

# *The Efficiency of Fiscal System from the Albanian Taxpayers' Viewpoint* \_\_\_\_\_

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## **Abstract**

*In order to build an efficient fiscal system, it is important to analyse not only the government's activity in the design and implementation of fiscal policy and fiscal system administration, but also how such activity is perceived by taxpayers, as one of key stakeholders of this system. Fiscal policies implemented by governments over the years are largely focused on the objective of realizing budget revenues, rather than building an efficient fiscal system that produces consistent results. This paper addresses the efficiency of the fiscal system, in the perspective of Albanian taxpayers' viewpoint, by focusing on three main directions: Fiscal burden. What is the fiscal burden and a general information on the fiscal burden in Albania compared to the region countries and the EU, and how the current fiscal burden is perceived by Albanian taxpayers. Fairness (Justice) of the fiscal system. Deals with horizontal justice and vertical justice, the principles of well-functioning of a fiscal system and their implementation in Albania, as well as the perception of Albanian taxpayers on the justice system of the fiscal system. The goods and public services received by the taxpayer in comparison with their contributions. Good public governance offers good and low-cost services and with the right standards. It also looks at how efficient the Albanian governments were in providing public goods and services, and how the taxpayers perceived the benefits they received compared to their contributions. The paper concludes with the main conclusions of the functioning of the current fiscal system and recommendations for improving the system based on the perception of taxpayers.*

**Key words:** taxpayers, fiscal policy, fiscal burden, fiscal justice, public services, fiscal efficiency.

## **Introduction**

The main objective of fiscal policy is to generate sufficient income to guarantee democracy, public order and the functioning of the rule of law. An efficient fiscal system should be not only a source of revenue for the functioning of the state, but it must ensure that the government actively contributes to achieve its political, economic, social and environmental objectives. The fiscal system is an important tool for redistributing incomes to citizens and social cohesion in society. Taxation is an important instrument that influences the behaviour of individuals.

When designing and implementing the fiscal policy, the effective provision and use of resources, particularly public resources, plays an important role, with the aim for the policy to achieve its respective objectives for economic growth and employment. Various researchers emphasize that it is not important to analyse only the impacts of government actions on how to secure and use revenue, but also how these actions are perceived by all stakeholders involved in the process.

## **Fiscal burden in Albania and in the Balkans**

The main objective of an efficient fiscal policy is to increase revenues, while maintaining the taxpayer's equality, in terms of respective tax burden they bear. The ability to pay taxes is usually measured by the income that a business generates or produces. The fiscal burden has a significant impact on a country's budget deficit, investments and economic growth.

During recent years, Western Balkan countries, including Albania, have been focusing on a fiscal policy of decreasing income tax, as well as increasing VAT rate, where none of these countries intended to make a fiscal policy that focuses on reforming the tax system. Instead they are focused on some minor changes, aimed at increasing fiscal consolidation, as well as granting tax facilities to certain groups within national economy activities.

The indirect tax base still remains narrow, and this requires a review of model's adaptation to the economic and social environment. Also, it is not concluded that a poor performance in indirect tax collection, should be compensated by an increased direct tax payment, especially the personal income tax.

The percentage of direct and indirect taxes on tax burden has remained unchanged in 2016, when compared to the previous year.

**TABLE 1:** Structure of taxes (in %)

Type of tax	2015	2016	2017
Indirect taxes	65	65	65
Direct taxes	35	35	35

Source: Ministry of Finance, Albania

This indicates for a tax burden that is still maintained by the Albanian consumer, and not from the real economy. On the other hand, this reflects the need for a fiscal policy modification, to shift the burden from consumption to capital, where mostly rich individuals and large businesses should bear the main weight in this regard.

There are three main discussion issues for Albania, in order to achieve a better management and efficiency of indirect taxes, especially of VAT as the main source of tax revenues:

*First*, the VAT registration limit. Changes made by the government to the recent fiscal package, by way of lowering VAT registration limit for businesses, running a total annual turnover of up to ALL 2 million, will expand the tax base by significantly increasing the number of businesses declaring and paying such tax. It is thought that this change will lead to a greater formalization of the economy, but the impact of such reform will be assessed in the following tax periods and this will depend, to a greater extent, by the capability of fiscal administration in managing this tax.

