Fiscal Policy Challenges for Countries that Join the EU

Ilda Kadrimi (Blaceri)

Artur Ribaj

Abstract

The choice of fiscal policy is one of the most controversial issues of the role of government in a country's social and economic life, not only by economists, but by a wider range of people.This article will discuss some of the issues on which the fiscal policy debate remains open. The analysis will focus on both the theoretical approach and the role that fiscal policy has played in our country, going further on some suggestions for the future. It will also analyze the status of fiscal policy in Albania seen in the context of fiscal sustainability. It will address the role that fiscal policy plays in social issues and the role of politics in the choice of fiscal policy. In a country with high level of poverty and an economy that requires large investments, the choice of fiscal policies is a controversial issue. This issue will focus on their impact on the economy of our country. The article concludes with conclusions and recommendations.

Keywords: Fiscal policy, Economy, Tax, Fiscal evasion.

Introduction

Fiscal policy is the use of government spending and taxes that affect economic activity. Fiscal policy is a very important topic in world literature. But also a difficult challenge for different countries, due to the competitiveness of the countries that have each other to attract foreign investment. But this challenge remains even more difficult for countries aiming to move towards the EU. Given the fact that Albania has been involved in the integration plans in recent decades and we are facing some dilemmas.

On one hand we aim for the EU but this will necessarily lead to fiscal policy approximation, not that we are directly asked for leverage or something like that, but it looks like the challenges will be the same, the need to raise revenue will be the same, and we also have a set of boundaries that will necessarily affect the different tariffs.

On the other hand, we aim for more foreign investment. But given this, we know very well that the biggest investors in our continent, but also very important in the world, are some of the EU countries. And as we are aligning policies with them, fiscal policy necessarily needs to be aligned with those of European Union countries.

Fiscal policy itself has several goals, such as: to reduce the impact of economic cycles on economic growth, in employment, and to assist in its growth in order to provide a higher level of employment.

Fiscal policy relates to government actions to change the composition of public revenues and expenditures, with the aim of managing aggregate demand to maintain sustained economic growth with relatively high employment, no inflation generation, no increase in public debt and. a satisfactory balance of payments. When the government is in charge of fiscal policy, it preliminarily evaluates a large number of factors including the performance of key economic and financial variables and indicators, due to their impact on the amount of tax revenue collected to meet the financing needs of government programs.

The discussion surrounding the impact of fiscal policy on economic growth is very relevant, as the development of appropriate fiscal instruments leads to continuous and sustained economic growth. The purpose of this paper is therefore to analyze the relevance of fiscal policy to economic growth in the case of a small country with an open and developing economy - Albania.

Methodology

The methodology is selected in accordance with the purpose of the study and includes various ways and instruments for collecting the necessary information. A methodology consisting of a combination of primary and secondary data was used to carry out this study. A considerable part of the secondary data is provided through the use of electronic libraries. The theoretical review is based on the legislation on the fiscal policy system. Information from various literatures has also served for this study.

The Qualitative Method, through which we provide understanding and clarification of case studies, research objects, from a historical and philosophical perspective, gathering data and information for the purpose of comparing cases or based on a single case study.

The Quantitative Method is used for the processing of which we rely on numerical data that are commonly presented in the form of statistics.

The methodology and methods which are used are:

1. Deduction - this method enables us to achieve research goals, starting with the general and reaching the intended target, namely the particular. In this case, the functioning of the value added tax, which is applied in most countries of the world in general, has been studied and analyzed and the focus has been on fiscal policy analysis.

2. Descriptive - here we have collected various materials and reports that deal with the study of taxes in general and in particular value the added tax in Albania. In this case, literature has been used by various internal and external authors, reports, studies by various agencies, and research published by organizations dealing with studies in this field. The design of this study is based on the following: Using local publications data from the: Ministry of Economy and Finance, Economic and Fiscal Council, Central Bank.

3. Comparative analysis - the materials used in this paper have been analyzed and compared with each other in order to be as objective as possible in the research.

4. Econometric model - is used to test the factors that affect it.

Hypothesis

"Reducing tax evasion is a key factor for the country's economic growth"

The hypothesis is an assertion expressed as a statement. The hypothesis should be considered as the formal version of the researcher's conjecture, which then he subjects this hypothesis to a complicated and detailed testing procedure, known as Hypothesis Testing. The hypothesis may predict a direction or express an acceptable relationship between variables.

What are known as basic or neutral hypotheses are very common, one case it might be "the average grade of a university depends on the average grade of high school", this is not true at all, there is no relation between the two parts of hypothesis. In this case the hypothesis is called null. The null hypothesis tells us that there is no correlation, whether similarity or difference between the subjects being compared.

