

# THE ROLE OF ALBANIAN FISCAL POLICIES TO THE IMPROVEMENT OF THE ECONOMY SITUATIONS

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## **Abstract:**

*It's clearly to say that, fiscal policies are one of the most keys in the hand of government that has many impacts in the growth of the country economy. Discussing about the tax evasion of the business and the informal economy like a product of it, I must say that is an current issue not only for my country, but also for all those countries in transition. All of us argue that in any country exists a business pressure to make fiscal evasion in order to achieve more their objective that is the maximization of profits. This seems to be aftermaths by many reasons especially by the economic environment of the country; meanwhile, by the other hand the government has another aim: how to get more and more revenues from taxation which is the main recourse of the financial budget. But , why are necessary the taxes? , Which are the criteria for tax design? Which is the relationship between policies and optimal taxation? How much is the growth of informal economy in Albania and which are the necessary strategies in order to reduce the tax evasion made by business? etc are some of the most important questions to made about the topics .Answering the questions, results an clearly picture about the economic environment of Albania and the things that must to do in order to resolve perhaps a bit the problem.*

**Key Words:** *Informal economy, tax evasion, tax design, fiscal policies*

**JEL Classification:** *H 21, H 30, H 26*

## **I. The consequences of a certain fiscal policy in economy**

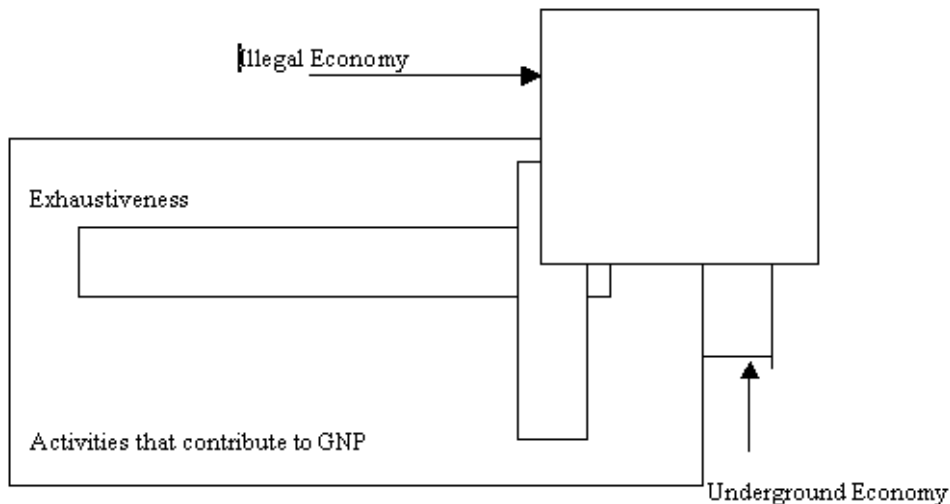
Discussing about the fiscal policies , immediately some questions focused in the informal economy and tax evasion gives up to mind , because these topics are as results of an good or bad drawing and implemented policies in reality. Sometimes, in order to stimulate the growth of economy, the government reduced taxes but the achievement of the aim is conditioned by the size of tax evasion and informal economy, making so the process very difficult, with high economic cost and also time.

Informal economy seems to be a grate problem, especially for the country which is in transition like Albania. Measuring it is not easy, because, not all activities within the economy are always observed by the peoples which have to draw up the national accounts (in Albania is the duty of INSTAT) .Is not a small work because the activities are illegal, underground,in the informal sector, undertaken by households for their own final use or missed because of deficiencies in the basic data collection programme. Some of the actions that reflect what is to say above are:

- Avoidance of payment's income, value added or other taxes
- Avoidance of social security payment contributions
- Avoidance in accomplishment of certain legal standards such as minimum wages, maximum hours, safety or health standards etc.
- Avoidance of procedures like completing statistical questionnaires or other administrative forms.

