Abstract

The main objective of this paper is analyzing the impact of trade liberalization on fiscal balance in Albania. A strategy that is broadly used in literature is combination of reduction in custom tariffs as a consequence of trade liberalization with an increase of consumption taxes, basically the increase of VAT and the increase in excise rate of imports. The main findings are that reduction of custom taxes in not being reflected in total fiscal income. This means that tax reform in Albania has been successful in having sound fiscal incomes during the trade liberalization process. An important contribution related to this performance has been played by VAT reform, and changes of excise duties.

Keywords: Fiscal reform, trade liberalization, transition

Introduction

The focus of this work will be the impact of trade liberalization on fiscal balance in Albania. The general trend of the EU trade policy toward developing countries has been increase of trade liberalization and simplification of trade regime; see Auboin and Laird (1998), Woolcock (2007). For the EU applicant countries, opening of economy toward foreign trade have brought about many domestic policy adjustments. Trade liberalization is generally accompanied by fiscal adjustment to maintain fiscal consolidation. This adjustment is important and needs to be studied as it is related to political decision, with implication not only with regards to short term macroeconomic stability but also for longer period of time.

The trade policy followed by Albania during transition process has been that of trade liberalization. Albania has signed bilateral trade agreements with eight countries, Macedonia, Croatia, Bosnia and Herzegovina,
Serbia and Monte Negro, Rumania, Bulgaria, Kosovo, und Moldavia. All these agreements have become effective during the period 2002 - 2004. Besides these bilateral trade agreements, Albania has also signed other important agreements, such as that of March 2000 with European Council in Lisbon, saying that Stabilization and Association with west Balkan countries should be oriented towards asymmetric trade liberalization. The European Union signed in July a memorandum on liberalization and stabilization of trade with eight countries, including Albania. With regards to bilateral level, stabilization and association agreement with Albania started in February 2006. Albania has become a WTO member from 2000 and has liberalized customs regime in accordance with WTO disposal.

The goal of this study is to analyze fiscal reforms undertaken by governments, in different stages of trade liberalization. The investigation will try to find out whether these policies have been successful in maintenance of fiscal stability which on its part is necessary in definition of future course of fiscal policy.

Background

According to economic theory, the early effect of trade liberalization in trade balance will be the increase of trade volume, expecting increase both in volume of imports and exports. A strategy that is broadly used to combine reduction of custom tariffs, as a consequence of trade liberalization, is an increase of consumption taxation; basically increase of VAT and of excise rate for imported goods. Adjustment of both these taxes has been the center of fiscal reform in developing countries and has simplified them surpassing of substantial fiscal losses especially in short run in fiscal balance, see Emran and Stiglitz (2005), Bird and Rotman (2005), Aarnes (2004), Baunsgaard and Keen (2005), Tanzi and Zee (2000), Stosky and WoldeMariam (2004).

In their work, Tanzi and Zee (2000), besides the increase in consumption tax as part of fiscal reform, consider also the increase in income tax. Although use of this tax is limited, based on negative impact it has on investment and administration costs, this work will investigate for all possible strategies used by government to deal with fiscal losses caused by trade liberalization.

Imports are subject of VAT and excise taxes, and exports are generally excluded. Some authors such as Fitoussi (2005), argue that “[one possible hidden purpose for consumption tax could be the attempt to increase the competition. In reality, taxation of consumption between other things means taxation of imports and exclusion of export]”. A similar conclusion was drawn by Cnossen (2005) on excises applied on imported goods, he argues that “[excise tax brings about a discrimination of imported goods because exports are excluded]. Other authors such as Avi–Yonah and Margalioth (2006) have found evidence that the use of VAT has been more efficient than import taxes, because it does not discriminate between domestic and imported goods.

This work trying to make a comparison among countries’ VAT and excise structure will investigate for possible competitiveness incentives. Excise literature review puts VAT adjustment in the center of fiscal reform in developing countries and shows that this tax has been more efficient compared to import taxes. This study after making a complete analysis of fiscal package will focus more on the efficiency of fiscal adjustment in short run and will investigate if initial adjustment needs further adjustment in order to maintain fiscal stability.

Taxes of foreign trade and fiscal income

The following graph shows total fiscal income versus customs income from year 1997. In the beginning of year 1997 customs tax was accounting for about 45% of total fiscal income, in year 2000 it accounted for about 14% and, in year 2005 it was about 9.5%. The trend has been decreasing in time. Albania actually uses five levels of customs tariffs, as follows, 0%, 2%, 5%, 10% and 15%.

The period of time, when these agreements have been in power, is very important, because the higher effect in fiscal income is expected to be during the first year of customs reduction, where reduction is higher than the following years, where it is less. During 1999 - 2000 there has been exerted an intensive work by gov-
ernment to reduce fiscal evasion. During 2001 - 2005 the state administration returned normality and the possibility for fiscal evasion was significantly reduced.