Fiscal Politic

"… It is important to have the right monetary policy, but even more important is to have the right fiscal policy (*Warren Buffett*) because fiscal policy is expressed and based on relevant financial laws and consists of government intervention to meet the costs of the government through the administration of the revenue collected through the fiscal system. A typical and quite limiting problem that governments face in this area is fiscal evasion.

Fiscal revenue is the main source of revenue for a state. Fiscal policy has the initial objective of guaranteeing minimal budget revenues. But once the financial sustainability of the state is guaranteed, the state sets other fiscal policy objectives.

The great thing about fiscal policy is that it has a direct impact and does not require you to tie the hands of future policymakers! (*Paul Krugman*). Typically, there are two distinct and opposing attitudes in the area of fiscal policy, both of which depend on political options and each has its own limitations. On the one hand, we have a fiscal policy that relies on relatively high fiscal burden on large incomes, thus favoring a redistribution of income to society; its downside lies in limiting the cash that the "rich" can spend on investment, and this, in turn, limits economic growth. On the other hand, we have a uniform fiscal obligation, or "flat tax", that preserves investment, but with potential negative consequences on consumption,

namely the middle and poor classes, which make up the vast majority of consumers. The decrease in disposable income affects the reduction of demand in the market and consequently there is a restriction on supply and consequently on production, investment and economic growth itself.

Tax evasion

The meaning of the term tax evasion, according to the science of finance, relates to all actions intended to reduce or eliminate the fiscal contribution to the state coffers by citizens or entities, in violation of specific fiscal provisions and norms. Tax evasion is the non-payment of tax liabilities arising from the law. Tax evasion has a devastating effect on the fiscal policy of the government causing the State a small loss from its fiscal revenue.

Tax evasion is possible through several actions that take place in very different situations:

- performing sales operations or services without issuing a regular invoice for the action taken against the citizen / consumer (so-called "black" sales);

- compilation of false declarations of income resulting from inadequate or misstatement of the fiscal statement that results in the missing payment of real liabilities;

- conducting an economic activity outside any rules: for example, "after work in the black" by employees (public or private);

- albeit in regular working reports, receiving part of the remuneration in undocumented, consequently non-taxable form, through cash (the typical form of integration or remuneration used in micro or small enterprises);

- after being subject to an agreement between the employer and the employee, changing the nature of the items accompanying the payroll, for example, by giving false (non-taxable) transfers in order to eliminate taxable items (for example, payments

- covert agreements with the client of the enterprise or the autonomous worker to reduce or completely eliminate invoices or change the nature of the items;

- filing fiscal documents to entities that are not real so that they can be accounted for at cost (in order to fictitiously reduce the taxable amount);

- non-payment of taxes or duties for the benefit of services or non-compliance with mandatory requirements, for example non-payment of TV, local service taxes, etc.

To give a quantitative measure of the magnitude of the tax evasion phenomenon, both at the individual and collective level, in addition to giving the total amount of evasive funds, the evasion index can be defined and calculated as the ratio between evasive funds and total of funds that the State should receive from taxes and levies. Another index, the macroeconomic index is the ratio between total evasive funds and GDP.

There is also a much heavier variant of evasion, fiscal fraud, which is carried out with sophisticated mechanisms that create a regular apparatus under which evasion is kept secret, making the task of controlling financial management more difficult. A typical instrument of fiscal fraud is the accounting for fake purchase invoices to reduce the taxable amount. Revenue from tax evasion and tax fraud goes into the so-called "underwater economy".

Tax evasion is punishable by fines and above a certain limit on the reduction of the taxable amount, even criminally. Fiscal fraud is punished far more severely by simple evasion, depending on the degree of economic damage and risk.

The Econometric Model

In this doctoral thesis I have built an econometric model based on independent and dependent variables that are oriented on the key components that build and implement fiscal policy. As a dependent variable we have received tax revenues which we study and analyse

In this model I used the Dickey - Fuller test, the Granger Causality test, and the regression model.

Augmented Dickey-Fuller

The Dickey-Fuller test tests the null hypothesis that a unit root is correct in an autoregressive model. Alternative Hypothesis is Variable depending on which version I try is used but it is stationary or stationary trend. This is a version I testify to

Dickey-Fuller for a great band and honors me with your timely model. Dickey-Faller statistics (ADF), the test used, is a negative number. The more negative I get, the stronger the rejection of the hypothesis that there is a unit root at some level of belief.