According many studies about informal economy, is important to say that parts of non-observed economy are entirely formal but yet observed due to deficiencies in data collection, or don't have to be reported to tax or other authorities for legal reasons(e.g. too small in scale).So, not all the underground economy "belong to" the activities under exhaustiveness and vice versa. Kazemier (2003) provided the following relationship between different categories.

**Figure-1. The relationship between underground economy, the illegal economy, the informal economy and exhaustiveness.**

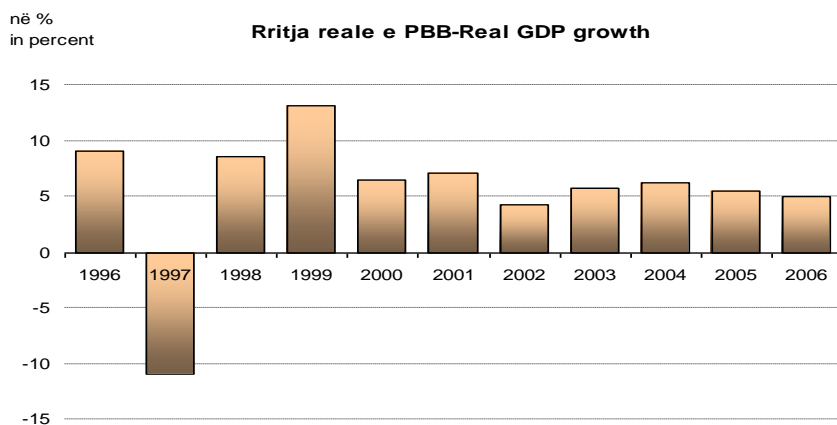


It is clear the categories cover partly the same sphere of the economy, partly others. Which definition is most appropriate depends on the point of view of the problem or on the perspective one chooses. From a tax perspective, the underground production-description suits best. This point of view will be the focused of the article, giving in this manner, the real economy of Albania.

Is clearly that a number of factors have caused informal activities to grow significantly in Albania since the beginning of the transition process. Previous studies have pointed at the high intensity of legal and administrative regulations (FIAS,2003;OECD-EBRD,2003),allied to a lack of trust in official institutions and administrative corruption. A decline in civic virtue and loyalty towards public institutions, combined with declining tax morale, a broad acceptance of illicit work and corruptible public officials, also a systematic non-payment of utility bills have contributed to generate an environment that promotes and accepts the presence of a significant informal economy.

In Albania these factors played an important role in promoting the first phase of the transition process, who ended with the political and economic crisis sparked by the collapse of pyramid schemes in 1996/1997. The aftermath of the crisis included the introduction of a series reforms and confidence building measures which expound the basis for a new cycle of economic growth.

**Figure .2 Real GDP-growth in Albania over the years**



Source : Bank of Albania

This is show and by the study of the graphic above, which also show the difficulties of the policies undertaken by the government (as a part of the factor) to the reduction of the real GDP growth from 2004 years and on.

As Albania moved towards greater political and economic stability, and the economy entered into a phase of sustained growth, other factors started to play a leading role in sustaining the informal economy. The relatively high overall tax and social security burden ,in combination with a very strong competition in the

market of goods and services, has been a potent mix fuelling to an expansion of informal economy.

Factors explaining the informal economy and tax evasion may be subdivided into three major groups: **1) socio-economic market, 2) institutional and 3) “societal”**, which include cultural traditions and the relationship between individuals, society and state. It is to say that, are the institutional factors that define the short-term developments of the informal economy, meanwhile historical factors connected with cultural traditions are the most stable long-term factors. The stability of informal economy in Albania to a large extent depends upon the weight of societal (cultural) factors and the strength of the state and other democratic institutions.

