

THE IMPACT OF THE REDUCTION OF THE VAT IN TOURISM THE CASE OF ALBANIA

Armand Hysi

“Eqrem Çabej” University, Gjirokastra, Albania

info@brilanthotel.com

Lorenc Koçiu 

“Eqrem Çabej” University, Gjirokastra, Albania

kociulorenc@yahoo.com

Abstract

In recent decades tourism has become a primary economic activity of many countries, and Albania should be a clear example of the need for the development of tourism. The various costs derived from it are evident (congestion, environmental degradation, etc.), however, economic and social benefits of tourism are clear (economic growth, employment growth). Tourism is a primary vehicle for job creation and economic regeneration. It is the moment that tourism in Albania to assess and take the weight it deserves. Quite Mediterranean countries, follow supportive policies for the tourism sector, including the fiscal area. Hotels prices level is the decisive factor of competitiveness of tourist destinations. The study is based on a comparative and descriptive analysis based on tourism statistics of the countries included in it. At the end of the paper is showed that the reduction of VAT level in the tourism sector will have a positive impact on tourism demand and supply.

Keywords: Value added tax (VAT), Tax reduction, Tax rate, Competitiveness, Tourism, Albania

INTRODUCTION

Currently, Albanian business hotels and restaurants applying the VAT regime cannot be said that can provide competitive prices for the same quality of service, if we compare with neighbors or other European countries. Currently VAT tax of 20% of room price in Albania, compared with Turkey (8%), Greece (6-9%), Montenegro (7%), Italy (10%), France (5.5%) , Malta (5%), Croatia (10%), Luxembourg (3%), is 200-400% higher. Part of policies supporter for the tourism industry,

in addition to investments in training and marketing should be and the review of the level of VAT on hotels and restaurants. Arguments for a reduced VAT for hotels and restaurants in Albania, based on the practice that follows the EU's for the system of reduced VAT in its member countries. In mentioned process, Albania as a tourist destination, which requires promotion and a long-term development, is not the exception, because the reduction of the total tax burden for the hotel industry could help the preservation of the competitiveness abilities of tourism in respect to other tourist destinations. A higher tax rate affects tourism negatively. Tourists face higher bid prices which puts our country in an disadvantageous position among Mediterranean competitors. It is important to find an optimal solution within the VAT system to encourage tourism development.

ALBANIAN TOURISM PRODUCTS

The Albania has three potential tourism offers: 1. Sun and beach tourism 2. Special-interest tourism 3. Business and conference tourism

Special-interest tourism includes: natural tourism, cultural tourism (archaeological parks, historic towns), eco-tourism, adventure tourism (hiking, walking, boat rowing, rivers, mountain bike, diving cylinder), rural tourism.

Coastal tourism in Albania has been the main product and is bordered by the sea and sun tourism, which is the main purpose of visitors to coastal destinations. Although not the main purpose of his visit to Albania, archeology, heritage, culture identified as the keys strengths of Albania in various studies carried out by visitors and travel industry from foreign markets. Cultural tourism in Albania is characterized by the following condition: World Heritage Sites archeological park of Butrint, Berat and Gjirokastra are attractions symbols, followed by a series of historical and cultural attractions, as well as monuments. So far, Albania is praised by many operators and international visitors to the landscape, nature, its beautiful appearance, which also considered the strengths of Albania.

Supply of Accommodation

In general, are missing the exact data on registered hotels and over the capacity of beds. According to statistics collected by the Tourist Service Office, accommodation capacity currently consists of 27,716 beds in 670 hotels. The offers of accommodation in Albania is characterized as following: The capacity of the hotels dominated by small hotels. Over 80 percent of registered hotels have less than 20 rooms and 7 percent have more than 40 rooms. Referring to their location, 80% of hotels are located in coastal and lake (Velipojë, Shengjin, Durrës, Vlora, Saranda, Pogradec), 10% of hotels located in Tirana and 10% are in other areas.