*Second*, imposing progressive VAT rates. During this period, Bosnia and Herzegovina and Albania apply a standard VAT rate of 20% only, whereas all other Balkan countries apply reduced VAT rates. The reduced rates are mainly applied to vital consumption products, such as: health care products, electricity supply, as well as books, magazines and cultural & sports activities. Therefore, even for Albania, applying progressive VAT rates, accompanied with an increasing administrative capacity, would be a move that would lead to an increased effectiveness of such tax.

*Third*, applying VAT exemptions for certain supplies. Generally, fiscal policies, a simple tax administration, tax justice (fairness) and economic neutrality of taxation are arguments which support a minimum use of tax exemptions. Various economic, political, social and tax administration situations in Albania and elsewhere have influenced the application of VAT exemptions. As above noted, the case of VAT exclusion for low turnover entities (small businesses with annual business turnover up to ALL 2 million), is a kind of general exclusion of all supplies of goods and services by subjects with a lower turnover than the VAT minimum limit. In many cases it is assumed that “exemptions” result in a VAT reduction burden on supplies. In order to avoid distortions, caused by the failure of VAT deduction for paid

purchases, a good policy may be followed by not excluding the supplies that are made for purely business activities.

The fiscal policy pursued by Balkan countries, regarding tax rates, has not had the expected impact on the economic growth of these countries.

**TABLE 2:** Fiscal Burden in Western Balkans for 2014-2018, in % of GDP.

	2014			2015			2016			2017			2018		
	Direct	Indirect	Soc.Sec/ Others	Direct	Indirect	Soc.Sec/ Others	Direct	Indirect	Soc.Sec/ Others	Direct	Indirect	Soc.Sec/ Others	Direct	Indirect	Soc.Sec/ Others
Kosovo	3,4	17,4	3,1	3,4	18,5	3,2	3,9	19,6	2,8	3,7	19,6	2,9	4	20,5	2,3
ALBANIA	4,6	12,2	7,3	4,6	11,8	7,3	5,1	11,9	7,8	5,3	12,3	8,1	6,1	11,6	7,7
Northern Macedonia	3,3	12,4	8,8	4,4	11,8	9	4,2	12,2	8,9	4,4	12,2	8,9	5,7	11,7	9,2
Serbia	7,8	15,9	11,3	7,6	16,1	10,9	7,5	15,9	11,7	7,5	16,7	11,9	8,5	16,7	12,8
Bosnia-Herzegovina	3,4	18,5	15,7	3,5	18,5	15,5	3,7	18,4	14,9	4,1	18,6	15,2	4,1	19,2	15,1
Croatia	5,7	16,40	14,20	5,5	17,1	14,3	5,6	17,5	14,5	5,7	18	14,9	9	18,5	12
Montenegro	8,4	18,9	11,8	7,9	17,2	10,9	8,1	17,3	10,7	5,8	19	11,7	6,2	20,4	11,8

Source: IMF, Ministry of Finance & Economy, ALTAX.

Changes made in the income tax rate, in cases of its reduction, have aimed to an expansion of the taxable base, but with an objective of not affecting budget revenues and fiscal stability. Regarding the income tax, Greece, Croatia, Albania, Serbia and Romania apply an above-average tax rate, while Montenegro, Kosovo, Macedonia and Bosnia and Herzegovina apply a below-average tax rate.

Studies regarding changes in consumption and capital tax rate show that they are less influential in the economy than changes in personal and labour tax rates, where shifting the tax burden from consumption and capital to labour and individuals is a rather difficult task for governments of these countries.

From the perspective of fiscal policy for Balkan countries, it is not considered as efficient the implementation of a comprehensive reform policy that is not based upon a higher management level and efficient fiscal capacities.

Tax revenues in Albania make up the bulk of budget revenues for 2016 and 2015, just 24.4% and 24.1% of GDP, respectively.

**TABLE 3:** Structure of tax revenues, in %.

Tax revenue	2015	2016	2017
Taxes and Customs	76.1	74.9	73.8
Local government	3.4	4.1	4.6
Social and health insurance	20.5	21	21.6

Source: Ministry of Finance, Albania.