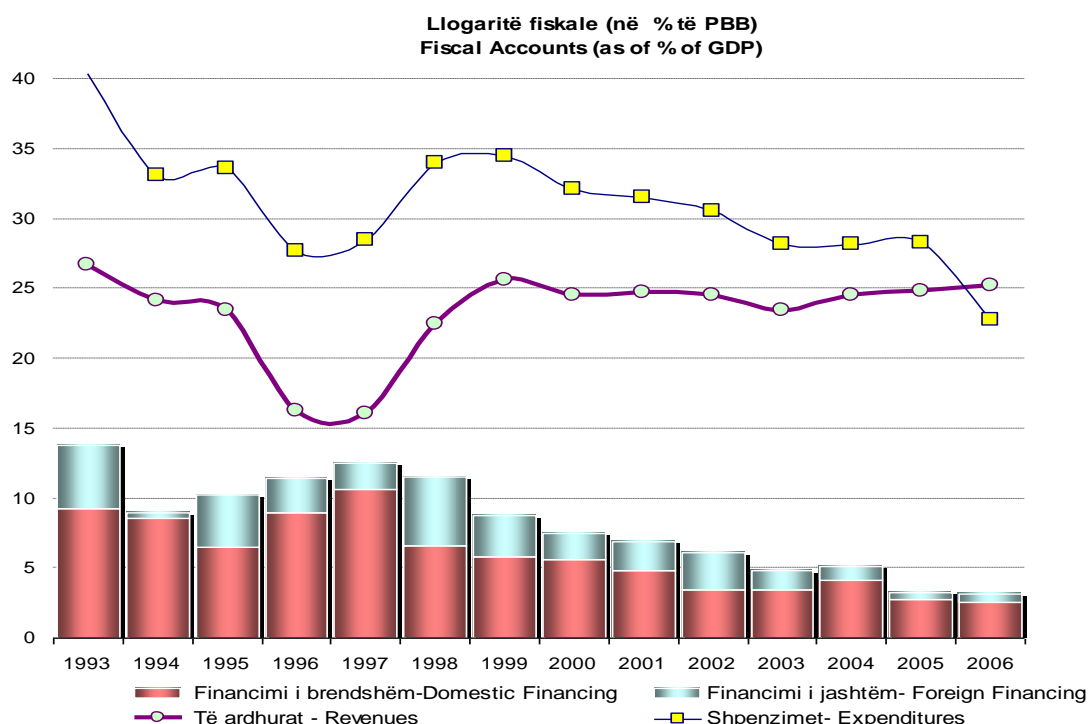
All the system seems to operate under a relatively stable equilibrium. The enterprises re-capitalised the revenues gained by the fiscal evasion for the development of their activities, proved by the high norm of the new firms especially of the small and medium enterprises. The price competitions provide that a part of revenues from fiscal evasion is to be accumulating to the owners or the stakeholders of the firms, and the state provide a minimum revenues from taxes, increased with the growth of the economy.

De Soto suggest that the informal economy is an rational response of the state's incapacity to fulfil the base needs of peoples and as a result many people are forced to make those actions since the costs conviction to the law surplus the benefits. This depends by the phase of the country economy ,and seems to be true for my country in which the informal economy is approximately 20-25% of GDP (OECD 2005).Despite this, must said that the Albanian government has made actions plans for reducing the informal economy. Some of them are:

- Reducing the cash payments among the agents by using the banking sector, this is increased strongly in Albania.
- Improvements of the fiscal laws.
- More efficiency public administration, especially employing the right peoples for the professional duties.
- The business now can pay the taxes electronically -this reduces the time for the process making it also more transparent.
- All the information regards the update law taxes can take by the site of the state institution using the internet.
- For the creation of the new firm exist an organisation that make the things more easily, by reducing time and money.
- Drawing a fiscal policy more efficient.
- Improving the behaviour of the agents in the labour markets.

After all, the Albanian government has a lot to do regards this, because some of those actions are in the beginning phase. The macroeconomic situation in Albania throughout 2005 and in continued is characterised by strong GDP growth and subdued inflation. Nevertheless, the repercussions of the energy crisis at the end of 2005, combined with weakening economic activity in the construction sector, decelerated GDP growth to an estimated 5.5% in 2005 and 5% in 2006.Economic growth continued to be led mainly by domestic demand fed by booming credit and significant remittances inflows.

