

ALBANIAN FISCAL SYSTEM EVALUATION THROUGH SOME ECONOMIC INDICATORS

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Abstract

The Albanian government, elected during year 2013, has announced the new economic and fiscal program, as immediate measure for impacting economic growth and strengthening public finance. This program is based on fundamental reform of tax system, and tax administration, as a supplementary supporting package. The last system has been in force since 2008, which mostly was attributed the flat tax rate and some other fiscal facilities for different sectors of goods and services.

The new regulatory fiscal reform which proposed and just approved, is based on progresive taxation rate for direct taxes (corporate and personal income taxation), maintaining the same Value Added Tax. Beyond any political assessment about which system is best for strengthening the public finance and economic growth improvement, this article aims to analyze which has been the impact of previous fiscal policy, that has been implemented on Albanian economy, and to make some assumptions whether if its “life” is over.

Keywords: Flat tax; economy response; fiscal policy; business response.

Introduction

This article is based on below framework, for explain the three main topics for evaluation if a new fiscal package is necessary in the current economic conditions of Albania. To achieve in right and reasonable conclusions, is used the methods of collection and analysis of the main outcomes of the economy, as result of the flat tax application, which has been on the focus of new policy changes.

Structure assessment framework

Fiscal package and economy reflection

Flat tax and bussines response. Is the flat tax a sucess story?

Other measures for supporting fiscal policy impact on public finance

1. Fiscal package and economy reflection. What was the last fiscal policy impact on economy?

As random happens in measuring each public policy impact on economy, the most popular and significant indicators are economic growth, poverty and unemployment reduction as well as citizen live improvement, freedom and expansion of the business, budget and trade deficit reduction etc. The main purposes of flat tax have been; increasing economy through expanding free entrepreneurship, increasing internal and external investments and employment in private sector.

However, beyond evaluation of above quantitative indicators which are unique and published for all world or regional countries, it is important that the Albanian fiscal policy must be coordinated with other indicators either qualitative, as well as other specific like political, social, cultural etc.

A number of countries have seen impressive economic growth after adopting the flat tax idea. This is especially true since the fall of the ex communist countries when many of them made the flat tax part of their system and saw great economic growth. But, would a flat tax be equally successful in the Albania, especially, during the global economic crises? To answer this question is necessary to explain better which has been the main purpose aimed to achieve from this fiscal policy and whether they included appropriate anti-crisis measures.

The new 2008 fiscal policy was oriented toward two main sub policies:

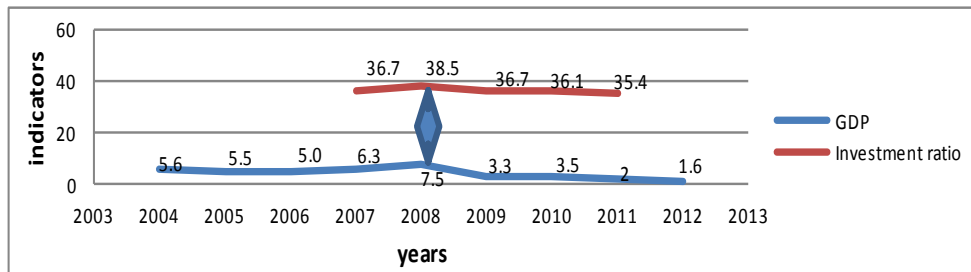
a) The first one was establishing of 10% flat tax rate on direct taxes only, like corporate tax, personal income tax and property tax, so deduction of fiscal burden.

b) The second one was promoting the opening of new businesses, creating more facilities on doing business, which includes improving services and shortening all business procedures, stimulating business investments, and facilitating exports and some other industries through excluding from indirect tax (VAT), etc.

1.1 Growth rate

Below is expressed the real impact on economy of previous fiscal package, through GDP ratio, expanded during previous and after fiscal reform.

