



<https://ijecm.co.uk/>

# THE VAT REDUCTION OF BASKET FOODS, IN THE CONDITIONS OF INFLATION, AS AN INSTRUMENT OF FISCAL POLICY IN ALBANIA

**Mariglen URUÇI**

PhD student, Faculty of Economy & Agribusiness, Agricultural University of Tirana, Albania  
u.mariglen@yahoo.com

**Arben KAMBO** 

Departments of Mathematics Informatics, Faculty of Economics & Agribusiness  
Agricultural University of Tirana, Albania  
akambo@ubt.edu.al, <https://orcid.org/0000-0002-2962-9780>

## **Abstract**

*The study analyzes the structure of expenditures of individuals or households in Albania, how much they spend on food basket products, do they meet their consumption needs, and the impact of Value Added Tax (VAT) on food basket products under inflation conditions and proposes a new VAT rate on this category of goods. Consumption is the largest component of the Gross Domestic Product (GDP) of the country and represents private consumer spending on consumer goods, making up the most important element of aggregate demand. In the conditions of a post-Covid 19 crisis with rising inflation, reducing the VAT rate for food basket products would lower the prices of these products and, in turn, would increase consumer savings and greater fulfillment of their consumption needs, especially the families in need, which are a considerable number in Albania. According to the Keynesian hypothesis of absolute income, consumption and saving are a function of income and have a positive relationship between them. It analyzes the impacts. Given the internal pressure to apply reduced VAT rates for food and the limited space for increasing the standard VAT rates, which are already at a relatively high level, Albania should focus on finding more and more other measures to increase additional VAT revenues improving the efficiency of the VAT system.*

**Keywords:** Food basket goods, consumption, VAT rate, inflation, income, savings



## INTRODUCTION

Nowadays, the economic crisis of rising prices has also involved Albania. This economic crisis, characterized by high unemployment, inflation, and low wages, affects the reduction of purchasing power in the market. Socio-economic effects will result in an increase in poverty, deterioration of welfare, and social marginalization of lower-income families. According to the World Bank, most Albanian households don't meet their food needs, while according to Eurostat, Albania is the lowest minimum wage country in Europe (40,000 ALL per month or about 380 Euros per month) and in the Western Balkans, while living is getting more expensive including the basic basket of food. According to the International Monetary Fund (IMF), Albania ranks as one of the poorest countries based on income per person for 2023 and the country with the lowest wages compared to other countries in the region such as Montenegro, North Macedonia, Serbia, and many times lower than the European Union (EU) countries. Basket food consumption accounts for half of the household income budget, so an increase in prices as a result of an increase in inflation would result in a decrease in consumption, less demand for basket food products, and a non-meeting of consumer needs, especially those with low incomes. The final objective of the government's fiscal policies is the implementation of fiscal policies aimed at increasing social welfare, and economic development, through proper planning of a country's state revenues and expenditures, where one of the keys to the fiscal policy is "value added tax" (VAT). Actually, for businesses registered with tax liability "VAT", the VAT application rate on food basket products is 20%, one of the highest rates compared to other countries in the region or the EU.

The main purpose of this study is to measure the effect of applying a reduced VAT rate to basket foods in inflation conditions, compared to EU countries, to increase the purchasing power of vulnerable consumers, meet their consumption needs, redistribute income, reduce poverty and increase welfare, especially for low-income families. In addition, we will analyze what impact a reduction in VAT rates on food basket products might have and will address this approach based on the application and practices of reduced VAT rates in EU countries.

## VAT AND REDUCING ITS RATE FOR BASKET FOODS

VAT is a tax instrument widely used in the European Community and VAT revenues account for about 20% of the total revenue collected in the community (European Commission 2006 a). The VAT system has been deployed in more than 80 countries around the globe (International Tax Dialogue, 2005). For the first time in Albania, VAT is implemented according

to the requirements of law No. 7928, dated 24.04.1995 and applied in 1996. According to the tax legislation<sup>1</sup>, VAT is a general tax on the consumption of goods and services, proportional to their price, which is charged at each stage of the production and distribution process and applied as a percentage tax on the price of goods and services and becomes required to pay after the VAT deduction directly burdens the elements of the cost of goods and services. This tax is paid: for all taxable supplies of goods and services carried out against payment, within the territory of the Republic of Albania, by a taxable person acting as such, and, for all imports of goods in the Republic of Albania. The standard rate of this tax, which applies to supplies of goods and services is 20%, unless otherwise provided in the law. Currently, all entities that have an annual turnover of over 10 million ALL (Albanian Lek) have the obligation of included in this regime.