**Figure. 3. The Fiscal Accounts over the Years in Albania**



However, as is shown by the figure, fiscal accounts are more broadly financed by domestic financing, which confirms what I say above. Average annual inflation remained moderate and stood at 2.4% up to 2006, meanwhile in the recent year has increased over the inflation target range decided by the Bank of Albania. The financing of the trade deficit remained largely dependent on significant remittances and other current transfers, estimated at 12% of GDP in 2005 and 13.5% of GDP in 2006. As a result, the current account deficit reached 8.6% of GDP in 2006.

**Figure-4. Macroeconomic developments**

|                                    | 2005 | 2006 | 2007 | 2008 |
|------------------------------------|------|------|------|------|
| <b>Real GDP(% change)</b>          |      | 5.0  | 6.0  | 6.0  |
| <b>Contributions:</b>              |      |      |      |      |
| -Final domestic demand             | 1.1  | 4.8  | 4.5  | 5.1  |
| -External balance of goods         | n.a  | 0.2  | 1.5  | 0.9  |
| <b>GDP deflator(% change)</b>      | n.a  | 1.21 | 1.25 | 1.29 |
| <b>CPI inflation(%)</b>            | n.a  | 3.0  | 3.0  | 4.6  |
| <b>Current account balance (%)</b> | n.a  | -8.6 | -7.9 | -7.4 |

Source :EFP 2006

The macroeconomic situation stressed more over the importance of the action plans above-mentioned and the things must be done just in the right time and in the right place, operating in this manner with efficiency.

## II. The impact of tax policies to the fiscal evasion

### 2.1 Why are so important the tax policies?

Focusing on taxes is important because, taxes are the main contributors of the state revenues. An efficient tax policy can discourage the payment with free volition by the side of pay-taxes agents. Naturally, this reduces the tax revenues, increased the desire for public corruption, also increased the non-transparent practices by the enterprises. Development countries have a lot to do regarding this, because tax evasion is in broad extension. Over time, was experimented with the change of the tax norms by the government in order to achieve their objectives, but the competition with taxes introduces opportunity- also risks.

Lower taxes can stimulate business, and when the circumstances are favourable, can increase the budget revenues. However, if they go down more, it can be dangerous for budget revenues, making public goods and services like health systems and education systems not at a favourable level.

Actually, the tax system applied in the modern world is composed of a diversity of taxes related to each other according to the kind, weight and the importance in order to be allocated efficiently among the contributors. It must be structured in the right manner, according to the tax laws, oriented by an efficient public administration, in order to achieve the objectives. If not, in some circumstances could be verified negative effects like fiscal evasion in different aspects by the opportunity of hiding taxes by contributors. *Surely, the fiscal system is the primary source of the state's revenues and concretely thereabout 50% of public revenues -much needed for running a good democratic state*

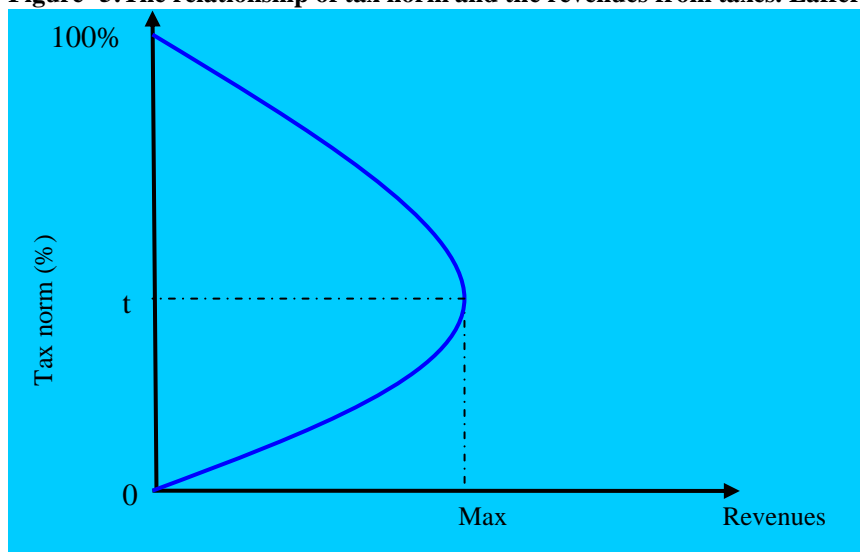
Actually by the government of Albania is applied a smoothly tax norm about 10% in the wages which in this manner reduced the bureaucratic processes, and also time in the calculation of the revenues from taxes. But regarding this, the Albanian citizens are not satisfied because, it is created an opinion that the poor stratum social disburse more than rich and medium stratum. I mean, the fiscal burden of taxes is much more in poor stratum than others.

