomic stability, also helped by the relevant institutions of the country which had set fiscal rules through the Law on Public Financial Management in Kosovo. Now it is clear that each state conducts various economic analyses to see how the public debt would affect the economy, on this basis the country is normally focused on creating social and economic stability, not to worsen the situation in country.

Kosovo’s public debt at the end of 2015 was about 28.50 percent of the GDP, which means that the Law on Public Debt allows room to the country to borrow up to 40 percent of GDP or expressed in monetary value it can borrow about 1.5 billion euros. When you try to get the debt it should be oriented to improve the socio-economic situation, to achieve this Kosovo should have clear development objectives, with concrete profitable projects so that the positive effects are greater than the debt burden, from which not only will the funds invested be returned but also the public debt will be paid, and the interest rate as well. Until now Kosovo’s Government has got into debt to invest in certain projects as budgetary support, as well as in projects financed by the World Bank and other creditors. Public debt serves as budget support as we have the case of borrowing from the International Monetary Fund, or the issuance of Government Bonds. Considering that the annual cost of debt service currently does not exceed 2 percent of the annual budget, it can be said that there is no risk to the financial stability of the Republic of Kosovo and is in accordance with the Law on Public Debt.
Thanks to the fact that Kosovo has approved the fiscal rule that limits the budget deficit to 2% (The Program of State debt 2014-2017, Ministry of Finance, Republic of Kosovo, December 2013, p. 9, n.d.) in relation to GDP, which is considered as a high limitation on general expenses including loan taking also the law defines that public debt can go up 40% in relation to GDP. This law also allows the state of Kosovo state to borrow funds and issue guarantees and the regulation of other conditions under which Kosovo may borrow and issue guarantees. The Ministry of Finance (MoF) is the only authority to enter into sovereign debts, it possesses the authority and responsibility to care for all the management and administration of loans and the authorized programs on loan guarantee of the Republic of Kosovo, including restrictions, development of a Debt Management Program and a Debt Management Strategy.

Kosovo’s membership in the International Monetary Fund (IMF), World Bank (WB), European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), Development Bank of the Council of Europe (CEB) and their willingness to give loans to Kosovo gives the country the possibility to finance development projects and speed up economic development. Whereas under the Medium Term Debt Strategy the main objective is to ensure the financing of debt with the lowest cost possible, but always taking into account the acceptable level of exposure to financial risks. If we analyze the level of debt increase from year to year it can be concluded that the increase is permanent, the debt external is being carried forward from year to year without any great increase but domestic debt is growing much faster, this burden of domestic debt increase is due to the sale of bonds.

From all that was said above we should also raise another issue that in economic science and particularly in public finances what is important. is not that much the level of public debt but its sustainability, the ability to finance it and of course, the ability to pay off the debt together with its interest, the concrete use of the debt in the economy and its expected effects on economic growth in this context. The rate of 40% prescribed by the Law on Public Debt, of course, it must assessed how this debt will be used and what effect it will bring to the economic growth, thus arguing its effect on the quality of economic growth. If it will be used exclusively for important financing that gives quick and significant effect on economic growth, it reduces unemployment and contributes to public revenue, then the risks
posed by the proliferation of debt are minimized and become more manageable, since with this action it is foreseen to increase investments on production and promoting employment, in the promotion of domestic consumption, etc. An important problem that needs more analysis remains "public investment priorities", sectors, activities or areas in which they are used, and particularly the level of profitability and the effect on employment given by each of them. Kosovo has an unbalanced indicator and does not have the equal relation between the level of economic growth, the level of public investment, the level of employment, etc. Now, it is a fact that for years the unemployment rate has remained at high levels despite positive economic growth and increased investment.