As seen from the reported figures the total tax income has been increasing during whole period under survey. The total customs taxes and their share versus total tax revenue have been decreasing in time but without affecting total tax incomes. This means that tax reform in Albania has succeeded in ensuring sounds fiscal incomes during trade liberalization process.

Table: Customs reduction according bilateral agreements

<table>
<thead>
<tr>
<th>Year</th>
<th>2002</th>
<th>2003</th>
<th>1 January 2004</th>
<th>1 January 2005</th>
<th>1 January 2006</th>
<th>1 January 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macedonia</td>
<td>22 March</td>
<td>90%</td>
<td>80%</td>
<td>70%</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td>Croatia</td>
<td>27 September</td>
<td>80%</td>
<td>65%</td>
<td>50%</td>
<td>35%</td>
<td>20%</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>23 April</td>
<td>60%</td>
<td>40%</td>
<td>20%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Bulgaria</td>
<td>26 March</td>
<td>60%</td>
<td>40%</td>
<td>20%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Serbia and Montenegro</td>
<td>13 November</td>
<td>60%</td>
<td>40%</td>
<td>20%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Bulgaria</td>
<td>21 February</td>
<td>60%</td>
<td>40%</td>
<td>20%</td>
<td>0%</td>
<td></td>
</tr>
</tbody>
</table>

Source of data bilateral agreement

Albania Membership in WTO

Albania membership in WTO was approved on 17 July 2000. It became a member of WTO on 8 September 2000. Albania, in the framework of obligation from this membership, started since 2000 a process of reduction of customs tariffs, a process which went on with a continuous reduction year after year. The law number 8981 “On approval of customs tariffs” has been the basic law. This law has suffered amendments each year, reflecting changes in customs tariffs. These amendments are reflected in laws number 9159, 9330, 9462 for years 2003, 2004 and 2005 respectively.

EU and Albania

During 1992 was signed an agreement on trade cooperation between Albania and EU in the framework of Phare program. In year 1999 started the EU process of Association Stabilization with five South–East European countries, including Albania. The same year Albania gained trade preferences with EU. Year 2000 marked an increasing access of Albanian goods, without customs taxes with EU.

In the following table is calculated the RCA index which measures the comparative advantages of a country for specific commodity related to foreign trade partners.

\[
RCA_i^j = \frac{\left( x_i^j - m_i \right)}{\left( x_i^j + m_i \right)}
\]

RCA: Measures the comparative advantage of a country in the production of a specific commodity i related to a given country j
\( x_i \) is the value of export of commodity \( i \) in the given county \( j \)

\( m_i \) is the value of imports of the commodity \( i \) in the given county \( j \)

**Table: RCA index with main trade partners**

<table>
<thead>
<tr>
<th>Code</th>
<th>Commodity</th>
<th>Italy</th>
<th>Greece</th>
<th>Germany</th>
<th>Turkey</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td></td>
<td>-</td>
<td>--</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>SITC 1</td>
<td>Food, beverages, tabacco</td>
<td>--</td>
<td>---</td>
<td>--</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>SITC 2</td>
<td>Minerals fuels, electric current</td>
<td>+</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>SITC 3</td>
<td>Chemicals, rubber products</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>SITC 4</td>
<td>Leather and leather manufacture</td>
<td>--</td>
<td>--</td>
<td>---</td>
<td>++</td>
<td>-</td>
</tr>
<tr>
<td>SITC 5</td>
<td>Wood and paper products</td>
<td>-</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>SITC 6</td>
<td>Textiles, clothing, footwear</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>SITC 7</td>
<td>Construction materials and metals</td>
<td>-</td>
<td>--</td>
<td>--</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>SITC 8</td>
<td>Machinery and transport equipment</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Others</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
</tbody>
</table>

RCA values between 0.7 and 1 (+++)  
RCA values between 0.35 and 0.7 (++)  
RCA values between 0 and 0.35 (+)  
RCA values between -0.35 and -0.7 (--)
RCA values between -0.7 and -1 (---)

The presence of Albania in EU markets is specialized in textiles and footwear. Of course there is a strong tendency to preserve and improve this situation in the future. Trade with neighbor countries, Albania has comparative advantage in group of products Leather and Leather manufactures. From the above reported data the foreign trade position of Albania is not very good. There is much to be done from our government in order to improve the foreign trade position of the country.