The Global Financial Crisis is another topic that stressed the fact in the economic sphere to reorganise the fiscal policies, but I agree with the opinion of ex-governor of the Bank of Albania (Cani, Shkelqim) that: **“Our country for many years is in coma, so the global economic crisis is an easily flu.”**

## 2.2 Some opinion about the lower taxes applied by the government

To the end of '70 years, was predicated the political course “The Economists of Supply Hands” based in the lower norms of taxes which will increase the initiative of enterprises, leading to high employment and so production. According to this course, a contraction into taxes will result to an increased revenue and so will not influence the increased budget deficit (by the Laffer curve). The following figure shows the meaning of the Laffer Curve.

**Figure- 5: The relationship of tax norm and the revenues from taxes. Laffer Curve.**



According to the figure- the revenues from taxes is in positive correlation with the tax norm up to a certain level and on- the relationship becomes negative. The advocates argue that taxes discourage the work as they reduce the revenues from the work, and so the savings and investments. They argue that the encouraging effect of lower taxes will be much greater producing increased revenues due to the increased tax bases. Theoretic argumentations still are not proved in practice. The practice indicates that the application of these ideas into the political programs results with the increased budget deficit because, despite the minimal increase in the work supply- the effect of private saving was thrown out by the reduction in public saving (increasing the budget deficit). The Laffer hypothesis failed.

So, an important issue for policy-makers is to find the optimal size of taxes and the right number of those both in national level and local level. It's not simple to decide because it varies from one country

to another and also depends on the current level of economy and the social and political norms of the country.

Clearly, the choice of tax and subsidy system should take account of administrative and compliance costs. Unfortunately, in many cases, administrative problems receive insufficient attention. No tax system is costless to administer; the trick is to think carefully about whether or not the administrative costs are worth that benefits. If the government levies more taxes, the smaller the excess burden of collection of a given amount will be. Intuitively, excess burden decreases because the tax burden is “spread over” more commodities.

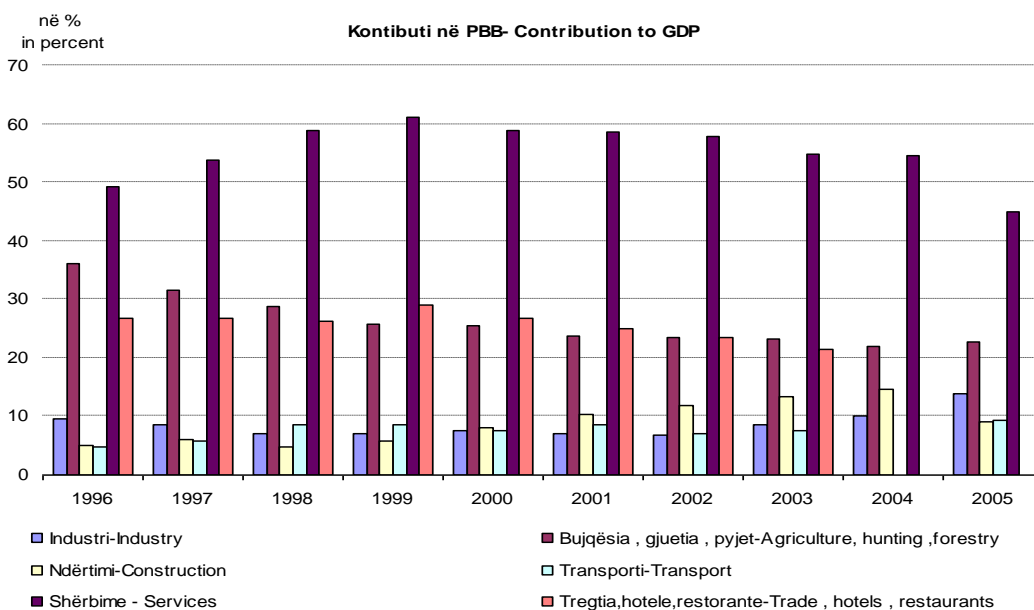
The optimal size of tax administration is the number of tax instruments for which the total costs of tax collection-excess burden plus administrative costs-is at minimum. Is important to take in consideration one face of tax administration: cheating. First of all, have to distinguish between tax avoidance and tax evasion. Tax avoidance is changing the behaviour of the agent in such a way as to reduce your legal tax liability. There is nothing illegal-and the agents which have a big dimension of this are to be successful, but in contrast, tax evasion is the absent desire to pay the legally due. This is more obviously in development country -like my country, Albania.