Kosovo's public debt in comparison with countries in the region remains low and at the end of 2015 there was a fast increase, although this debt consists of a considerable debt inherited from the former Yugoslavia to the IBRD's [IBRD](The Program of State debt 2014-2017, Ministry of Finance, Republic of Kosovo, p. 10, n.d.). The economic growth from year to year follows a positive trend but still the main development challenges are associated with the path of economic growth, creating quality jobs and uses key natural resources in a sustainable and environmentally friendly way. Kosovo's economic growth model in recent years has focused largely on the availability of external sources of funding, especially in donor assistance and remittances, which are estimated at 400 million euros per year(Golden Situation of Kosovo for Investments: International Economic Forum, Prishtina 2012, Kosovar Bussines Alliance.). Economic activity should also be focused on the development, support and promotion of investments and businesses, improving the free movement of goods or regulation of the Internal Market and the promotion of trade policy, which will lead to engagement to adopt and implement policies that contribute to the growth of domestic production and competitiveness of Kosovo in the European and international markets.

**Statistical analysis on the relationship between public debt and economic growth**

Since after the war (1999) and the beginning of the functioning of institutions in Kosovo, fiscal policy or particularly the budget balance was characterized by surpluses or low levels of budget deficit. But in 2009 in
Kosovo there was an increase in the budget deficit of 85.6 million euro or 2.2% of GDP (Annual Report 2009, CBK, p. 32.). Existing policies were conditioned and the only way that the Government of Kosovo had to finance budget deficits was through budget surpluses accumulated from previous years (Annual Report 2009, CBK, p. 32.). This conditioning policy was due to the unsolved status of Kosovo until the declaration of independence, which happened in 2008, which prevented the country borrowings from international financial institutions and another obstacle was the lack of law for the public debt in Kosovo.

But these obstacles began to be eliminated when the political status of the country was solved, also at the end of the fiscal year 2009 the Law on Public Debt was enacted, which enabled the country to be able to get public debt to finance the budget deficits, to support investment projects for the benefit of the country’s economy and enables the country issuing bonds. Under this law, the criterion of which must be met is when entering into debts the country must not exceed the amount of 40 percent of GDP. Besides, good opportunities came to Kosovo in June 2009 when the country became a member of the International Monetary Fund (IMF) and World Bank (WB), these international organizations assist member countries to achieve macroeconomic objectives such as: sustainable economic growth, the improvement of the balance of payments, financial stability, etc. In figure 1 it is shown the performance of public debt from 2009 to 2015, which indicates that every year there is an increase, especially at the end of 2015 when there is the most significant debt since 2009 the year when the public debt began to be applied.
It should be mentioned that data on public debt was taken from the Ministry of Finance publications as it was there so was the data on economic growth from the publications of Central Bank of Kosovo. All series have 7 observations, from 2009 to 2015, the interval in which GDP has fluctuated from a minimum value of 4 billion euros up to a maximum value of 5.7 billion euros. The real public debt has fluctuated from a minimum value of 249.01 million euros to 748.9 million. On the other hand, real
economic growth has fluctuated from 2.8 percent to 4.4 percent, with an average annual increase of about 3.45 per cent over the period 2009-2015. While the public debt as a percentage of GDP, has fluctuated from 5.51 percent to 28.5 percent of GDP, and its annual average is 10.68 percent of GDP. The standard deviation of GDP is almost six times the standard deviation of the public debt. Whereas the standard deviation of the public debt expressed as a percentage of GDP, it is about three times larger than the standard deviation of economic growth.

Figure 2: Skater diagram, graphic presentation of the relationship between the public debt and economic growth
In graphic A, we can see that after 5 billion Euro value of GDP and 409.92 million euros of the public debt, there is a strong almost linear relation between these indicators. Also in chart B, in which indicators are measured in percentages, there is a negative relation on the level of debt 8.44, but that the relation is not very strong between these two indicators.

Regression analysis is used to describe the relation between two variables, the dependent variable (Y) which in our case is the economic growth and the independent variable (X) which in our case is the public debt.

The findings of necessary parameters for this analysis were done through regression using software MS Excel.