Null Hypothesis: Tax Revenue has a unit root

Exogenous: Constant

Lag Length: 0 (Automatic - based on SIC, maxlag=1)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		1.059766	0.9929
Test critical values:	1% level	-4.297073	
	5% level	-3.212696	
	10% level	-2.747676	

*MacKinnon (1996) one-sided p-values.

Warning: Probabilities and critical values calculated for 20 observations

   and may not be accurate for a sample size of 10

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(TAX REVENUE)

Method: Least Squares

Date: 06/03/19   Time: 21:57

Sample (adjusted): 2009 2018

Included observations: 10 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
TAX REVENUE (-1)	0.106434	0.100432	1.059766	0.3202
C	-18303.35	32154.72	-0.569227	0.5848

R-squared	0.123105	Mean dependent var	15491.33
Adjusted R-squared	0.013494	S.D. dependent var	13138.40
S.E. of regression	13049.46	Akaike info criterion	21.96774
Sum squared resid	1.36E+09	Schwarz criterion	22.02825
Log likelihood	-107.8387	Hannan-Quinn criter.	21.90135

Null Hypothesis: PBB has a unit root

Exogenous: Constant

Lag Length: 0 (Automatic - based on SIC, maxlag=1)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-0.161840	0.9152
Test critical values:	1% level	-4.297073	
	5% level	-3.212696	
	10% level	-2.747676	

*MacKinnon (1996) one-sided p-values.

Warning: Probabilities and critical values calculated for 20 observations

and may not be accurate for a sample size of 10

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(PBB)

Method: Least Squares

Date: 06/03/19   Time: 21:58

Sample (adjusted): 2009 2018

Included observations: 10 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
PBB(-1)	-0.009718	0.060045	-0.161840	0.8754
C	67004.59	80337.16	0.834042	0.4285

Since hypothesis testing is done using the time series of economic variables then the variables must first be tested for the statistic and the possibility of co-integration, that is, the presence of a long-term relationship between them. Constant variance and auto-covariance that are not dependent on the time't', that is, the time series tends to move toward the long run average.

Granger Causality Tests

Y The Granger causality test is a statistical hypothesis test to determine if one time series is useful in predicting another. Usually regressions reflect correlations simply but Granger argued that causality in economics could be tested by measuring the ability to predict future values in one time series using previous values of another time series. Since the question of "true causality" is profoundly philosophical and due to the post hoc ergo propter hoc error of the assumption that one thing before another can be used as a proof of causation. A Time Series X BY Granger - causes Y if it can usually be shown through a series of tests t and F tests for residual values of X (and with residual values of Y also included), that these values of X provide statistically significant about future values.

Pairwise Granger Causality Tests

Date: 06/03/19   Time: 22:00

Sample: 2008 2018

Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
TAX REVENUE does not Granger Cause PBB	9	4.23015	0.1031
PBB does not Granger Cause FISCAL REVENUES		0.13557	0.8771

The Granger Agility Test is based on the premise that the future cannot cause the present or the past by using the concept of autoregressive model. This test attempts to determine how past values of one variable help predict changes in another variable. This test depends entirely on the observed or otherwise stated variables.

Regression

Regression Analysis is used to predict the value of the dependent variable based on an independent variable. The dependent variable is the projected or estimated variable. The independent variable is the variable that provides the basis for evaluation.

Dependent variables are variables that we want to predict or explain. While independent variables are the variables we use to expedite the dependent variable.

Dependent Variable: TAX REVENUE
Method: Least Squares
Date: 06/03/19   Time: 22:02
Sample: 2008 2018
Included observations: 11

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-83963.84	37621.32	-2.231815	0.0525
PBB	0.302423	0.027519	10.98947	0.0000

R-squared	0.930646	Mean dependent var	326774.1
Adjusted R-squared	0.922940	S.D. dependent var	51290.27
S.E. of regression	14238.04	Akaike info criterion	22.12819
Sum squared resid	1.82E+09	Schwarz criterion	22.20053
Log likelihood	-119.7050	Hannan-Quinn criter.	22.08259
F-statistic	120.7685	Durbin-Watson stat	0.688469
Prob(F-statistic)	0.000002		

Regression analysis is a statistical technique that uses the observed data to relate the dependent variable to the independent variable. The objective of regression analysis is to construct a regression model (or predictive equation) that is used to predict or control the dependent variable based on the independent variable.