Enterprises systematically under-declare wage levels, and so, under-pay social security contributions,, abusing the provisions of the minimum wage. This is done largely in collusion with employees-forced by the economic conditions-who prefer immediate direct cash payments to future social benefits .For many reasons this behaviour, for both agents ,is excused( update information proved this). Some of them are :

- Too low current level of state pension
- Poor state of national health system
- The labour market is highly distorted and non-transparent because according to the Social Administration Department ,officially registered enterprises under-report their labour force by approximately 30%.
- An high level of unemployment in report with the number of the population and the investment in the human capital-causing a bad moral of the point of view of things especially to the young peoples.
- An high level of remittances by the emigrants , indicating the unemployment and the level of the economy.

Private sector development has been vigorous in the recent past in Albania. The growth of GDP has been fairly steady at 6 % per annum (IMF,2004),fuelled by expansion in sectors such as constructions, transportation and services. As a results, the share of private sector activity is among the highest in the SEE region, at 75 % of GDP (EBRD,2005).The most mainly sector that contributes in the Albanian GDP is shown as follows:

**Figure.6.The Contribution of the different sectors of Albanian Economy into the GDP**



Despite this, such sectors in the recent year has been in bad situation by the high inflations about 4.6% in 2008( Bank of Albania) caused by the increased price of electricity and gasoline ( Statistic Institute) making the life more expensive. It's to say that Albania has subscribed with the foreign international organizations like IMF and World Bank, the EFP 2006 program which will contributed to the reduction of fiscal evasion and to the economic growth of all the countries that subscribe the programme, especially Balkan Region countries.

According the Government Programme, tax policies must be changed and for the period of time **2006-2009** it will be concern in:

- Continuous descent of fiscal burden
- Making the tax system more simply in order to be easy for management.
- Over the time the system must be smoothly taxes-actually *de facto* in Albania.
- Arbitrage' avoidance among the taxes.
- To decreased the informality.
- To decreased the fiscal evasion and to increased the competition among the enterprises.
- To increased the norm of employment and,
- To increased the budget revenues.

With the supposition that the policy will be practiced by a good fiscal administration ,the results will be determine by a change in tax norm of social contribute, in VAT, in tax norm of personal revenues, on tax cigarette etc. To the end of the programme is to prognosticate a growth of economy with an reduction in the norm of unemployment.

It's not to forget that many factors like the subjective factors of the contributors, affects the final result of any fiscal programme. Those varied differently in many countries, and are based in their core culture.