As for the fiscal burden in Albania, tax revenues and customs in 2017 are 73.89% of total tax revenues, with a decrease of 1.1 percent. This decrease in

central government income is compensated by local governments' revenues with a weight to the total by 4.6%, where their growth compared with the previous year was 0.5%. Likewise, insurance contributions, in 2017, have a weight of 21.6% of total income. The increase with 0.6% for these incomes results from labour formalization, as well as legal changes regarding the removal of income tax ceiling for health insurance calculating purposes.

The collected revenues, which coincide with central customs & tax administration activities, constitute the main part of tax burden, as 17,9%, 18,3%, 18.7% of GDP for 2015, 2016 and 2017, respectively. This increase is mainly due to increases in income taxes and other taxes on capital, national taxes and increased excise duties.

In recent years there is a declining tendency of indirect tax burden and a slight increase in direct taxes, where the greatest impact is on corporate and personal income tax. This reflects the impact of the government's fiscal policy which aims at redistributing revenues by benefiting more taxes from capital gains.

## **Fiscal System Fairness**

The process of preparing fiscal packages by the government should be subject to a broad discussion with taxpayers, before defining fiscal burden, as taxes need to be properly perceived, in order to guarantee the tax equality, they should pay. This would also significantly increase the taxpayer's tax obligations and the state budget revenues.

During all these years, all governments have not made such a discussion with all stakeholders (taxpayers) and in cases when it has been happening, their opinion has been rarely taken into account.

The basic principle, upon which a fiscal policy is based upon, and the country's fiscal system is built, is the *principle of justice (fairness)*. This principle requires equal treatment of all taxpayers. Justice (fairness) in the fiscal system should be applied in the horizontal aspect, where taxpayers under the same, or similar circumstances, should be treated equally, likewise in the vertical aspect, where higher-income taxpayers must hold a higher fiscal burden, thus placing the fiscal burden progressively, as revenues go up. The principle of justice, in terms of fiscal administration, requires that the law should be applied in a comprehensive, fair and neutral manner, regardless of the taxpayer's status. No one should have preferential, or discriminatory treatment, when implementing the law. Also, the principle of justice implies that tax legislation does not contain any discriminative criteria against taxpayers, or certain taxpayer groups. So, it is not enough just to project the fiscal system equally, but it is very important to function efficiently, since taxation should be guaranteed by procedures that it really works fine.

In the implementation of horizontal justice, equal treatment of taxpayers, still taxpayers in the same or similar circumstances, are not treated equally for various reasons (corruption in fiscal administration, their connections and recognitions, political creeds, etc.) Even in the application of vertical justice it is concluded that, for the moment, labour income is taxed more than capital income, so the labour that is rewarded through wages is taxed more than self-employment, as result of a considerable freedom of action enjoyed by self- employed and professionals, in determining their taxable income. In addition, indirect tax rates, especially for excise goods, vary by increasing the tax burden, whenever the government has problems in realizing tax revenues.

An important principle is that *the fiscal system should be simple, transparent and easy to administer*. Thus, the fiscal system should be easily understandable and applicable, not only by the fiscal administration, but also by taxpayers and their consultants. Transparency should be such as to enable taxpayers to understand the functioning of the system. There are cases in fiscal practice, where the system is difficult to understand and followed by taxpayers themselves, as well as to be administered by tax administration. This not only increases the cost of tax administration for taxpayers and fiscal administration, but it creates complicated schemes that can lead to tax and fiscal evasion.

Another principle is *fiscal system efficiency*, so that a fiscal system should be designed in such a way as to encourage the maximum of a country's economic development. This is achieved when the tax system affects, as little as possible, the pricing system and competition. Thus, the tax system should equally weigh on different sectors and be neutral, in terms of making business decisions. This requires a functioning system that leads to an accomplishment of pre-defined objectives.