Table 1: Hotels and their capacity (2003 – 2012)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Hotels	199	170	220	243	221	240	370	357	590	670
Bed places	5,735	5,650	6,742	7,248	8,649	8,038	11,932	11,793	18,905	27,716

Source: INSTAT 2013

Capacity of accommodation unregistered (informal)

Unregistered market (informal) of rooms and apartments which are given for rent, is a significant part of supply in coastal areas. No recording of private rooms and apartments that are rented by the owners of apartments in destinations, as well as for the second homes. *Unregistered accommodation capacity not only represents a level of "higher" the informality in tourist accommodation market and avoids paying taxes, but it also constitutes an unfair competition in the market accommodation.*

DEMAND OF TOURISM PRODUCT IN ALBANIA

Since 2001 the number of international visitors has increased significantly. The growth was particularly strong from Southern Balkans (Kosovo and the former Yugoslav Republic of Macedonia) and partly from Western Europe between 2008 and 2012. "The Way of the Nation" built recently has significantly affected the number of visitors, increasing the number of persons from Kosovo from 473,422 in 2009 to 1,179,327 in 2010. After 2010 the number continues to grow about 260,000 per year or about 18% . In 2012 the number of international tourist visitors grew by 25.7% compared with 2011. In 2012 the share of tourists from Kosovo in comparison with the total number of international tourists remain impressive: at 48.63%. In 2013 the increase of numbers almost stopped in the base year; there was only a slight increase compared with 2012.

Figure 1: International Visitors for the Period 2006-13

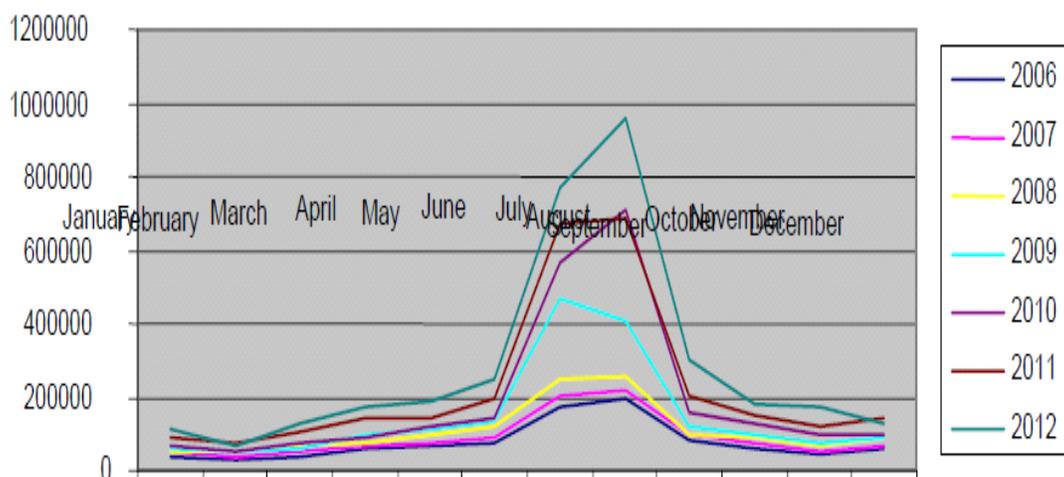


Source: MZHUT

Foreign tourists by months

Tourism in Albania depends significantly from the summer season due to vacations of the beach. Because of the total number of international visitors in 2012, 50% of them (or 1,724,673 visitors) have stayed in Albania in July or August. This percentage has not changed in recent years while the peak of the summer season has become more important due to the increasing number of visitors. The large number of visitors in the summer seems to be affected significantly by Albanian immigrants and the community of Kosovars living abroad who travel with foreign passport and this hypothesis is confirmed when analyzing the main points of entry and mode of transportation. *The large number of visitors in summer (July-August), not only does the seasonal tourism product but also a closer market tourist. Extending the width of the season tourism remains a problem in Albania.*

Figure 2: Number of total Foreign Visitors (season wise)



Source: MZHUT

The numbers of Western foreign tourists that are visiting cultural attractions, even with an increase of 15-25% per year, are very low (2008-2012) and in 2013 they have significant reduction by counting only 109,771 visits.

Table 2: Visitors Cultural Attractions 2008-13

Visitors	2008	2009	2010	2011	2012	2013
Local	94,142	253,002	291,542	265,103	1,301,479	245,703
Foreign	65,347	81,991	93,716	107,836	131,254	1,109,771
Totals	159,489	334,993	385,258	372,939	1,432,733	1,355,474

