



## **THE IMPACT OF VALUE ADDED TAX AND CORPORATE INCOME TAX ON ECONOMIC GROWTH IN ALBANIA**

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### **Abstract**

*The impact of taxes as a source of revenue for the development of a countries economy has been subject for different studies during recent decades. The main objective of our study is to analyze the impact of Value-Added Tax (VAT) and Corporate Income Tax (CIT) on the economic growth in Albania. To conduct this study, secondary data were collected on an annual basis for a time span of 10 years. We have used the method of linear regression analysis by identifying the gross domestic product as the dependent variable and the Value- Added Tax (VAT) and Corporate Income Tax (CIT) as the independent variables. The study results indicate that the independent variables have a positive effect on the economic growth of Albania.*

*Keywords: value added tax, company income tax, gross domestic product, economic growth*

### **INTRODUCTION**

The correlation between taxes, such as Value-Added Tax and Corporate Income Tax, and the economic growth has attracted the attention of many researchers in recent years. The basic instrument of the state fiscal policy is the state budget, which accumulates government revenues and transforms them into government expenditures (Hajdúchová, 2015).

According to Gaston Jèze, taxes are money that a government collects from businesses on the basis of its sovereignty without direct compensation, with the aim of covering public expenses. Value added tax (VAT) is a general tax on the consumption of goods and services at every stage of consumption until it reaches the final consumer. VAT is applied as a percentage tax on the price of goods and services and becomes payable after first deducting the VAT that directly burdens the cost elements of goods and services.

Today, VAT remains the most favorable form of general multi-circulation of goods and services. In addition to VAT, company income tax is another component of a state's revenue from taxes. A corporate income tax (CIT) is levied by federal and state governments on business profits. The statutory company income tax (CIT) rate in Albania has been reduced over the years, from 30% in 1999 (Law No. 8438, 28.12.1998), to 20% in 2007, 10% from January 2008 until 2014 where based on Law no. 177/2013, the company income tax rate is 15%.

With the repeal of the turnover tax and its replacement with the Value Added Tax, in 1996, VAT became the main and most stable source of income in the Albanian tax system. The VAT system in Albanian fiscal legislation is admirably designed: it is simple, broad-based, contains a standard rate of 20% and has a reasonable exemption threshold, typical of developing countries.

The purpose of this study is to analyze the impact of Value Added Tax (VAT) and Company Income Tax (CIT) on the economic growth in Albania. We have chosen VAT and CIT considering that they cover a considerable part on the revenues of the state. The study main purpose is to show the positive impact and importance of these two types of taxes in order that the state undertakes new fiscal policies to collect as much revenues as possible from these sources.

## LITERATURE REVIEW

In neo-classical economic growth models, taxation only affects the level of income, but not the growth rate, while endogenous growth models suggest that taxes can affect the long-term growth rate.

Nguyen (2021) on their study examine the effects of individual income, corporate, and consumption taxes in the United Kingdom from 1973-2009. They find that income tax cuts, defined in their paper as an aggregate of individual and corporate income, have large effects on GDP, private consumption, and investment. The effects of consumption tax cuts are comparatively smaller and did not produce statistically significant effects, but the paper

finds that switching from an income to a consumption tax base has positive effects on growth.

Zeraibi Ayoub, Subhadeep Mukherjee (2019) investigated the role of Value-Added Tax (VAT) on the economic growth in China with the gross domestic product (GDP) as a dependent variable and the total population, employed persons, consumer price index, and value-added tax as independent variables. The data used for the study is a time series of the period from 1985-2016. The current findings add to a growing body of literature on identifying the properties of VAT in China and identifying the tax system reform from 1993 to 2012 and the mechanism of transfer application of the business tax in the services sector to Value-Added Tax. The test result indicated to have a positive relationship between the GDP and the independent variable value-added tax (VAT).

Hassan. B, (2015) and Inimino (2018), states the positive impact of VAT on economic growth. Kalaš & Milenkovič (2017) found a strong relationship between value-added tax and gross domestic product. Miki (2011) identified in the first trend of consumption and the economic growth display when the VAT rate change.

Ezeji E. Chigbu, Peter Ifeanyichukwu Ali (2014) on their study empirically analysed the relationship between VAT and economic growth in Nigeria. Using the Engle and Granger co-integration technique on annual data sample covering 1994 to 2012, this paper shows that VAT has positive effect on economic growth represented by real GDP. The results also show absence of both long-run and short-run relationship between VAT and GDP.

Aghion (2013) use an innovation-based growth model in his study to show that capital taxation can promote economic growth by shifting the tax burden away from labour taxation. While Jones (1993) demonstrates that capital taxation may spur growth if tax revenues are used for higher productive public expenditures.

According to Peretto (2003), corporate income taxation can enhance economic growth, but asset income taxation reduces growth. That is why measurement of corporate tax changes is a relevant factor in determining its impact on economic growth (Devereux, 2008).

