

## Albania Government and It's Challenges in Progressive Tax Implementing

Armalda Recì (PhD candidate)

Credins Bank, Albania

Doi:10.5901/jesr.2014.v4n2p35

### Abstract

*Horst Dieter Vesterhoff (economic adviser to three German chancellors) said that a tax system should meet at least three conditions. First the state to bring enough income must be based on the solvency of citizens and should not impede or dissolve desire to work, to do investments or research and further discoveries. Progressive tax is one of the key points of the new government. Progressive taxation is a type of tax system that is designed to put the greatest tax burden on those who make the most money. The main reason for establishing progressive taxes is to achieve fairness in taxation, at least according to some. Theoretically, those who make little should pay very little in taxes, while those who make more should pay more. How many of ways the progressive taxation can work? In the US, the income tax paid per year by citizens is progressive. It is based on income levels, and as these income levels rise, so do tax levels. It's a complicated system, where the next portion of income above a certain level is taxed at a higher percent. A progressive tax system allows a government to collect a larger amount of tax revenue, which, can be used for the benefit of public services, such as education, welfare and medical assistance. From the above, the question naturally arises, is Albania's prepared to implement successfully progressive tax? Based on this question in this article I would like to do a synthetic analyses of fiscal system during last 15 years in Albania and identifying what are advantages and disadvantages of progressive tax implemented by stressing the opportunity of government on this process.*

**Keyword:** progressive tax, flat tax, comparison, government, welfare

### 1. Introduction

The notion of taxation has been known since the establishment of states. A social organization, as primitive as it may be, requires sufficient financial means to accomplish its goals. Taxes are a substantial means of providing the financial resources of a country. They occupy the leading place in the public income of modern countries. The great part of our neighboring countries and countries with quite a similar economic situation as ours are applying flat tax. So as to improve the economic situation and the fiscal administration, since 2008 Albania is applying the flat tax system. Previously Albania applied another tax that was progressive tax. Flat Tax or Progressive Tax – a dilemma that is frequently discussed by the specialist of the field, leaves room for debate and provides no definite answers. Different countries apply different economic policies and, as the data have shown, they obtain different results from the application of different policies.

### 2. The Effects and the Performance of the Implimentation of Flat Tax in Albania in 2007-2013

Personal income tax was one of the most hited taxes from the fiscal evasion in Albania. Fiscal reforms of 2007 basically changed the tax structure, replacing the progressive tax rates with a unique degree of 10 %, for all kinds of personal income.

Albania, in about 5 years of experience with flat tax, there were positive results from the collection of additional revenue from personal income tax, as a result of the implementation of the flat tax. Thus, from 1.1 % of GDP this tax covering 4 years before applying progressive tax amounted to an average of 2.2 % of GDP after the flat tax application.

The formula applied to every penny of tax on salary earned was heavy with unfairly high taxes wages of employees with low incomes, such as those of the health sector, the education sector and the manufactured sectors where is used the cheap labor. The flat tax is introduced in July 2007, to 10% for all employees, for social and economic reasons:

1. Application of the flat tax to reduce informality in the labor market in Albania;
2. Application of the flat tax to be consistent with regional tax policies to attract foreign investors.

To proceed further with tax cuts, last incentives was that of May 2013 that all employees with salary and under

thirty thousand leke exempt from paying 10 % tax.

Passing from progressive to flat tax system has been an important step in our country's economy, but this type of flat tax failed any of his goals.

1. Informality in the labor market continues to be a problem in Albania;
2. At 8 years flat tax application is not a study done, which connects investments increase in Albania with flat tax concerning personal income tax.

### 3. Economic Benefits of Progressive Tax System

In 2001, Premier Gordon Campbell announced that the government would revitalize the provincial economy, invest in education and invest in health care. Campbell decreased the taxes of large corporations. At the present moment, the corporate income tax in BC is 13.7% down from 16.5% in 2000 (Ramsey), while in Canada is around 21%, down from 28% from the year 2000 (Canada 83). There have been great cuts in corporate taxes since 2001. Unfortunately, that does not help the economy. The amount of money economized by those large corporations is likely being invested outside of BC, if invested at all. For this reason, the provincial government has lost billions of dollars in revenue, which only aggravated the provincial debt. Also, with lower taxes, the large corporations were enabled to become more predominant in the province. When you take into consideration the huge amount of money lost in the taxes, in investments and large cuts in the public sector, it is not hard to understand why the provincial debt increased by about 3 billion dollars.

Campbell argued that by reducing those corporate taxes, the province would be attracting investments and "revitalizing" the economy. Clearly, Campbell is either ignorant of economics or simply corrupt, since even a basic knowledge of economics would show him that the way to invest is by decreasing the taxes of small business to stimulate the local economy, while increasing the taxes of large multinational corporations in order to force them to raise their prices, which would help making small businesses even more competitive. Decreasing money supply could also increase investment, although that is only possible in the federal level.