Source: MK

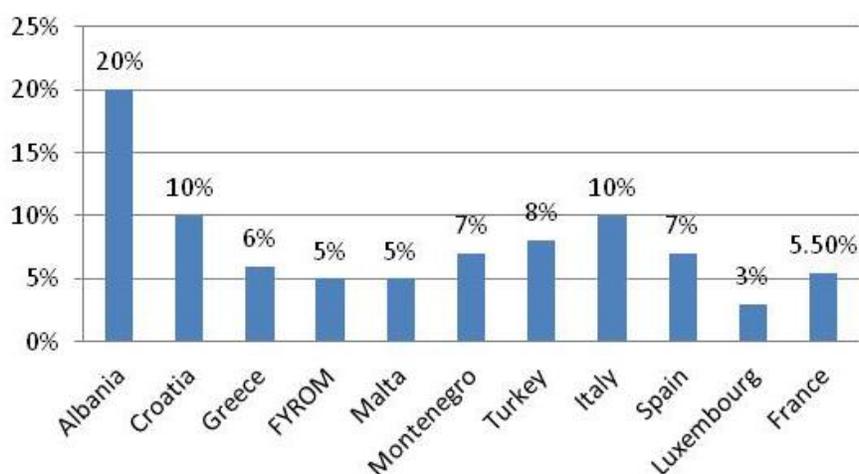
Factors affecting tourism demand and its elasticity

Tourism demand and its elasticity depend on many factors such as population, income, own and substitute price, taste, etc. Own and substitute price elasticity and income elasticity are used to describe tourism demand. Elasticity measures percentage change in tourism demand as a result of percentage change in price or income (Blake and Jimenez 1997). Price and income elasticity are very useful to consider in relation to pricing, exchange rate and taxation. A large number of empirical studies have attempted to estimate the price elasticity of demand for international tourism and the results vary. Tourism demand varies significantly as it depends on tourists' origin, destination and purpose of the travel so it can be both inelastic and elastic (Mak 2004). Tourists who travel for business seem to be less sensitive to the price changes. It can be explained by the fact that business travels have less or none alternatives as opposed to leisure travels. Business travelers generally have less flexibility to postpone or cancel their trips. Holiday tourism and visiting friends and relatives tourism are price sensitive markets. The price of foreign currency is also important in international tourism demand. Tourists must have currency of the country they are visiting in order to spend during their trip. Changes in currency exchange rate alter the prices paid for foreign goods by tourists in their home currencies. Taxation of goods consumed by tourists can help to raise revenues and shift tax burden from home residents to tourists. The general rule is that the highest tax rates should be on goods with the lowest price elasticities. However if both tourists and local citizens consume the goods, they both will pay the tax. Income elasticity of tourism demand is generally expected to be greater than one. In other words, tourism is considered to be a luxury good. Consumers are usually sensitive to the change in their income and that's why, for example, during financial and economic crisis in 2008 and 2009 number of tourism nights spent in collective tourist accommodations in the EU countries fell by 0.6% and 2.8% accordingly. However in 2010 the number of tourism nights increased by 0.8% and that percentage accelerated to 5% in 2011 and the developing continues.

COMPARISON OF IMPACT OF VAT RATES FOR HOTELS AND RESTAURANTS ON TOURISM

For years the hotels and now restaurants too, in EU countries according to European Commission directives (Directive 2006/112 / EC) have the opportunity to be subject to reduced VAT. Nearly 20 of the 27 EU countries have a VAT smaller or equal to 10% for hotels (mostly Mediterranean countries). Meanwhile, Albania still has the highest VAT in the region and beyond.

Figure 3: VAT levels



Source: Eurostat, 2014

VAT rates have a huge impact not only on the hospitality sector, but also on the whole tourism industry of Europe, which is directly and indirectly providing for more than 10% of the EU GDP and about 12% of the EU labor force. One of the targets in the EU 2020 Strategy is to enhance the competitiveness of the European tourism sector. Moreover, since years the European Commission has been working on a tourism policy in order to keep Europe the number 1 tourism destination in the world, especially when looking at the falling share of Europe in international tourist arrivals. The application of reduced VAT rates for the tourism sector is probably one of the most important tools to achieve these aims. Currently 24 out of 28 Member States are making use of a reduced VAT rate on accommodation services, i.e. only 4 apply the standard rate. Currently 14 out of 28 countries are making use of a reduced VAT rate on restaurant services. Travelling is important for business and educational or training reasons, often implying overnight stays. “To sleep” is a basic need for everybody. Therefore travelers, and especially those with low income, should not be hindered with a high level of taxation.

