



## THE CRISIS OF THE FISCAL SYSTEM AND FISCAL POLICY CHALLENGES FOR THE FUTURE

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### Abstract

*The global crisis pressured the Albanians economy. As a result of the global crisis, economic growth rates were significantly reduced in Albania. Fiscal decentralization reform has significantly changed the structure of the revenue sources of local governments. In 2002, which is the last year of the old scheme of financing local government, this structure was 76 to 24 per cent in favor of the resources coming from the state budget. After this year, with the introduction of a new package of fiscal increasing fiscal autonomy of local government, this structure has changed and grown significantly from year to year, especially after 2014 and onwards, this autonomy is over 75 percent. The purpose of this paper is evidence of the crisis of the fiscal system in the last ten years and the challenges of fiscal policy for the future in Albania, compared with the region, developing a discussion of: what structure, what level of taxation helps more growth the country's fiscal policy and which better distributes the benefits of economic growth. In conclusion we can say that: Any political attempt to tax cuts unstudied deterioration will bring stability to the country's public finance and fiscal policy in Albania for the period 2016-2020 will be oriented towards fiscal consolidation.*

*Keywords: Fiscal policy, economic crisis, financial autonomy, progressive tax*



## INTRODUCTION

Fiscal revenues constitute the main source of income of the state. Fiscal policy is the main objective guarantee minimal budget revenues, but from the moment that guaranteed financial continuity of the state, the state sets targets other fiscal policy. Today encounter two opposite positions in the area of fiscal policy, which depend on the political agenda, but that each has its limitations. On the one hand, we have a fiscal policy that is supported by a high fiscal obligation major income (progressive tax), thus favoring a re-distribution of income in society. The downside of this fiscal policy is the limitation of cash that the "rich" can spend on investment and consequently it brings a limitation to growth.

On the other hand, we have a tax liability equal (flat tax), which preserves investments, but with negative consequences on consumption, for the middle classes and the poor, which constitute the vast majority of customers. Reduce disposable income affects the demand in the market and therefore have a limitation on the offer and on production, investment and economic growth on themselves. Debate on the challenges of each country is focused today not simply the percentage of growth, but the opening of new jobs. This strategy will reduce poverty and will help to reduce the level of debt.

Fiscal policies have a significant impact on this challenge, but the impact should not be considered absolute. The effect of the impact of the fiscal system of a country's economy is depending on the economic and political environment of each country.

Therefore, in anticipation of declining economic cycles and economic crisis, it is recommended that positive economic situations should be no budget deficit; the debt should be reduced, to have more room to intervene in the economy in times of crisis. This is to help the economy to stop its deterioration and return to growth. Faced with this situation our economy is today, the government reduced the deficit and debt when the country had high economic growth, which means that we have less room to increase budget spending at a time when economic growth has slowed significantly.

### **The crisis of the fiscal system and economic development after the crisis**

As a result of the global crisis, economic growth rates were significantly reduced. The economy has continued with a moderate growth rate of 3.8 percent in 2010 and 3.1 in 2011. In 2012 and in 2013, economic growth has weakened further. The growth rate decreased by 1.3 % to 2012 points and continued to sit down sharply in 2013. In 2014, the estimated growth of 0.4% resulted INSTAT lower compared with a year ago. While GDP in the third quarter of 2016 was estimated to increase by 3.08 % versus the third quarter of 2015. The main contribution to this growth was provided branches: Trade, Hotels, Restaurants and Transportation by +1.12 points

percentage, Building with + 0.77 percentage points, financial and insurance activities with + 0.42 percentage points, other services +0.29 percentage points Agriculture, Forestry and Fishing +0.25 percentage points. It contributed negatively Industry, Energy and Water with -0.30 percentage points, professional activities and administrative services to -0.08 percentage points. Net taxes on products contributed positively to +0.41 percentage points.

Albanian reality shows that lowering taxes is unstudied associated with increased economic growth. Every government has the clear slowing economic growth increases the risk that the fall in revenue from tax breaks abusiveness lead to an increase in tax collection and increasing the deficit and public debt.

And the curve Lifer is a point at which further reduction of taxes does not increase revenue, so we have to find in the Albanian reality optimum level, so not the lowest, not the highest, we meet two conditions important: sustaining economic growth (because it promotes private investment) and improves the sustainability of public finances.

### **Packages fiscal after years 2014-2015, the effect of their tax policy**

Fiscal Package 2014 brought significant changes in tax policy so as to indirect taxation and direct taxation. The effect of changes in taxes was estimated at around 21 billion extra in 2014. Budget excise some changes had the following products:

*For tobacco products.* Cigarette excise tax was increased, escalating over the years, according to the progressivity of the following:

4500 ALL / 1000 pieces, on January 1, 2014;

5500 ALL / 1000 copë, on January 1, 2015;

5500 ALL / 1000 pieces, on January 1, 2016;

6000 ALL / 1000 pieces, on January 1, 2017.

According to the EU directive, the minimum level of excise on cigarettes should be 57% of the retail price. The level of excise duty in Albania, this change has been at 34% of retail price.