Indicator	2004	2005	2006	2007	2008	2009	2010	2011	2012
Real GDP	5.6	5.5	5.0	6.3	7.5	3.3	3.5	2.0	1.6
Investment ratio	N/A	N/A	N/A	36.7	38.5	36.7	36.1	35.4	N/A



It was about 1.8 percentage point increase of investment ratio for 2008, while the rate is returned into a slowdown trend after first year of reform. Considering the contribution on GDP growth rate from four main industries, below are presented the results for period before and after reform time.

Indicators	Contribution of main sectors in real growth rate ²³									
	2004	2005	2006	2007	2008	2009	2010	2011	2012	
Industry	1.08	0.21	0.64	0.34	0.35	0.28	0.28	0.28	0.27	
Agriculture	1.51	0.22	0.73	0.75	1.06	0.98	1.05	1.02	1.03	
Construction	1.12	1.73	1.58	1.62	1.71	1.75	1.77	1.68	1.50	
Transport	0.53	0.33	0.73	0.99	0.08	1.14	1.14	1.17	1.17	

Through analyzing all above data, it is easy to make some assumptions as:

- The best positive impact has been presented on the first year of the reform, but after this, the GDP rate is decreased. Even GDP has expressed a substantial economic slowdown sharply, although Albania avoids recession because of global crises impact. The slowdown reflects low consumption growth and less investment.

- The most 4 important industries have contributed differently in real growth rate. Industry and construction contribution is less than before, while transport shows an expanded tendency. Those three branches are effected directly from flat tax policy. On the other hand the agriculture has been significantly increased continually from year to year, but this is not a “good behavior” towards flat tax or good fiscal policies in strengthening public finance. This is mostly as result of other fiscal facilities that the government has offered for agriculture, as well as result of agriculture dominance on the Albanian economy. Moreover, agriculture in Albania is expanded, because of emigrant returning from neighbor countries, more of them farmers through building new farms or developing those that they have abandoned or left inefficient. It is important to underline that the agriculture, has not any significant contribution on public finance or revenue collection, because this

²³ INSTAT Albania.

is not considered contributor for Albanian public finance till now, even if agriculture is the most potential sector of country’s economy. The agricultural sector, accounts for almost half of employment but only about one-fifth of GDP.

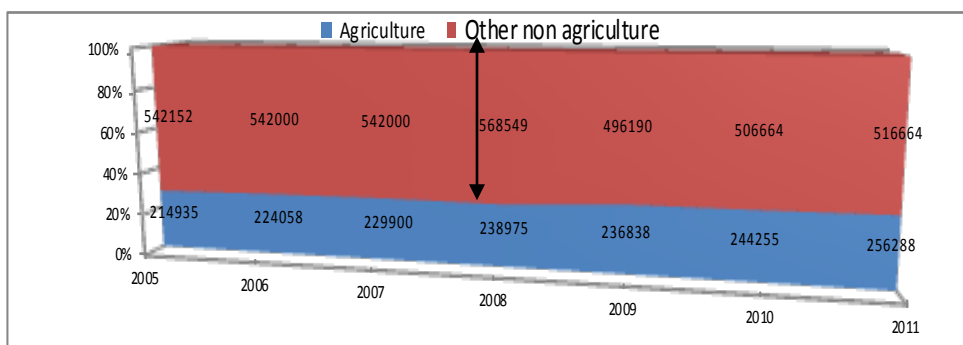
1.2 Employment

Employment increase on private sector has been one of the most important purposes of flat tax establishment. The trend of unemployment rate is as below presented.