In the case of the hospitality industry there is evidence showing the benefits to the whole economy of the application of a reduced VAT rate to the sector. Going against the negative trend with regard to employment in the recent years of crisis, the sector managed to increase the number of jobs by 3,8% between 2008 and 2011, while employment in the overall economy dropped by around 2.1% in the EU 27. Significant increases in employment in the sector could be observed in Belgium (4,9%) and France (12,2%), where a reduced VAT rate was recently introduced on restaurant services. Moreover, the hospitality industry is an important point of entry into the labor market for young and unskilled people. In fact, 20,5% of the people employed in the hospitality sector are between 15 and 24 years old, while in the overall

economy this figure is only 9,1% (Source: Eurostat). Below are some examples of positive effects of reduced VAT rates in the hospitality sector:

In France, the VAT rate on restaurant services was reduced from 19,6% to 5,5% in July 2009. Until 2011 around 50.000 jobs were created only in the restaurant sector. During the same period the construction sector had to cut over 30.000 jobs. The consumer price index in restaurants and cafes dropped following the introduction of the reduced VAT rate (Source: Synhorcat, France).

In Germany, the VAT rate on accommodation services was reduced from 19% to 7% as from January 2010. Since then an annual increase of 2,4% and 2,9% in the number of jobs in hotels could be observed in 2010 and 2011 respectively (Source: German Hotel Association (IHA-D)).

In Belgium, the VAT rate on restaurant food was reduced from 21% to 12% in January 2010. The business closures observed in 2009 could be stopped and in the first 9 months 2570 full time equivalent jobs were created. It could furthermore be observed that investments were rising again with an increase of 2% compared to 2009 and an even more significant increase of 7.2% in turnover could be realized (Source: Horeca Vlaanderen).

In Sweden, the VAT rate on restaurant services was reduced from 25% to 12% in January 2012. Restaurateurs in Sweden could observe the biggest increase (4,4%) in turnover in the last 10 years over the period of January-November 2012. It is estimated that the employment in the hotel and restaurant industry has increased by 5,3% (with the equivalent of 6 000 full-time employees) in 2012 (Source: Visita- Swedish hospitality industry).

In Luxembourg, thanks to the low level of VAT on hospitality services, in 2012 the sector increased by 5%, against the local economy which only increased by about 0,4%. The hospitality industry has created 1650 new jobs in 2011 and more than 1800 new jobs in 2012 (Source: HORESCA – Luxembourg).

In Latvia, the VAT rate on accommodation was increased in January 2009 from 5% to 21%. In 2009 the number of persons employed in the sector fell by 12.000 resulting in losses for the government in social and income taxes of around 14 million EUR. Following the re-introduction of the reduced VAT rate in May 2010 at 10%, employment grew by 8.3% and also the before dropping number of visitors started to rise again (Source: Latvian Hotel and Restaurant Association).

The number of foreign tourists that came to Croatia through travel agencies in 2006 is at the level of 2005 while the number of overnight stays is by 2.2% down in relation to 2005. This is partly due to the increase of reduced VAT rate from 0% to 10% on 1 January 2006, to all accommodation services rendered to foreign or domestic guests, directly or through travel agencies. Higher prices that accompanied the increase of VAT rate led some tourists to

competitive countries with lower VAT rates and also lower prices for the same services. The number of foreign tourists that came to Croatia through travel agencies in 2009 is by 13.6% lower than in 2008 while the number of overnight stays is by 17.5% lower than in 2008.

IMPACT REDUCING VAT ON TOURISM DEMAND

Hotel industry and tourism are significant factors of competitiveness abilities and development of country. For example, only in European Union member states tourism today contributes to around 10 % of the gross domestic product while in many countries, especially smaller and more dependent on tourism, tax revenues from tourism are considerably higher than 10% (McAleer et al, 2005). Tourism is sensitive to taxes, but it cannot be exempt from them since it is a significant source of revenue for the budget (Dombrovski and Hodzic 2010). Value added tax (VAT) most strongly affects the tourist competitiveness of the country. This makes public regulation of tourist activity a necessity, and such regulation must pursue a certain balance (budget revenues realized - demand tourist services), not always easy to reach. Among the public policies affecting the tourism sector, taxation plays an especially important role. On the other hand, high rates of taxes are disastrous for realization of competitiveness and wanted revenue from tourism. Decisions on the level of tax rates should be the result of implemented research of their impact on tourism and the budget. In that way taxing presents public policy that mostly directly or indirectly influences hotel industry and the whole sector of tourism, because due to the relative elasticity taxes changed prices modify the behaviour of potential guests. The study of Deloitte and Touche (1998) showed that higher tax burden reduces hotels and tourism revenues, while the increase or decrease of tax rate significantly influences the decisions of the tourists regarding the destination of a voyage. In other words, because of mobility, information and sensitivities to prices, tourists very often select the destination having in mind the prices required by providers of accommodation. Due to all mentioned, hotel industry in any country has an aim to achieve more favourable position in comparison to its competition, and one of the way how to achieve it is to provide encouraging taxing of tourist services and hotel industry. An important factor in selection of the tourist destination, beside the natural beauty and abundance of facilities is also the price of overnight stay and food. Tourists tend to choose a country with more convenient prices. Rate of value added tax affects the prices and subsequently also the competitiveness of each country.