*For the beer.* Beer excise restructuring is made under Article 4 of the Directive of the European Council, based on two basic criteria:

Applying a single production threshold as a threshold level of taxation separator for production quantities greater than 200,000 hl per year;

- The level of excise duty is expressed by the directive, ALL / HL / degree of alcohol.
- Reduced fee (360 ALL / HL / degree alcohol) should not be less than half the basic fee

*New excise products.* Added to the list of excise products, with two new products, grease with 40 ALL / kg and "energy drink" with 50 ALL / liter.

The date January 1, 2014, income tax became 15% from 10% which was before. This change was consistent with the formula of progressive taxation in Albania and the logic that the individual, who earns more, pays more taxes.

#### *Personal income tax*

From January 1, 2014 date; the tax on personal income tax is progressive on salary, with the tax rate:

<i>Taxable income (ALL / month)</i>	<i>Percentage of tax</i>
0-30.000 (220 euro)	0 %
30.001- 130.000 (221 euro – 930 euro)	13 % of the amount over 30.000 ALL (on the amount of 220 euro)
Over 130.001 ( over 931 euro)	13.000 ALL +23 percent of the amount over 130.000 All (95 euro + 23 % of the amount over 930 euro).

The government has placed on top of its priorities in the fiscal package in 2015 fiscal consolidation, with a focus on the reduction of debt and deficit reduction. In this fiscal package, remains visible support on apparel industry favoring domestic production or on the other hand, one of the most sensitive issues for business in the Fiscal Package 2015 has been the growth of income tax at source of 10% to 15%. In fact, the transition to progressive income tax resulted in a modest increase of income of employees in the private sector of only 3%.

The decentralization reform in general and fiscal decentralization in particular, has significantly changed the structure of the revenue sources of local governments. In 2002, which is the last year of the old scheme of financing local government, this structure was 76 to 24 per cent in favor of the resources coming from the state budget. After this year, with the introduction of a fiscal package to increase the fiscal autonomy of local government, this structure has undergone major changes. Income fund local governments to exercise its functions were provided with a clear 50 percent of local taxes and fees. Financial autonomy of local governments has increased significantly from year to year, given that in 1996 the local government had the right to decide for only 1 percent of its budget, while in 2014 onwards, this autonomy will be over 75 percent.

#### **Fiscal System Reform under the principles of the EU**

EU fiscal rules are based on the criteria of Maastricht Stabilization Pact and also are a product of the Monetary Union, with the ultimate goal of price stabilization. The EU has recently taken a series of measures to eliminate harmful tax competition and other negative phenomena that

affect the process of strengthening the single market. Harmonization of tax forms in the EU is carried out only in the sphere of indirect taxes (VAT and excise partially), while the share of indirect taxes remained virtually without harmonized, despite some attempts to regulate enterprise profit tax.

However, the tax differences between member states of the EU are resolved when the issues are regulated elimination of tariff barriers and non-tariff barriers within the internal market with the benefit of free market development of common European. With the installation of the Customs Union regime, gradually remove customs barriers preliminary internal markets and at the same time eliminate obstacles and barriers are other than customs related to free movement of people, goods, services and capital. But, within the member countries of the EU, still remain amendments that were the product of different structures, tax, methods and goals of the use of public funds as well as a series of changes related to regulations, techniques, standards, etc., policies state in this important segment. In addition, EU countries, also distinguished by different levels of the phenomenon of corruption and the informal economy which have effects in both the level of public finance structures and functioning of the legal economy segment. In the EU there are many discussions about the tax structure, its partial harmonization as finding opportunities for full harmonization. This debate actually shows the complexity of the tax system throughout the EU. Although in reality so far it has been a small result in the harmonization of the fiscal system on EU territory - of not activities for locating missing bases for common policies and fiscal system.

Policy European Union fiscal is decentralized and their character is the fact that national taxes are strongly bonded with the member countries. That's because, with the exception of harmonization of customs tariffs, lower rates of VAT, and excise taxes on a few certain products, tax systems are located in the exclusive competence of the States member. Up to this moment we have failed all efforts related to reconciliation policy EU tax, and any attempt to transfer at least some tax jurisdiction of the bodies of the European Union. Until the EU is financed by member states, its institutions and legislative government have no fiscal effect. This means that the EU is able to set, impose and collect taxes. If we compare indicators of economic freedom in Albania with that of the most developed countries of the EU, we will notice that their freedom Fiscal much smaller than Albania, but indicators of freedom from corruption, indicators of good governance and the rule of law, are several times higher than ours. The tax burden in the Balkan region in 2015 is on average, 31.5% of GDP, compared with 31.2% that was in 2014. Every year there is a reduction of 0.3% of the tax burden.