Referring to the budget data, regarding the tax revenues and expenditures that affect the economy of the country, we graphically present the following:

Figure1 - Tax Revenue
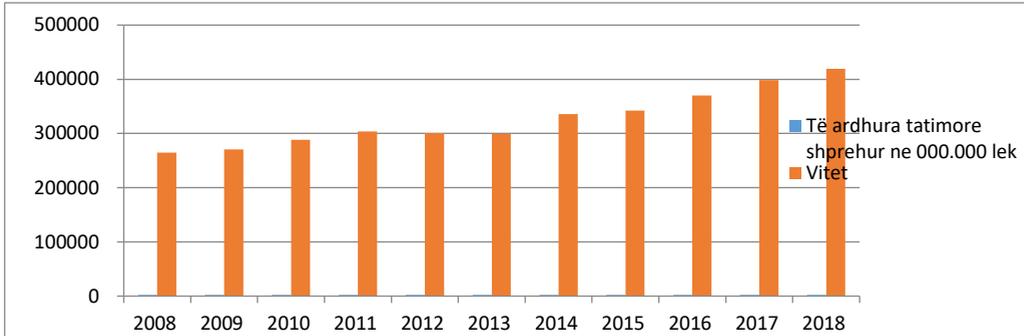
Tax revenues are the main item of revenue in the state budget. Tax revenues in the state budget consist of tax and customs revenues, revenues from local government and revenues from social funds (contributions). tax and customs income consists of value added tax, profit tax, excise tax, personal income tax, national tax and customs tax. During 2008-2018 there have been significant fluctuations and changes in tax revenues, for various reasons.

Tax and customs revenues are revenues collected from all types of taxes and duties levied by the central government. Responsible for their collection are the Directorate General of Taxation and the Customs.

In recent years the General Directorate of Customs has had a steady increase in revenue collection which is its competence. In recent years it has had the highest growth in 2017 compared to previous years where tax and customs revenues have increased by 18.9%. Tax and customs revenues have taken into account all the main factors influencing the budget, including the effect of economic growth and price index. New fiscal policies have led to steady year-on-year economic growth that has impacted the country's economic growth.

Figure2- Expenses of 2018-n
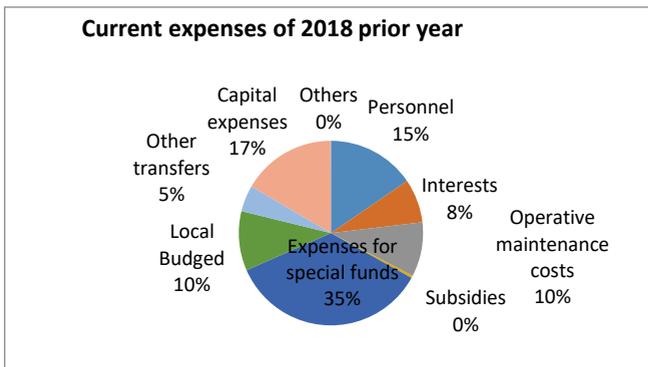
The figure above shows the structure of state budget expenditures. We see that the largest percentage is spent on special funds. Expenditure on special funds is the main item in this category. In 2018, according to the consolidated budget data, this share is 35% of total Budget expenditures. There are three main components of Special Fund expenditures: social security costs, health insurance costs, and owner compensation. The largest share is occupied by 17 percent of capital spending. Capital expenditures are expenditures that will result in some fiscal periods being otherwise considered investments. From the data in the Consolidated Budget, 17% of capital expenditures were made. Personnel costs are the third most important item in terms of weight. Consolidated Budget 2018 staff costs are 15%. According to the data. With 10% we have the local budget and operating and maintenance costs, then we have other items that have a relatively smaller percentage. The largest share is spent on special funds and capital expenditures, which play an important role in the country's economy.

Conclusions

-Fiscal policy affects the improvement of the economic structure.

-The state intervenes through fiscal policy instruments to regulate the balances needed for a better economy.

-Fiscal policy is a component of state economic policy that is used for macroeconomic purposes to influence the level of output, employment and prices.

-The state's intervention in economic flows through fiscal policy is justified by the adjustments made to eliminate the phenomena that impede the maintenance of the general welfare of society.

-Fiscal policy is one of the components of state economic policy that is used for macroeconomic purposes affecting the country's economy.

- Governance by applying fixed fiscal policy instruments has a positive impact on the country's economy. Political stability, economic efficiency, fair management of public finances, implementation of development fiscal policies and the promotion of fairness and equitable distribution of income can then be said to be the path to successful economic growth.

- The orientation of taxation in these countries generally reflects an improvement of the personal system, making it more efficient in both tax collection and further tax management. This has resulted in an increase in public revenues and a decline in national evasion.

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