One of the options to consider during the period of economic crisis is reducing the rate of VAT as an instrument of fiscal policy, for basket foods. A standard VAT rate for basket food will reduce the consumption of goods purchased by the consumer because it will be included in their prices. So a consumer will pay tax on the payment of his purchases. (James and Nobes 2010, pp. 239, 244). The reduction of the VAT rate for food basket products results in lower prices for consumers (Bernal 2018). Many economists have been against the uniform VAT rate because of attempts to reduce economic welfare and make products less attractive to buy; if the demand falls, production can also fall. A reduction in the VAT rate for basket products has its advantages and disadvantages. The advantages of reducing the VAT rate are: improves the economic welfare of people, consumers can buy more products by meeting their consumer needs and the demand is growing as demand increases, production increases. Low-income households will circulate savings from reduced VAT in the economy, improving the redistribution of income after consumption, which means savings. The disadvantages of reducing the VAT rate are: high-income families also benefit; there will be higher administrative costs; there will be a lower income in the state budget, and an increase in food consumption will contain the risk of rising threats to biodiversity.

## **CONSUMPTION AND INFLATION**

As we noted above, consumption is the largest component of GDP and almost half of the household income budget goes to consumption of basket food as shown in the table 1.

---

<sup>1</sup> According to Articles 1 and 2 of Law 92/2014, dated 24.07.2014 "On the tax on added value in the Republic of Albania" (as amended)

Table 1: The average monthly consumption expenditures structure of the Albanian households, 2021–2022

Main groups	2022 (%)	2021 (%)
Food and non-alcoholic beverages	39.7	41.3
Alcoholic beverages and tobacco	4.2	3.8
Clothing and footwear	5.0	4.6
Housing, water, electricity, gas, and other fuels	9.8	10.0
Furnishing, household equipment, and routine maintenance of the dwelling	6.5	6.8
Health	4.3	5.4
Transport	6.9	6.3
Communication	3.9	3.9
Recreation and Culture	2.7	2.8
Education	3.5	3.3
Restaurants and hotels	7.3	5.5
Miscellaneous goods and services	6.3	6.2
Total	100.0	100.0

Source: INSTAT, Household Budget Survey

The consumer basket serves to describe the structure of the average household consumption (the methodology in detail is explained in the Albanian Statistical Office INSTAT). In 2021 and 2022, Albanian households spend the largest part of their income on food and non-alcoholic beverages, almost half of their monthly income. Albania has the highest monthly expenditures on food and non-alcoholic beverages compared to other countries in the region such as Serbia 26% or Bosnia Herzegovina and North Macedonia with 31%. In the following table, we will reflect the monthly consumption according to prefectures and average monthly consumption in Albania in (ALL Lek).

Table 2: Monthly consumption expenditures by prefecture

Prefecture	2022	2021
Berat	82,850	77,402
Dibër	72,724	72,048
Durrës	83,473	77,925
Elbasan	75,899	74,609
Fier	83,371	80,752

Gjirokaštër	81,522	76,877
Korçë	85,398	83,591
Kukës	73,099	71,636
Lezhë	82,557	78,163
Shkodër	83,014	78,764
Tiranë	104,426	99,416
Vlorë	79,337	75,481
Total ALL	88,367	84,548

Source: INSTAT, Household Budget Survey

As noted by the table above, monthly consumption expenditures for 2021 are 84,548 ALL or about 805 euros and for 2022 it is 88,367 ALL or 842 euros (1 Euro = 105 ALL). Albanian households have the lowest income level per capita in one month in Europe. One of the most “thieves” of this income is the economic crisis of inflation. The increase in prices of products in the main, especially basic products, is felt most strongly in low-income households and weakens their purchasing power. While the inflation rate in Albania in February 2023 reached 7.1%, (INSTAT 2023), the prices of the food group increased by 11%, and there were even food basket items that for this period increased about 4 times, making them more expensive than the cost of living. Thus, households with incomes that have the same level or increased not proportionate to the inflation rate, will buy fewer products, which leads to the non-meeting of consumption needs. This will also bring socio-economic effects such as increased needs and deterioration of welfare, where according to the World Bank, most Albanian families do not meet their food needs. Faced with such crises, one of the mechanisms that the government can use is to apply the reduction of the VAT rate for basket foods. Such mechanisms that have applied the reduction of VAT rate for basket products have also been used in the most developed EU countries such as France, Germany, Spain, Italy, Portugal, Poland, etc.