Formula equation: \( \hat{Y}_1 = b_0 + b_1X_1 \)

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<thead>
<tr>
<th></th>
<th>Coefficients</th>
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<tbody>
<tr>
<td>Intercept</td>
<td>3.935752626</td>
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<tr>
<td>Debt ( million €)</td>
<td>-0.001123878</td>
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Economic growth= 3.935752626 -0.001123878 (€- debt)

In this case when the public debt is 0 (X₁), the impact on economic growth remains the same. B₀ coefficient is the estimated average value of Y when X is zero (if X = 0 it is in the range of observed values of X). While b₁ measures the estimated change in the average of Y as a result of change in the unit of X. So when b₁ shows that the level of public debt affects the average of economic growth for every euro of public debt.

If we want to predict the economic growth with 1 ml. Euro public debt, then:

Economic growth = 3.935752626 - 0.001123878 (€ debt)  
= 3.935752626 - 0.001123878 (1000)  
= 2.81

Economic growth with 1 ml. € debt is 2.81%.

The coefficient of determination \( R^2 \) represents the part of total variations in the dependent variable which is explained by the variation in the dependent variable. In our case we have \( R^2 = 0.165779 \). This means that 16.57% of the variations in the level of economic growth is explained through the level of the public debt.
H₀: The level of the public debt affects economic growth  
H₁: The level of the public debt does not affect economic growth

Based on the results in excel t- Test = -0.99680, the value of P is 0.3646 in the level given of significance α=0.05.

Then the value of is P (Z ≥ (-1707)

The value of P = 0.3646 ≥ α = 0.05 - Do not override the hypothesis H₀.

So, based on the results of the analysis of simple regression we are able to answer the research question, which relates to whether the public debt affects the economic growth in Kosovo and what the effect is. As a conclusion, the public debt has an impact on economic growth, this impact is estimated to be negative but in a very small degree. But what can be noticed is that the public debt in 2015 had a rapid increase, an increase that has to be observed in order to preserve and create suitable and stable structure for getting into and management of the public debt.

Public debt in the countries of Southeast Europe

When we talk about the public debt of a country we must consider the fact that it is closely related to two important economic variables: government spending and public investment. The public debt is one of the methods that governments use to fund government operations. If we want to compare the public debt of Kosovo with other countries of the region, particularly the countries of Southeast Europe 6 (Kosovo, Albania, Serbia, Montenegro, Macedonia, Bosnia and Herzegovina) then we can say that Kosovo is characterized by a small debt public and is one of the countries of the region that does not have significant financial-economic problems in this field.

Unlike the countries of the region, Kosovo has very limited access to international financial markets and as a result there is less external debt. From June 2009 to September 2013, four countries have emerged in international markets by issuing Eurobonds (Macedonia in 2009, Albania in 2010, Montenegro in 2010 and 2011 and Serbia in 2011)(South-East Europe, the Report of economical development, p 11, 2012) or taking foreign loans through IBRD guarantees (Serbia, Macedonia, Montenegro). In Serbia, Albania and Montenegro, the public debt is very high. At the end of 2015, Serbia’s public debt stood at 76.00% (Republic of Serbia- Public Debt Administration, debt statistics, p 5, 2016), well above the limit set by the Fiscal Responsibility Law. Albania has also violated its limitation of public
debt of 60% (http://www.tradingeconomics.com/albania/government-debt-to-gdp, n.d.) of GDP. The public debt of Montenegro has increased significantly over 50% (http://www.tradingeconomics.com/montenegro/government-debt-to-gdp, n.d.) of GDP, mainly due to high deficits during and after the crisis and from state guarantees. These countries need to make additional efforts to implement fiscal consolidation and ensure the confidence of lenders. Bosnia and Herzegovina, Kosovo and Macedonia are within the level of public debt sustainability. Bosnia and Herzegovina’s debt was approximately 41.30% (http://www.tradingeconomics.com/bosnia-and-herzegovina/government-debt-to-gdp, n.d.) of GDP at the end of 2015 but it has to decrease considering the vulnerabilities of the country. Kosovo's public debt at the end of 2015 was around 28.5% (Annual Report 2015, CBK, p. 31) of GDP, although efforts to build on a domestic credit market may increase it slightly in 2016. The public debt in Macedonia is moderate, around 38.40% (http://www.tradingeconomics.com/macedonia/government-debt-to-gdp, n.d.)