Unemployment rate for period 2008 - 2013²⁴

Indicators	2008	2009	2010	2011	2012	2013
Unemployment rate	12.7	13.8	13.5	13.4	13.2	12.8

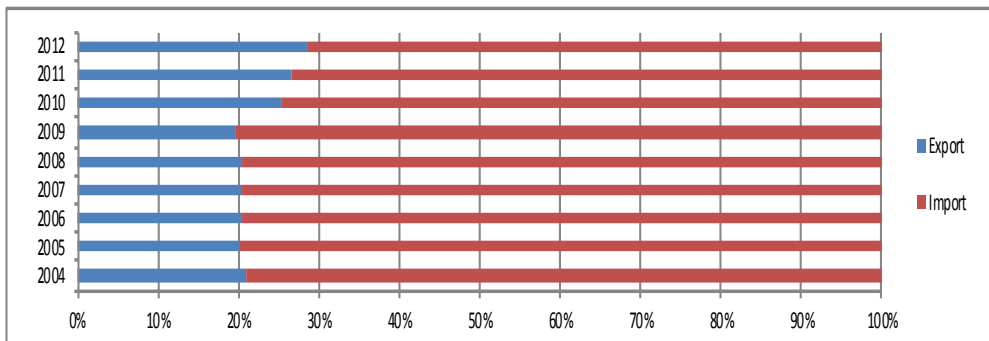
Employment rate regarding private sector only, shows that after fiscal reform, the economy has reacted positively through expanding business and employment growth. During first year of the reform, are employed about 26 000 persons, but after this, the employers number is slightly reduced, from year to year. On the other hand agriculture sector, which has been increased continuously, shows a significant impact in the employment rate sustainability till the end of 2012. Through explaining results comes from graph below, the number of employees of each of the two main sectors of economy before and after 2008 fiscal package, shows that the non agriculture sector has had a negative response expressed through decreasing of employee number year to year.



1.3 Foreign Trade balance

Impact on foreign trade balance was improved toward reducing deficit after 2009 and the highest rate as percentage of covering with 40.3% in 2012 that is a positive response to the fiscal policy. But, behind positive trend of covering rate, the deficit of trade balance remains too large.

²⁴ INSTAT Albania



1.4 Assumptions

Through analyzing all above data may conclude that the effect of fiscal policy was short term. After first year, it showed a non-positive response of the economy. Flat tax has resulted to be not fit with necessary limitations because of crisis time, in order to alleviate its effect or to work as an anti-crisis measure as well. Other factors, as legal, administrative or anti-corruption measures are not well combined and harmonized with fiscal measures, to support the new fiscal package implementation. Tax administration has been not efficient to fill the “gap” by lowering the tax burden, through improving its performance. Tax payment and fiscal evasion are not under control.

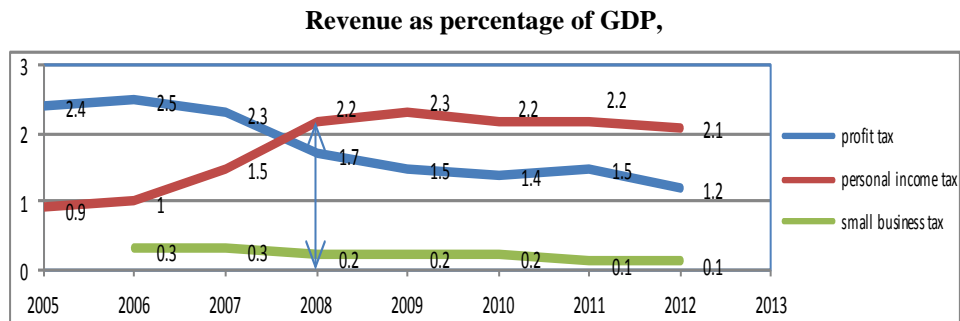
2. Flat tax and business response. Is the flat tax a success story?

Taxpayer’s response can be measured through tax collection, and analyzing the incomes from taxes after flat tax took place. Considering the contribution paid from businesses and individuals before and after flat tax establishment only, we can see which has been the effect on tax revenue, behind other different factors.

2.1 Revenue indicators

There are given data of incomes in nominal terms and as percentage of GDP for 4 kinds of taxes that are subject of flat tax rate, to analyze what are the revenues achieved because of this.