It is important, for the efficient functioning of the fiscal system to respect taxpayers' rights and obligations, which are sanctioned in the law and taxpayer card, such as: (1) *the right of information*, where taxpayers have the right to have continuous information on the functioning of the tax system and the ways of calculating tax liabilities; (2) *the right of appeal* to any tax administration decision, regarding the determination of their tax obligations, or violation of legal and regulatory acts by the officials of fiscal administration; (3) *the right to pay the correct amount of tax and to be treated accurately* by fiscal administration; (4) *providing reasonable and timely assistance from fiscal administration*, in order for the taxpayer to be able to meet the obligations within the deadlines set out in relevant legal and regulatory provisions; (5) *the right of taxpayers to predict the tax consequences of their activity*; (6) *the right of confidentiality*, in order to avoid misuse of information, received by fiscal authorities; and (7) *the right of representation, in relations with the tax administration*. Also, it is important that the taxpayer, in addition to the rights,

should meet respective obligations for: *identification, information and enforcement of fiscal legislation*.

Respecting taxpayers' rights from the fiscal administration and the meeting obligations from taxpayers will significantly increase the efficiency of fiscal system's functioning and revenues in the state budget.

## **Public goods and services that taxpayers receive compared to their contributions**

The main function of public organizations is to provide goods and services to citizens with low cost and in the right quality and standards. Public organizations provide a significant amount of goods and services, which require large financial resources, where the main part of these resources is realized by the fiscal system (taxes).

Public organizations need to make enough efforts to follow good public governance principles in fiscal and budget issues. The better the governance is, the greater the taxpayer's confidence in the government, and the greater their willingness to pay taxes.

The tax system is an important tool for income redistribution to citizens, solidarity and social cohesion in the society. Also, tax is an instrument that influences people's behavior. Contemporary infrastructure, modern healthcare, appropriate education policies, active employment and environmental protection require the use of substantial funds from public finances.

If taxpayers receive a fair compensation in public goods and services, they will be willing to pay the price for it, otherwise they create the idea that their money is not spent properly and, in this way, they will not be willing to contribute properly.

Also, for reasons of social justice, a progressive VAT should be applied, where basic goods and services should be taxed at a lower rate, compared to benefits and other services. In order to protect the living standards of vulnerable groups in society, special care must be taken to ensure that indirect taxes are not overly dominant, in the tax system. Also, from a social point of view, direct taxes should have priority over indirect taxes. Capital income tax should be comparable to personal income tax.

A good governance, in the area of budget and fiscal policies, can only function if there is a supporting behaviour culture, in line with public-oriented rules. Creating such a culture requires a long, continuous and gradual process of changing attitudes and governing actions, as the lack of this culture will not create the right trust in government and thus it will be difficult for taxpayers to pay taxes through self-declaration.

## Conclusions

Determining the fiscal burden should be the main purpose of a government's transparency, in drafting and implementing fiscal and budget policies; if this burden is not equally distributed, some economic costs will build up, which will lead to distortions in the economy.

The drafting and implementation of an efficient fiscal policy that stimulates a country's economic resources development should not only be based on changing tax rates but should orient fiscal burden on those segments of taxpayers who have the greatest opportunity. If tax cuts are not conceptualized with policies and other reforms to be undertaken by the government then this will lead to an increase in the budget deficit.

In Balkan countries, including Albania, it is noticed that the fiscal burden is still maintained by consumers and not by the real economy, thus reflecting the need to modify fiscal policy to shift the burden from consumption to capital, where rich individuals and large businesses should be the ones who should bear the main weight of such burden.

The implementation of a comprehensive reform policy is considered efficient if it relies on a higher level of management and efficient functioning fiscal capacity.

The basic principle upon which a fiscal policy is based is *the principle of justice (fairness)*. This principle requires that the law should be implemented in a comprehensive, fair and neutral manner, regardless of the taxpayer's status, so no one should have preferential or discriminatory treatment during law enforcement. It is not enough just to design a fair fiscal system, but it is very important for it to function efficiently, as taxation should be guaranteed by procedures that work in practice. The fiscal system should be simple and transparent, easy to administer and built in such a way as to stimulate the development of the country's economic resources at the fullest. Also, for an efficient functioning of the fiscal system it is important to define and respect taxpayers' rights and obligations.

In the functioning of an efficient fiscal system it is important how such system is perceived by taxpayers. If taxpayers receive fair compensation in public goods and services, they will be willing to pay the price for it, otherwise they create the idea that their money is not spent properly and, in that way, they will not be willing to contribute. So, the better the governance is, the greatest the trust of taxpayers in the government, and the greater will be their willingness to pay taxes.

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