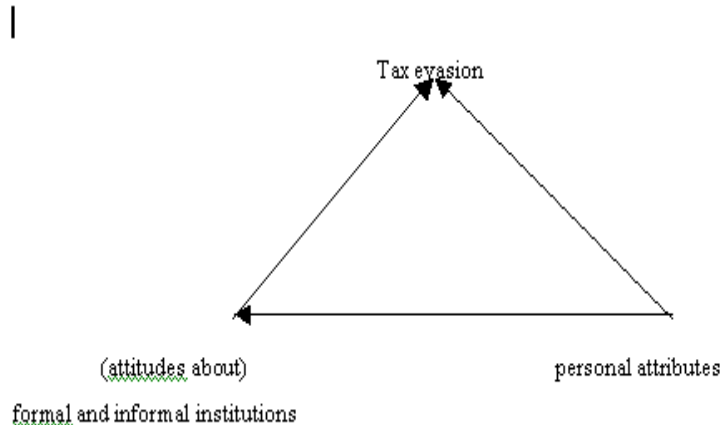
### III. The impact of social norms and subjective factors on tax evasions

In the relationship of the desire to pay or not the taxes, also have their impact many subjective factors, not a little important in the model. According to them exist many institutional theories which distinguish two kind of institutions: formal and informal. Formal institutions include laws, tax regimes, and the explicit operating rules of organizations, while informal institutions comprise (cultural) norms and established conventions. When informal and formal institutions clash, non-compliant behaviours proliferate, forming various underground economies (Feige,1997:22). The Feige conjecture is based on three building blocks :

- Individuals' attitudes towards formal and informal institutions; and the determinants thereof.
- Individual tax evasion, as determined by their attitudes towards institutions.
- Individual tax evasion and determinants thereof.

The third might be considered to be result of the first and second, but there may also be determinants of tax evasion not related to institutions. This is summarized in the following diagram:

Figure- 7 : Feige's conjectural triangle



According to the studies of Gerxhani (2002) who proved the Feige's conjectural triangle in Albania was perceived detailed regression results that estimate the three tips of this triangle. Gender affects attitudes: males are more optimistic about formal institutions, but they are characterized by negative trend with respect to informal institutions than female. ***This shows that male tend to generated more evasion in economy***. It's a fact that in Albania mass of business are holding by men, but in recent years the things are going to change in favour to women, making the situation more optimistic in this point of view.

Differently from the developed country, in development country the motivation of peoples to avoid the taxes is much greater than "the desire" to pay. Those differences depends on "the social norm" factor to pay the taxes. If the peoples believed that the necessity of payment is a social norm, then they will pay regularly it. That means, the existence of social norms of taxes still depends on public judgment. On the other hands, if non-payment becomes dominant, social norms of payment disappear. Social norms of tax obedience varied among different countries. Societies in many countries, especially in transition in fact don't considered fiscal evasion like an economic crime.

In Albania, this judgment still exist but in small reports according to the previous years. That's because to the actions that the government has take, by the influence of the foreign international organization focused in this camp, and also by the grate desire of the agents to used the services of internet (the payment of taxes through the internet-applied this year)

The problem how to encourage the peoples to pay taxes, is not only our problem, but to all economic policymakers around the world, but especially for that in development countries. It's clearly that the payment is a complex issue of individual's behaviour interlaced with the socio-economic factors. It is said that there isn't place in the world that people are happy to pay taxes, but they still pay by the motive of their fiscal culture. In many countries when the informal economy and fiscal evasion is a big problem, the people are stimulated with the fiscal culture ever since they are in school-discussing later and in home in this manner. This can reduce a bit the problem, but is to accumulate the forces in all the dimensions of the problem in order to reduce a bit it.

## **Conclusion**

The experience shows that there is not a magic formula or a solution for transforming the informal economy to formal economy. This depends on the circumstances and resources that country has for resolving the problem. However is possible to implement a set of political doings that could dislodge the economic balance from informal sector to formal sector. Must keep in mind that, action plans doesn't be isolated with each others, and seeks an efficient dialog process among the interest groups like government, public administration, civil society, business sector and employee's syndicate for being successfully. In principle, tax moral depends from the efficient allocation and uniform of taxation among the contributors in society. Fiscal liberties and fiscal an equality weakness the tax discipline and stimulate the fiscal resistance via hiding of taxes. In the creation of the tax moral is important the organization of fiscal administration and its well-being.

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