Indicators	Incomes in nominal term				In million ALL			
	2005	2006	2007	2008	2009	2010	2011	2012
Profit tax	19,237	22,251	21,077	18,108	17,149	16,606	19,712	16,553
Personal income tax	7,402	8,581	14,850	24,498	26,820	27,058	27,967	27,128
Property tax	n/a	n/a	n/a	1,586	1,509	1,896	1,942	2,690
Small business tax	n/a	n/a	n/a	2,584	2,486	2,318	2,570	1,803

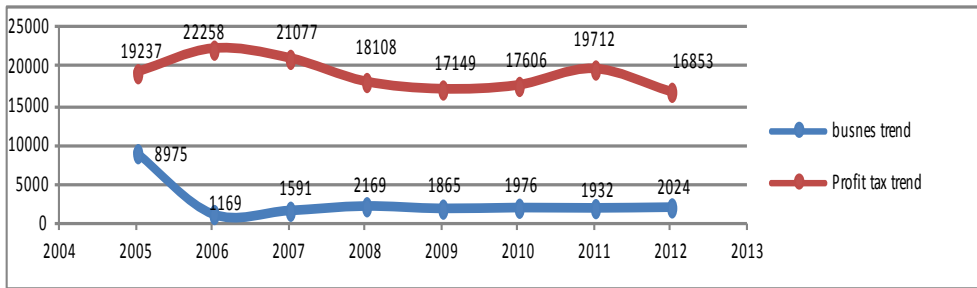


Regarding two different indicators, each of them was responded differently, or it is not any regular correlation between tax policy and business response. The profit tax contribution is decreased up to a half comparing a year before 2008, which is the first year of flat tax implementation. This is the same with flat tax rate reduction which is halved from 20% to 10% as well, so currently we have not any gap filling because of tax rate reduction. The personal income tax has reflected a different behavior, through a positive tendency, but it is very important to analyze what are the reasons. The Albanian government has implemented some administrative measures that are established by rules, and have affected positively more than flat tax policy in tax collection. So those have been some mandatory level of wages for private sector, or minimum employer's number, for personal income tax declaration purposes. Those measures which were published as necessary for combating fiscal evasion have had a significant impact on revenue for about 4 years being in force. The minimal limits have been different by each kind of industries, kind of businesses and its measure, different job positions, and annual turnover; have given the more impact on positive trend of personal income tax, than flat tax policy. This is showed based on 2012 result, after repeal of this limitations, so based on above analyze, we can say that this result is not the "merit" of flat tax rate.

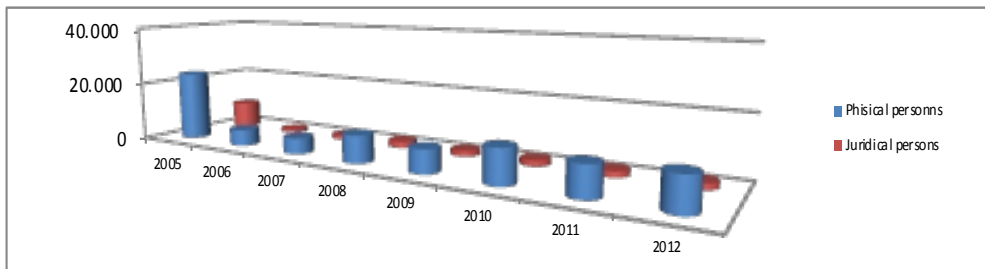
To explain more about relation between business response to the flat task, it is useful to analyze two trends; a) Business expansion trend, and; b) profit tax expansion trend for corporate only.

2.2 Business expansion

Regarding below data, after 2008 the number of new registered businesses is increased slightly, while this has not any impact on profit tax trend. There is not any good relation between two indicators which means that the new opened businesses are not oriented in the same direction with profit tax income trend. For all other years, the contribution of new opened businesses has not any positive response on profit tax revenue collection.