## AN APPROACH WITH EU COUNTRIES

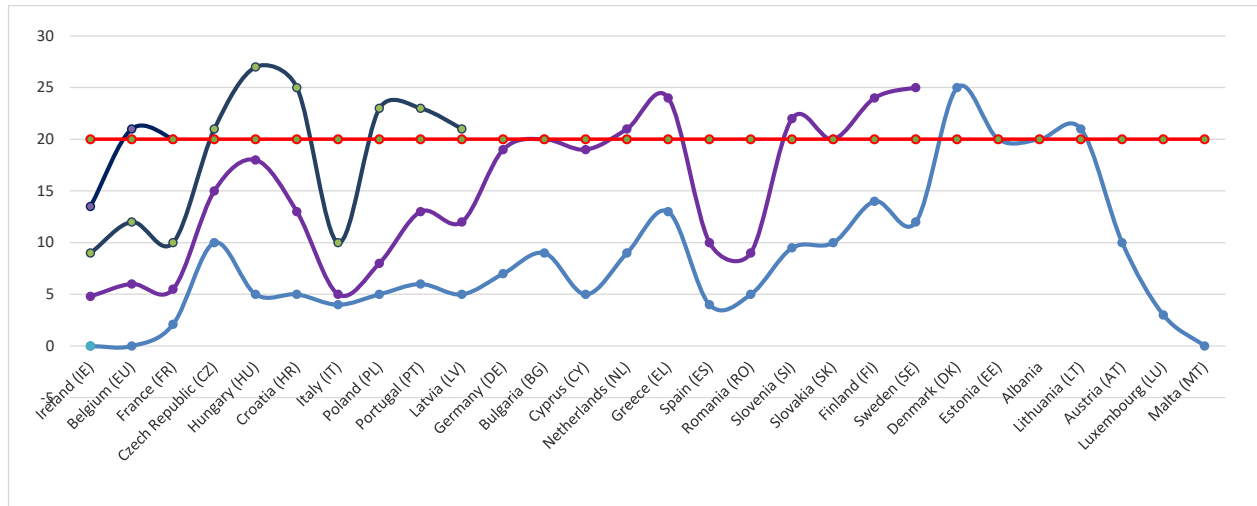
In the post-COVID-19 crisis, the world economy faced an increase in the unemployment rate and an increase in the overall price level. This was even more important for the low-income population. Many developed EU countries apply reduced VAT rates to basket food to vulnerable families. The following table presents the standard rates and reduced VAT rates applied in EU countries.

Table 3: VAT Rates among European Union  
Member States, on January 2023

Country	Super-reduced Rate (%)	Reduced Rate (%)	Standard Rate (%)
Austria (AT)	–	10/13	20
Belgium (BE)	–	6/12	21
Bulgaria (BG)	–	9	20
Croatia (HR)	–	5/13	25
Cyprus (CY)	–	5/9	19
Czech Republic (CZ)	–	10/15	21
Denmark (DK)	–	–	25
Estonia (EE)	–	9	20
Finland (FI)	–	10/14	24
France (FR)	2.1	5.5 / 10	20
Germany (DE)	–	7	19
Greece (GR)	–	6/13	24
Hungary (HU)	–	5/18	27
Ireland (IE)	4.8	9 / 13.5	23
Italy (IT)	4	5/10	22
Latvia (LV)	–	5 / 12	21
Lithuania (LT)	–	5/9	21
Luxembourg (LU)	3	7	16
Malta (MT)	–	5/7	18
Netherlands (NL)	–	9	21
Poland (PL)	–	5/8	23
Portugal (PT)	–	6/13	23
Romania (RO)	–	5/9	19
Slovakia (SK)	–	10	20
Slovenia (SI)	–	5 / 9.5	22
Spain (ES)	4	10	21
Søeden (SE)	–	6/12	25