Below is the presentation of the impact of VAT to the level of the price for overnight stay and lunch in Republic in Luxembourg, Croatia, and Albania. For example, a selling price without VAT used for overnight stay in a single hotel room is 100 Euro and that of lunch in a restaurant without VAT is 10 Euro. The calculations above point out that Luxembourg and Albania

according to their regulations apply the same rate of VAT for hotels and restaurants. Republic of Croatia applies 10% to accommodation services and 23% to restaurant services.

So the above data reference, the price of overnight stay in a single hotel room with VAT is then 103 Euro in Luxembourg and lunch costs 10.3 Euro. In Albania, the overnight stay in a single hotel room with VAT costs 120 Euro, lunch is 12 Euro. In Croatia, overnight stay in a single hotel room is 110 Euro, lunch is 12.3 Euro, VAT included. Luxembourg is most competitive with 3% rate for overnight stays and lunch. Overnight stay in Croatia is by 7 Euro higher than in Luxembourg due to the 10% rate. Cost of lunch in a restaurant in Croatia is by 2 Euro higher than in Luxembourg. Price of overnight stay in Albania is by 17 Euro higher than in Luxembourg and 10 Euro higher than in Croatia due to the high tax rate of 20%. The price of lunch, taxed with the same rate is by 1.7 Euro higher than in Luxembourg and 0.3 Euro lower than in Croatia.

Assuming that $E_{y,x} = -1,5$, where y is the quantity of demand for overnight stays in hotels and lunch in restaurant and x is rate of value added tax for the stated services, the elasticity coefficient value is interpreted:

Quantity of demand for overnight stays in a hotel and lunch in a restaurant in Luxembourg will fall by 4.5% if the VAT rate for those services is 3%, provided the other variables remain unchanged.

Quantity of demand for overnight stays in a hotel in Republic of Croatia will fall by 15% if the VAT rate for those services is 10%, provided the other variables remain unchanged. Quantity of demand for services of lunch in a restaurant in Republic of Croatia will fall by 34.5 % if VAT rate for stated services is 23%, provided the other variables remain unchanged.

Quantity of demand for overnight stays in a hotel and lunch in a restaurant in Albania will fall by 30% if the VAT rate for those services is 20%, provided the other variables remain unchanged.

Tourism is sensitive to taxes. Product of elasticity coefficient and tax rate implies that a significant fall of demand occurs if a high tax rate is applied, i.e. there is a small fall of demand if the state introduces a lower VAT rate.

CONCLUSIONS

It is clearly seen that the VAT rate strongly affects the price of the service. Tourism is sensitive to taxation and the best idea would be to make it exempt from payment of VAT. Since that is impossible, solution should be looked for in application of reduced rates within the framework prescribed by the EU Directive. In times of crisis and saving, a small difference in price has

great significance. Solutions should be sought in the VAT system in order to have an effect on prices and encourage positive growth in arrivals and attitudes about foreign tourists.

VAT is the most important of rate and the source of the budget. But, should be found an optimal way for filling the budget which should not be an obstacle for development of tourism and life of citizens. With one of the highest rates of value added tax, Albania may realize short - term expected revenue. But on the other hand it has reduce the competitiveness of the sector and tourist demand. It is followed by a drop of tourists' expenditure and insufficient money in the budget. On the contrary, lower rates shall enable decrease of prices, higher demand with higher expenditure and filling of the budget.

The creation of this tourism product and competitive position in the tourism market, first of all requires the evaluation and management of two its essential components: tourism supply and demand. The analysis and concerns, that are identified in this paper tend to encourage the government and its institutions in tax policy as an element in the growth of tourism demand.

At the end we could say that, this paper tends to foster and increase a little bit awareness, for more in-depth studies regarding the best tax policies that need to be implemented in the field of tourism, with the aim of creating a tourist product and competitive position in the market tourism in our country.

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