In Albania there are 104,272 businesses in total and most of them about 82,576 or 79.2%, are physical persons²⁵. The annual increase by two groups of businesses before and after flat tax is presented below, and shows that the flat tax has not encouraged construction of new corporate. Moreover, the small business where continuously in god relation with flat tax implementation, but we should consider that the contribution of this kind of business on tax collection as percentage of GDP, was approximately about 0.7% versus 23.6% of total fiscal revenues.



2.3 Other factors

Impact of other factors should complete above analyze. The tax payments indicator reflects the total number of taxes and contributions paid only, but also are important the method of payment, the frequency of payment, the frequency of filing and the number of agencies involved during, and after first year of new fiscal reform operations which includes profit tax, personal income tax and some other incomes by low.

During 2009-2013, Albanian government has published consolidated fiscal indicators, without considering arrears of public finance to private sector. This kind of public debt to private businesses includes except a lot of unpaid public works goods of services, also debt of fiscal administration to them for credit VAT, or credit profit tax etc. After new elections, the new government has estimated the total public debt to private sector which results as below.

²⁵ INSTAT Albania

<u>Estimated Arrears Stock</u> ²⁶	Billion ALL
Contractual arrears	28.53
Utility bills	5
Other agency arrears and court orders	2
VAT refunds	12.84
CIT returns	10
Local government centrally financed contracts	4
Total	62.37

Impact of arrears that Albanian public sector has to private sector has been multi -dimensional on the Albanian economy where more significant are;

a) A government's inability to pay its bills as they fall due and the consequent accumulation of a large stock of payment arrears causes negative impact to the economy, including reduced economic growth and increased unemployment.

b) If businesses dependent on government contracts cease or delay activity as a result of payment delays causes difficulties in accessing credit from commercial banks. Loan repayments to banks could suffer if liquidity is constrained as a result of rising arrears.

c) Impacts on market liquidity could also be severe. These factors can result in a detrimental impact on aggregate demand and could limit the government's ability to use fiscal policy as a tool for macroeconomic stabilization. As Government suppliers calculate the likelihood of long delays in receiving payment, they may try to mitigate the risks and opportunity cost of delayed payments by adjusting their prices upward, resulting in the government being required to pay above-market prices for supplies.

d) The delivery of public services has in some cases been halted entirely when suppliers have ceased implementation of construction of investment projects due to nonpayment, resulting in the degradation of some investments, particularly in the roads sector.

There is evidence that a part of the increase in banking sector's non-performing loans in the past few years can be attributed to government arrears. The credit growth during 2008-2012, is;

<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
43.8	20.5	8.6	11.7	7.4

²⁶ The estimated outstanding stock of claims against the government, is under supervision process.

3. Efficiency of other measures for supporting flat tax impact on public finance.

The fiscal package was accompanied with other efficient administrative measures for supporting flat tax effects. Some administrative barriers are minimized like, reduction of time for register the new business, the main fiscal declarations performs on line saving bureaucratic etc, so Albania has improved its post in rank on economic freedom and doing business.

There are some reasons to say that above measures are not sufficient for supporting reform, without accompanied with some others, like below.

3.1. The culture of taxpayers.

The culture of tax payment is continued to be low, and based in lack of “bilateral trust”. The tax payment is not yet based fully on self declaration. This “gap” is substituted with some administrative rules based on unilateral government decisions, as mandatory for private sector. Regarding two mayor flat taxes, there were in force some administrative rules in tax collection, which are;

- a) For personal income tax of private sector, administrative measures were based on tax assessment from tax office using mandatory wages level for corporate or mandatory lowest number of employees for small businesses that is into force at least 3 year.
- b) Profit tax continues to be paid in advance or like prepayment before profit calculation and declaration. Tax administrative rules have predicted to prepay it during year into 4 installments, correcting it after annual profit declaration.
- c) Property tax for non businesses is not yet based neither on self declaration, nor on self payment. Since 2011, this tax is included in water supply bill as requirement to be paid without the desire of payers or self declaration.