### Challenges of fiscal policy for the future

Fiscal policy consists of government intervention to meet the expenses of the State through the management of revenue collected through the fiscal system. Fiscal policy objectives can be numerous, but they are classified under three traditional functions of intervention, which makes the state in the economic sphere:

- a) *distribution function of the financial resources* needed for the production of those goods and services that the free market is unable to supply effectively, including public goods, for example, justice, national defense, road infrastructure, etc;
- b) *Re-distribution function*, aimed at changing the distribution of income and wealth through changes in taxation sources of income taxpayers;
- c) *The regulatory function of economic activity* through changes in the level of taxation or control of macroeconomic aggregates.

Fiscal policy for the period 2014 - 2020 has been oriented towards a path of fiscal consolidation. It aimed at establishing a sustainability of public finances as one of the main pillars of economic growth and sustainable development of the country. Fiscal policy under the Government Economic and Fiscal Program for the medium term next level has the main objective of the structural deficit, which ensures the sustainability of public debt in the medium and long-term and short-term minimizes negative effects on economic growth. The main objective of fiscal policy at the macro-fiscal framework currently today is to maintain the overall fiscal deficit, which each year was as follows:

- For 2016, the overall fiscal deficit was 6.7% of GDP
- For 2017, the overall fiscal deficit was 4.8% of GDP
- For 2018, the overall fiscal deficit was 3.4% of GDP

Public investment is projected to be kept at a level of 5% of GDP -that which is considered as an optimal level to support high economic growth and stable.

At the end of 2017, total budget expenditures is projected to reach 489.9 billion ALL level (3.5 billion Euros) or 28.4 percent of GDP. The resources will be used mainly for:

- Significantly reducing the budget deficit to 1.3 percent of GDP;
- Differentiated increase of pensions;
- Maintaining a sustainable public investment in mass to 5.1% of GDP.

A typical problem and very restrictive with which governments are facing in this area is fiscal evasion.

IMF, WB, G-20-a and the EU have made clear that the key to exit from the crisis is a return to economic growth. How fiscal policies contribute to economic growth, which of them has

positive or negative effects, this is a debate not easy and mostly apolitical, but that should be entrusted to experts.

When discussed in Albania for taxes and fiscal burden, not by chance, take into account the average tax rate that guarantees funding priorities without increasing public debt and its cost. The flat tax applied in several European countries, there was a much higher level than 10%. Estonia started the application of the flat tax by 26%, while Slovakia, which became a magnet of foreign investment in the early 90s, applied a 19% flat tax.

It is true that Ireland rejected the first time the Lisbon Treaty because the feared losses of independence of its fiscal policies, which apply a 10% income, tax for businesses in manufacturing. This tax is assessed much lower than the average of countries in the EU, but this policy did not save Ireland from the crisis and at the same time put the disappointment of the Europeans that one of the country's most benefiting from structural funds of the EU, making competition abusive foreign investments, applying low taxes.

It must deepen the debate which structure and level of tax which helps more qualitative growth of the economy. Fiscal policy which better distributes the benefits of economic growth, reducing the immediate and unstudied tax or reduction of public debt; the cost of debt reduction and increased private and public investments in priority sectors of the economy.

Taxes have magical effects, first because if it were so, it would be applied immediately by all countries as a lower level of taxation and would eliminate the economic downturn and rising debts. Likewise, if you see reality in different countries of the EU, we will not find a direct link between the level of tax, economic growth and the debt crisis.

Each strategic investor, to make an analysis of the risks in the Albanian economy, will need to refer to estimates of the IMF, WB and the Rating companies. This is because in their assessment report to determine the costs that companies will secure funds from international markets. The poor rating for our country, the greater the cost of financing their investments, which will either divert their investments to other countries, or would divert investments in time for another period.

## CONCLUSIONS

The current crisis showed that where countries have economic and fiscal policies that enhance solidarity and social cohesion, it has a growing economy and cope better quality strikes crises. Focus on "tax halved" if not accompanied by qualitative improvement of fiscal management, reducing administrative abuses, reducing corruption and strengthening the rule of law, it does not produce positive effects.



Meeting a higher tax on income from rents remains a challenge even greater given the high informality in this field. The largest percentage of households benefiting from rents, which in the absence of effective legislation regarding the declaration of personal income, do not declare this income, which therefore not taxed.

Any attempt populist landing unstudied tax will bring deterioration of the stability of public finances of the country; will be a wrong step in the wrong direction, which will jeopardize the growth of debt, increasing their costs and increase risks crisis.

## FURTHER STUDIES

Future studies shall looking into following areas:

- Aspects of tax harmonization in the field of income tax in Albania
- Importance of Taxation of the agribusiness sector in reducing informality
- Fiscal policy as a driver of investment and economic development.
- The application of new fiscal instruments is a must for the Albanian reality

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