![Graph showing public debt as % of GDP in countries of SEE6 for the year 2015.](image)

**Figure 3**
So, based on these data it is shown the Kosovo is the country with the least public debt in just 28.50% of GDP at the end of the year 2015. It is worth noting that the poor economic conditions in the Eurozone have also affected the countries of South Eastern Europe to feel the need to get into new debts because even the automatic stabilizing costs increased immediately in Southeast European countries thus, pushing these countries to conduct a review of fiscal policies. While as a response to this Eastern European countries have relied on domestic debt and getting into debt to Foreign International Institutions.

Conclusions

- Public debt represents one of the financial instruments that the state uses to meet its needs, as a way for the formation of its revenues. There are many definitions and economic schools have examined and defined public debt, depending on their approach. Overall the public debt can be defined as the sum of borrowed cash that the state owes to its creditors at a certain moment.
- The public debt presents one of the main sources of income, especially in the modern economy, the economic growth represents one of the main objectives of macroeconomic stabilization of one country for all decision-making levels. The public debt continues to be one of the most controversial topics by economists as through it there can be economic growth and the funds should not be used for purposes that are not productive for society, such as salaries and pensions, but should be used for investment purposes, such as: education, health, energy, infrastructure, etc. In this case the use of debt will be effective. At the end of this analysis of the public debt and its effects in one country, in Kosovo respectively, it has to be considered the nature of the debt: Was it taken to overcome a budgetary crisis or to invest in the economy?!
- Based on the results of the analysis of simple regression we can say that the public debt has an impact on economic growth in Kosovo and this increase is estimated to be a negative impact, but in a very small degree, and it does not have any visible effect on the economy. But what can be noticed is that the public debt in 2015 experienced a rapid increase, an increase which has to observed in order to
preserve and create suitable and stable structure for getting into debts and the management of the public debt.

- The goal of sustainable economic growth is closely related to the goals of high employment. In the case of the state getting into debts the main objective should be the economic growth through full employment, economic stability and the improvement of the social welfare of the population. This created situation will be accompanied by the consolidation of economic activity that depends on the use of the money saved from savings, which ensure stability and growth in the long term.

- The public debt in Kosovo functions and is processed in the same way as in the other countries. Kosovo is a country that is in the process of transition, which is focused on the stabilization of these pillars: social-political and economic development through positive growth of GDP, improvement of trade balance and payment, the growth of employment, etc. Besides all these it has a more specific story because the public debt is a debt that was inherited from the time of former Yugoslavia. In 2009 in Kosovo the service of the public debt started to function. So in 2009 Kosovo began to perform the services for public debt (external) as well. In the last quarter of 2009 one part of payment of the public debt was made in the amount of 43.8 million euros to the World Bank, for which no payment of interest was required.

- In 2012, Kosovo started getting into debts from international financial mechanisms such as the IMF, IDA and WB. Kosovo reached agreement on the "Stand By" agreement with the IMF, from which 107 million euro was received for the country's budget, the debt to be paid back by 2015. Also in 2012 for the first time in Kosovo's economy the public domestic debt started to function, which marks a milestone in the money market in Kosovo because the first product that was sold was the issuing of bonds.

- Kosovo at the end of 2015 had public debt in the amount of 748.9 million euros or 28.50% shown as a percentage of GDP. On this basis and criteria set for the limit of debt allowance (Treaty of Maastricht and the Law on Public Debt in Kosovo), Kosovo is within the sustainable level and there are conditions and opportunities that
public debt increases and through the use of debt for investment and productive purposes to promote economic growth.