Regarding all above, it is evident that the aims to apply new or advanced fiscal reforms is not sufficient without accompanied with other progressive administrative, anticorruption, legal and cultural measures framework.

3.2 Impact on public finance

The general government deficit in all years after fiscal reform has turned out to be higher than planned in the budget. Let’s consider the recent fiscal deficit for 2012 amounted to 3.4% of GDP which is higher than the 3.0% target in the budget, while because of a significant shortfall in collected revenues, a budget revision in December 2012 increased the deficit target to 3.7% of GDP. Total revenues fell by 0.2% year to year and by 1 percentage

point as a share of GDP (to 24.5%) and they were 7.3% lower than in the original budget. On the other side, the government fiscal policy has increased public debt from year to year, as an instrument for filling the budget deficit instead of cutting public expenses or public investments. So the fiscal reform is not going forward consolidation of public finance or to insure a fiscal stabilization. The risks associated with the fiscal projection were mainly on the side of higher deficits and debt during all years after 2008. These risks relate primarily to the revenue side of the budget, so because of non stability revenue to GDP ratio is necessary to undertake major changes in tax rates, tax regime and an enhanced effort by tax administration on tax collection.

In particular, further measures are needed to improve the business environment by strengthening the legal system, addressing the issue of property rights, improving tax administration, as well as measures to minimize informal economy and weak tax collection.

Although some measures to enhance the business climate are taken before, they are not so ambitious. On the other side fight against economic crime and corruption even if is seen as a strategic priority, no wide-ranging measures are proposed to address clearly this problem and a lot of propaganda has been presented more than concrete actions taken.

Conclusion

The five years life of last fiscal reform has learned that it is time to review and analyze real impact of it, or to evaluate the outputs earned versus those expected. This article presents that a set of economic and fiscal indicators are responded well in short terms only, while not other sufficient other measures are taken for supporting its successfully implementation. The government strategies for combating the informal economy, fiscal evasion and corruption, had a minimum impact on forecasted fiscal reform results. The economy remained fragile during on all five years of its life, and the all government's reforms are not in accordance with anti-crises measures, to mitigate its impact. The agriculture is limited primarily to small family operations and subsistence farming because of lack of modern equipment, unclear property rights, so this sector mostly has been excluded from tax contribution.

Recommendations

Challenges of new governance need to be focused on developing and implementing a new strategy on public finance and fiscal policies including;

- a) Revision of fiscal structure and tax burden, harmonized with efficient measures for higher economic growth rate, and public expenses as well.
- b) Strengthening the legal framework for combating economic crime, informality, and for ensuring business right and business freedom. Tax

evasion and informality, tax justice, tax burden, and tax attractive must be object for short and long term strategies, based on concrete objectives to be achieved. Informality in labor market, behind tax system review, needs other measures for strengthening tax administration as well as education of taxpayers.

- c) Implementing a strategy not to pay stock of arrears only, but to prevent further accumulation in the future, to the detriment of the business.
- d) More measures for market liberalization through privatization of strategic sector of economy, demanding in exchange a concrete impact of economy that is not obviously up to now, even if some fiscal facilities that government has offered to encourage investments in these sectors.
- e) Before a simple tax burden changes, or aggressive tax planning, the new governance in power must perform deep tax policy analyses in accordance with current country economic situation, as well as regional or world recent lessons leanings.
- f) Enhance the information to taxpayers and their education, as well as attracting business in fiscal policy making to be agrees with them, so doing that those policies be more acceptable. It is necessary that the governance has to persuade business for haw will improve the trend of corruption indicators.
- g) Solving land property rights for facilitating enhancement of farms and including widely of agriculture in fiscal scheme.

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