Source: European Union, “VAT rules and rates,” European Commission

Figure 1: EU countries that apply some VAT rates to Food Products vs. Albania



Source: Eurostat 2022

Albania doesn't apply a reduced VAT rate for basket food products compared to countries such as France 5.5%, Germany 7%, or Italy 4%, but it has a standard VAT rate. In our study, we refer to Latvia, which in 2012 reduced the VAT rate on fruits and vegetables from 21% to 5% and the average VAT rate from 21% to 12%. These fiscal policies were monitored for 3 years by the Latvian government and as a result, there were decreases in prices, but these reductions were less than the reduced VAT, so they were not proportionate to the reduced VAT rate. By ex-ante (Nipers et al. 2013) estimate, a reduction in the VAT rate from 21% to 12% would lower prices by 5.5%, while a reduction in the VAT rate for fruits and vegetables from 21% to 5% would lower prices by 11.7%.

## METHODOLOGY

In this paper, quantitative methods are used. This method is considered more efficient as it ensures the collection and processing of data that are structured and can be present numerically. Descriptive statistics methods and graphic methods of description were also used. Careful research and processing of data is carried out in such a way as to have the most reliable and valuable results. The data are taken from surveys and bulletins of INSTAT, tax legislation, domestic and foreign literature, as well as various economic scientific journals and publications. The paper is based primarily on secondary data, which consists of using VAT literature with its specifications and applications, by referring to authors' studies and analysis on value-added tax rate reduction in particular.

## RESULTS

For this study, we will take into account consumer spending, consumer expenditures on food goods and non-alcoholic beverages, and the effects of the VAT rate on these products. We will also analyze what is the effect of a reduced VAT rate on the products of the presumed basket under the following formula:

$VAT = C * \frac{\tau}{1+\tau}$  Where, C is the amount of consumer expenditure including VAT,  $\tau$  is the VAT rate applicable to considered consumption.

Table 4: Analysis on standard and reduced VAT rates

Year	Average monthly consumer spending (ALL)	% of spending on basket food consumption (ALL)	Monthly consumption expenditures on food and non-alcoholic beverages (ALL)	Annual consumption expenditure on non-alcoholic foods and beverages (ALL)	Applied VAT 20% (ALL)	Reduced VAT, assumed 6% (ALL)
<b>2022</b>	88,367	39.7	35,082	420,984	70,164	23,829
<b>2021</b>	84,548	41.3	34,918	419,016	69,836	23,718

Source: INSTAT, calculation of authors

In the above table, we analyzed annual household consumption expenditures on non-alcoholic foods and beverages based on data obtained by INSTAT for the years 2021-2022. In total, the VAT rate for non-alcoholic beverages and food is analyzed, which shows that in 2021 a household pays an average VAT on this product category of 69,836 ALL or about 665 euros per year and for 2022 a household pays an average VAT on this product category 70,164 ALL or about 670 euros per year. Based on these data on consumption, if we assume a reduced VAT rate of 6% for this category of products, then for 2021 a household would pay an average VAT on this product category of 23,718 ALL or about 225 euros/year, and for 2022 a household would pay on average VAT on this product category 23,829 ALL or about 227 euros/year. Referring to the period 2021-2022, a household would save on average for 2021 about 440 euros and for 2022 about 443 euros. So, a family will be able to save more than a monthly minimum wage (380 euros/month) during the year and can increase their purchasing power and meet their consumption needs if the costs are incurred in entities registered with VAT tax liability. This is another gap since if they buy in entities that are not tax liability VAT, then do not benefit from the reduction of the prices of basket products in proportion to the VAT rate and these entities benefit by not paying this tax in the state budget. On the other hand, with a new



reduced rate for basket foods, we will have a better distribution of income after consumption by improving the socio-economic aspect of low-income households. However, according to (Filmer et al. 1998), and (Gauthier 2007) the agreement between increasing public revenues and the implementation of poverty-fighting programs is not verified in the short term.