## **METHODOLOGY**

This section provides the methodology used for analyzing the impact of company income tax and value added tax on economic growth in Albania. We have conducted the study by using a linear regression model analysis. The data we are using in this study are annually time series data in the period of 2012-2021. The data for the study variables (VAT, CIT and GDP) was collected from the Institute of Statistics in Albania. The statistical computer software used to run the analysis is The Statistics Package for Social Sciences

(SPSS) 20. The regression equation used to study the relationship between VAT, CIT and GDP is:

$$\text{GDP} = \beta_0 + \beta_1 (\text{VAT}) + \beta_2 (\text{CIT}) + e$$

Where,

GDP= Gross Domestic Product, the dependent variable

VAT= Values Added Tax, first independent variable

CIT= Company Income Tax, second independent variable

$\beta_0$ = is the constant term

$\beta_1, \beta_2$ , = are the coefficients of the independent variables

e = is the error term of the equation

## FINDINGS AND DISCUSSIONS

In this study we have analyzed the impact of Value Added Tax and Company Income Tax on GDP using a linear regression model ran on The Statistics Package for Social Sciences (SPSS) 20. In Table 1 is presented the data collected for the study for all the variables during the period 2012-2021.

Table 1: Aggregate annual value of GDP, VAT and CIT  
for the period 2012-2021 in billions of Albanian Lek (ALL)

YEAR	GDP	VAT	CIT
2012	1332.8	115.95	17.33
2013	1350.1	112.06	14.85
2014	1395.3	124.18	20.93
2015	1434.3	126.22	24.38
2016	1472.48	131.05	29.45
2017	1550.65	139.56	31.01
2018	1636.73	144.03	34.37
2019	1691.9	131.97	37.22
2020	1617.5	146.7	28.4
2021	1769.3	161.5	35.6

Table 2: Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation	N
<b>GDP</b>	1332.8	1769.3	1525.106	150.76602	10
<b>VAT</b>	112.06	161.5	133.322	14.98669	10
<b>CIT</b>	14.85	37.22	27.354	7.74852	10

Table 2 displays the descriptive statistics of the research variables. The minimum Gross Domestic Product within the period of the study was 1,332.8 billion ALL and the maximum was about 1,769.3 billion ALL and the mean 1,525.106. The standard deviation of 150.76602 billion ALL indicated the observations in the GDP for the period under review are not highly spread out. The minimum Value Added Tax in the period of the study was 112.06 billion ALL and the maximum was about 161.5 billion ALL with a mean of 133.322. The Company Income Tax has a minimum value of 14.85 billion ALL, with maximum value of 37.22 billion ALL and a mean of 27.354 ALL. The standard deviation for both independent variables (14.98669 for VAT and 7.74852 for CIT) shows that the data are clustered closely around the mean which makes them more reliable.

Table 3: The log-run relationship

Variable	Coefficient	Std. Error	t-statistics	Prob
<b>Constant</b>	641.545	173.776	3.692	0.008
<b>VAT</b>	4.314	1.809	2.384	0.049
<b>CIT</b>	11.274	3.500	3.222	0.015

According to the results shown in Table 3, by substituting the computed coefficient values of the variables in the equation, we have:

$$\text{GDP} = 641.545 + 4.314\text{VAT} + 11.274\text{CIT} + e$$

From the substituted equation VAT and CIT have positive coefficients and can result in a positive change in Gross Domestic Product whenever its value increases. This indicates that an increase in VAT for 1 unit, will result in an increase in the Gross Domestic Product by 4.314. On the other hand an increase in CIT for 1 unit, will result in an increase in the Gross Domestic Product by 11.274.

Table 4: Regression results

<b>R</b>	0.960
<b>R-Square</b>	0.922
<b>Adjusted R-Square</b>	0.900
<b>Durbin-Watson Stat</b>	1.24
<b>Sig. (P)</b>	<0.001 <sup>b</sup>

According to the results in Table 4 the degree of correlation between CIT, VAT and GDP is high ( $R=0.960$ ) and 92.2% of the total variation in the dependent variable can be explained by the independent variables. The results in Table 4 also indicates the constant P-value  $<0.001$ , which means that the regression model statistically significantly predicts the outcome variable. The calculated Durbin-Watson values are 1.24, less than 2.0, which means that there is no autocorrelation between the independent variables. The two independent variables have statistically positive significant relationship with GDP, given the fact that the Prob values are lower than 0.05, respectively 0.049 for VAT and 0.015 for CIT. The results of the study analysis have shown that Value Added Tax and Company Income Tax have a positive impact on the economic growth.

## CONCLUSIONS AND RECOMMENDATIONS

This study analyzed the impact of Value Added Tax and Company Income Tax on economic growth in Albania. We determined the Gross Domestic Product as the dependent variable and Value Added Tax and Company Income Tax as the independent variables. The data used to fulfill the objective of this study was collected from the Institute of Statistics in Albania for the period from 2012 to 2021. The analysis was performed by using a linear regression model ran on The Statistics Package for Social Sciences (SPSS) 20. The results from the statistical analysis from the data indicate that Value Added Tax and Company Income Tax have positive significant impact on the economic growth of Albania.

The limitation of this study is that we have not taken in consideration the changes in time of the rates of Value Added Tax (VAT) and Company Income Tax (CIT). There are also other types of taxes that take part on the states revenues that can be taken into study in future researches.

Based on the findings of this study and the potential of the Albania in certain areas, since VAT has a higher impact in state's revenues, we recommend using differential VAT rates. Referring to Albania's opportunity for integration into the European Union and increasing

income, we recommend that Albania should consider the possibility of expanding the taxable base by lowering the registration threshold.

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