**Customs incomes and VAT**

One strategy for compensation of incomes reduced by customs tariffs is by increasing consumption tax, basically VAT. All imported goods in Albania are VAT subject. In developing countries reduction of customs tariffs with an increase in VAT taxation has been in center of the reform (M. Shahe Emran & Josef E. Stiglitz 2005). (Richard M. Bird & Joseph L. Rotman 2005) – If VAT could be administered in an adequate way, it offers the best way to substitute the losses due to trade liberalization). (Dag Aarnes 2004) – Reduction of imported tariff as part of trade liberalization is possible to cause losses in short term budget incomes. These losses could be eliminated through reduction of tariff exclusions in existing tax system, through excise rate for imported goods, or through consumption tax like VAT changes. (Vito Tanzi, Howell H. Zee 2000) – Reduction of customs tariff in developing countries, as a requirement of WTO membership, or bilateral agreement on free trade signed between countries could translate into important consequences in budget income in these countries. Reduction of tariff, if not accompanied with other trade barriers, generally brings about lower levels of effective protection. It also could bring important budget losses, at least in short term before the imported goods volume has sufficient time to be adapted. Other measures very often involve increase in consumption tax; rarely increase in income tax because of the negative impact in investment and administration. (Reuven Avi –Yonah, Yoram Margalioth 2006) – The tax reform in developing countries is substituting custom taxes with consumption taxes. The aim of this substitution is generally improvement of macroeconomic stability and introduction of the profits from foreign trade in developing countries. VAT is more effective than imported taxes, because this tax doesn’t discriminate the goods produced in a given
country and imported goods. By eliminating import taxes, domestic consumer profits from lower prices in competition created between domestic and foreign producer, this strengthen the domestic producer to be more efficient and focus their efforts in comparative advantages).

**In Albania VAT is constituted by Law No. 7928 of 27 April 1995.** For imported goods is applied a standard rate of about 20%. For imported machineries and equipment from persons that are registered in tax offices is applied specific reimbursement of VAT. For this category of goods are not adapted customs duties.

**Table: Development of VAT in Albania**

<table>
<thead>
<tr>
<th>1995</th>
<th>2001</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>VAT 0% for exported goods and international services</td>
<td>Are excluded machineries and equipment</td>
<td>Are excluded from VAT: Renting public building, university services, casinos</td>
<td>Is placed VAT for the first sale of residences, for airplanes flying, for leasing services. Are excluded subcontracts and some services related to merchandise</td>
</tr>
</tbody>
</table>

*Source: Ministry of Finance*

**Excise tax**

The Law on excise in Republic of Albania that corresponds with time under survey in our study are:

**Table: Changes in excise duties**

<table>
<thead>
<tr>
<th>6 December 2004</th>
<th>4 August 2006</th>
<th>9 July 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>First group:</strong> Coffee</td>
<td>40lek/kg -250lek/kg</td>
<td>Increase 10lek/kg-20lek/kg</td>
</tr>
<tr>
<td><strong>Second group:</strong> Non alcoholic drinks</td>
<td>2 lek/liter</td>
<td>N/O</td>
</tr>
<tr>
<td><strong>Third group:</strong> Alcoholic drinks</td>
<td>20lek/liter-200lek/liter</td>
<td>Increase 20 lek for strong alcoholic drinks with alcohol more than 12%</td>
</tr>
<tr>
<td><strong>Fourth group:</strong> Tobacco</td>
<td>1500lek/kg-2240lek/kg</td>
<td>N/O</td>
</tr>
<tr>
<td><strong>Fifth group:</strong> Oil</td>
<td>13lek/liter-38lek/liter</td>
<td>N/O</td>
</tr>
<tr>
<td><strong>Sixth group:</strong> Cosmetic commodity</td>
<td>60% of their value</td>
<td>N/O</td>
</tr>
</tbody>
</table>

*Source: Ministry of Finance*
Both VAT and excise taxes have marked a positive impact on total fiscal revenues. Both taxes have been increasing during all the period of trade liberalization process. Adjustment of excise in year 2006 has reflected a small positive impact in budget income generated by it. It is noticed a significant positive impact due to a broadening VAT base during 2005, in level of total income generated by this tax during next year. Therefore both taxes have positively contributed in generating fiscal incomes and avoiding the negative impact of customs taxes reduction during trade liberalization process.

Conclusion
Trade liberalization in Albania is followed as expected by an increased volume both in import and export. Regardless the fact, that during 2002 - 2005 it is noticed a faster increase in export versus import, the trade balance deficit in Albania has been high and increasing as tendency. Trade with neighboring countries, Albania has free bilateral trade agreements, is low as opposed to total trade volume of the country. Liberalization process has marked a positive impact in increasing total trade volume with these countries. Total customs taxes share versus total budget revenue has been decreasing in time, without being reflected in total fiscal incomes generated by the government. This means that tax reform in Albania has succeeded in ensuring sound fiscal incomes during the trade liberalization process. An important contribution related to this performance was played by VAT reform and changes in level of excise.
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