## CONCLUSIONS

Albania is one of the countries with the lowest wages in the region and wide and one of the countries with the lowest income per person. In Albania, the standard VAT rate for food products is 20%, unlike many developed countries of the EU, which apply a lower rate on food basket goods. Also, in Albania, there are out-of-taxation VAT subjects with annual turnover below 10,000,000 ALL (about 95,000 EUR), which are not obligated to be registered with VAT tax responsibility. This creates avoid as these goods are not sold 20% freely after the tax burden is paid by the consumer, and on the other hand, are missing revenues in the state budget if they were responsible for the VAT tax. As in the case of VAT applied on the sale of books, and accommodation in hotels, which are applying reduced rate, we recommend a 6% VAT rate application on food products. In the condition of inflation and economic crisis, a supposed reduction in the VAT rate of 6% would enable low-income households or consumers to buy more food products, redistribute income after consumption, increase their purchasing power, and recirculate their savings from VAT reductions again in the economy by meeting their basic consumption needs and improving their socio-economic standard of living. Preferential VAT regimes such as reduced rates and exemptions can also add significantly to the complexity of the VAT system. A more effective policy to achieve distributional objectives may be to generally reduce the scope for reduced VAT rates, where possible, the use of measures directly aimed at increasing the real income of the poorest families and public services for these families. However, in Albania, it is difficult or impossible to implement it in practice. The economic obstacles to expanding the VAT base are indeed great, especially when the system of support and social transfers and benefits is not effective enough to ensure that the poorest families, who are significant in number, are properly compensated for the impact of VAT increase for the cost of their food consumption basket. Given the internal pressure to apply reduced VAT rates for food and the limited space for increasing the standard VAT rates, which are already at a relatively high level, Albania should focus on finding more and more other measures to increase additional VAT revenues, improving the efficiency of the VAT system. These measures mainly include VAT collection for supplies of goods and services from online sales and measures designed to improve compliance and efficiency of exceptions and differentiations in previous periods as well as combating fraud.

## LIMITATIONS & FURTHER STUDIES

The reduced VAT rate proposed by this study can serve as the beginning of a more in-depth analysis of the problem. More analytical studies are needed to better specify the differentiated rates for VAT of food items and exemptions. More in-depth analyses of the role played in the economy of differentiations and exemptions for sectors and special goods in the past are needed. More detailed studies including the list of food items and the differentiated VAT rates.

## REFERENCES

- André M. Biotteau A. (2019). Effets de moyen terme d'une hausse de TVA sur le niveau de vie et les inégalités : une approche par microsimulation
- Copenhagen Economics (2007), Study on reduced VAT applied to goods and services in the Member States of the European Union Final report
- De Quatrebarbes C. ,Boccanfuso D. ,Savard L. (2011). La fin des exonérations de TVA est-elle favorable aux pauvres ? Le cas du Niger.
- Enache C., (2023). VAT rates in Europe.
- General Directorate of Taxes, law no. 92/2014, dated 24.07.2014 "On value added tax in RSH" (amended)
- Haliti B. (2014). Fiscal policies in Kosovo and their harmonization with the countries of the region and the EU. /No. 6 04.04. 2014.
- Institute of Statistics, INSTAT (2021-2023).
- Mancellari A., Haderi S., Kule Dh., Qirici S., (2002). "Introduction to Economics"
- Moberg E. a,\* , Sall S." b , Hansson P. a , Rööös" E. a, (2021). Taxing food consumption to reduce environmental impacts – Identification of synergies and goal conflicts.
- Monitor Magazine, April 2023
- Monitor Magazine, March 2023
- Nipers A.1 , Upite1 I., Pilvere I.1 , Stalgiene A.2 , Viira A. 3. (2019), Effect of VAT rate reduction for fruits and vegetables on prices in Latvia: ex-post analysis
- Široký J., Kovářová A., Randová K. (2012) - The role of the value-added tax on foodstuffs in the consumer basket, Agric. Econ. Czech, 58, 2012 (8): 387–395
- Taxes in Europe Database v3". [https://europa.eu/youreurope/business/taxation/vat/vat-rules-rates/index\\_en.htm#shortcut-5](https://europa.eu/youreurope/business/taxation/vat/vat-rules-rates/index_en.htm#shortcut-5)
- Thomo L. (2021). Exploring the impact of VAT reduction for goods and services consumption expenditures, ISSN 2410-3918