- In order for the public debt to be used effectively, there must be specialized teams from the government to make public debt management. The public debt management should include the main financial obligations over which the government exercises its control. Thus, there should be monitoring processes over every problem that arises about the sustainability of the debt as a result based on the analysis of the portfolio of the risk and market reactions observed during the operations of debt management. The main goal of the debt management is to ensure that government borrowing needs are covered by lowest costs possible, with a reasonable level of risk and that the debt service is paid on time.

- In Kosovo, the public debt management is part of the Department for Public Debt Management in Kosovo, which operates within the Department of Treasury and it is realized through Informatics System of Finance Management in Kosovo. Within this department the public debt accounting is led, in which every transaction that occurs must be recorded in the system SIMFK. So, the Treasury records all state debts in the electronic data base, and it has also to report to the Ministry of Finance on a monthly basis on the state of the public debt.

- Unlike the countries of the region, Kosovo has very limited access in international financial markets and as a result there is less external debt. At the end of 2015 the public debt in relation to GDP was 72.13% in Albania it was 72.13%, in Serbia 76.00%, in Macedonia 38.40%, in Montenegro 61.40% and in Bosnia and Herzegovina 41.30%. Poor economic conditions in the Eurozone also affected South-Eastern European countries to have the need to get into new debts because immediately there was an increase on automatic stabilizing expenditures in SEE countries, pushing these countries to conduct a review of fiscal policies.

**Recommendations**

- Kosovo's public debt at the end of 2015 was 28.50% of GDP, which means that the Public Debt Law allows getting into debt up to 40%
of GDP. But the government must have a strategy and specific objectives about the debt that they will get into in the coming years so that it is oriented to improve the socio-economic situation of the country. The state must have clear development objectives, with concrete profitable projects so that the positive effects are greater than the debt burden, which in addition to creating the ability to pay back the debt and the interest rate also affect the country's economic growth especially in the long term.

- In 2012 in Kosovo the domestic public debt began to function through the issuance of Treasury Bonds or known as Treasury bills, which is considered as an achievement for the country in the financial markets, respectively in its segment –in the money market. This should remain one of the objectives of the Government, to develop this market even more in the future. It should focus more on issuing the domestic debt that will affect the development of domestic market of bonds. So, they should increase the percentage of internal public debt to the percentage of public external debt since as many economists estimate that debt does not represent a burden for the country, in this case "we owe ourselves."

- Although it is not good for countries that have budget deficit to make it a habit to engage external debt to cover the deficit. Sometimes it is almost inevitable to do so. Kosovo’s budget is accompanied with a budget deficit that the government covers part of it with foreign borrowings. But it is important that in such cases the government must rely on external borrowing from lenders who provide soft financing terms and from financial institutions in which Kosovo has membership.

- One other very important issue in economic sciences is that the public debt level is not that important compared to how important it is its sustainability. The government through its mechanisms should always have the control of monitoring the progress and sustainability of public debt to ensure the ability to finance it and the ability to pay back the debt together with the interest, its concrete use in the economy and the expected effects on economic growth.

- According to the Law on Public Debt it is defined the rate of 40% of the limits of debt allowed, it is quite natural that we should evaluate
the debt and what effects it will bring to the economic growth, therefore, there should be arguments about its effects on economic growth. They should aim that this debt will support such investments that will cause rapid effects and significant economic growth, such as reducing unemployment and generating public revenue, because it will help to reduce the risks arising from increased debt and it will become more manageable.

- The economy of Kosovo has an unbalanced indicator and does not have right relation between the level of economic growth with the level of employment. This indicates that unemployment remains at a very high level despite positive economic growth that follows from year to year. The government should take steps to achieve this macroeconomic objective using public debt as a very good opportunity to invest in this direction, above all in order the economy of a country to be considered successful in the best way it is seen through its citizens, by improving economic standard and economic welfare.

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