If costs of living are high and the income tax system is not progressive, there will be lots of people who will work in many jobs just to survive, which is not attractive to corporations since the wages are high and the demand is low. With underfunded public services the situation is even worse, as it increases costs of living. For instance, with higher tuition fees, students often have to loan more money, which reduces their purchase power. In this scenario, even if the corporate taxes are very low, large corporations with the ability to invest in other places will prefer to invest where there are lower wages and higher demand. A progressive tax system would fix that. This is the system in place in the Scandinavian countries, as well as many other developed first world countries. In this system, the poor pays little while the rich pays more. This increases the purchase power of the poor, while increasing the amount of cash flow which would be otherwise stuck in the riches' savings. The same applies to corporate taxes for small businesses and large corporations. With lower taxes for small businesses, they are able to compete against the large corporations.

If the government adopts a progressive tax system, there will be an increased tax revenue, which could be used to pay the debt as well as increasing expenditure in the heavily underfunded public services such as education, health care and welfare. A progressive tax system would also encourage small local businesses, which would expand the economy. It would also increase the purchase power of a great majority of the population, which would even further expand the economy.

### 4. Three Reasons Why We Need Progressive Tax Rates

Conservatives have two central tenets in their tax reform agenda. The first is to simplify the tax code by eliminating tax expenditures – government spending through the tax code – that come in the form of deductions and exemptions. The second is to move from a progressive income tax to a flat income or consumption tax. But conservative politicians often conflate these goals, suggesting that "simple" and "flat" are one in the same. Tax expenditures are what complicates the tax code, not progressive rates. While we should aim to eliminate expenditures, especially those that benefit those who are relatively well off, progressive tax rates are justified economically and morally for these reasons:

#### 4.1 Efficiency

What is the optimal amount of public goods and services the government should provide? If the government creates a

rule that says everyone must pay an equal share of their income, revenue will be restricted to the rate that the lowest earning workers can afford to pay.

Consider the case of a married couple with drastically different earnings. One spouse earns \$40,000 per year, while the other earns \$400,000 a year. If the couple goes Dutch, they will restrict their shared consumption. However, if the couple adopts a rule that the higher earning spouse pays more, then they can enjoy a higher level of shared consumption. This means they will consume a better house, better car, and better lifestyle.

#### 4.2 Happiness

Advocates of progressive taxation often say "Rich people can afford to pay more." What they really mean is that \$100 means more to a person making \$5,000 a year than it does to a person making \$500,000 a year. This means that allowing poor people to keep a larger share of their income will result in a happier society than making everyone pay the same rate.

#### 4.3 Justice

If people deserved most of their income, there would be a good case that they should be able to keep it. However, people don't morally deserve their income because almost everyone's income results largely from factors beyond their control. For example, the poorest Americans are richer in absolute terms than the richest Indians. This isn't because Americans are that much more hardworking than Indians, but because Americans have access to a superb set of institutions and a grand scale of specialization and trade within our borders.

The knowledge and technology we have that allows us to be rich is the result of a multi-millennia human project and social cooperation. Other factors — such as our genes, parents' income, our order of birth, year of birth, and even month of birth — have enormous impact on our future earnings.

Because people don't morally deserve their income, it means that society can fairly ask the wealthy to pay more. Doing so allows us to produce more public goods and services that benefit everyone, while creating a more happy and just society than if we asked everyone to pay the same. But, we still need to be concerned about incentives. We don't want to make rates so progressive or so high that they make it unattractive for people to be productive. Fortunately, this is an empirical question, and all the evidence suggests that the wealthiest among us are doing quite well, and their lot is improving.

#### 4.4 The advantages of the progressive tax

1. It is reasonable- as under progressive taxation the rate of taxation rises as the taxable income rises hence people from higher income group are asked to bear the heavier load.
2. Progressive taxation is fruitful- this form of taxation is beneficial for the government as the income yield is comparatively more than any other form of taxation.
3. Progressive taxation is cost-effective- the cost incurred for collecting the taxes doesn't rise along with the rate of tax.
4. Brings about equality in income sacrifice- under progressive taxation there is an equality of income sacrifice amongst all tax payers. this is owing to the fact that the law of diminishing utility is applicable with money as well. with every rise in earnings the marginal value of money decreases. therefore, a rich individual doesn't feel the pinch while paying a certain amount of tax. so by levying him more income tax he can be requested to make equivalent sacrifice.
5. Reduction of income inequalities- this form of taxation helps to a certain extent in reducing inequalities in wealth distribution. furthermore, equal circulation of income will result in raised well being of the society, as the richer individuals will forfeit only their comforts, whereas the poor individuals will be capable of satisfying their necessities to a better degree.

All these advantages of progressive taxation make it an important arsenal for the government for collecting revenues which decides the growth and development of the country.

#### 4.4.1 The advantages of the implementation of progressive tax in Albania

After the fall of communism, many countries applied the system of progressive income tax, which was earlier applied in Western Europe. But it soon turned out to be a system that discouraged economic growth.

Progressive tax is one of the key points of the new Albanian government in 2014. Progressive taxation is a type of tax system that is designed to put the greatest tax burden on those who make the most money. The main reason for establishing progressive taxes is to achieve fairness in taxation, at least according to some.

Progressive tax tends to reduce the consequences of taxation on individuals with low paying capacity by disproportionately shifting it to individuals with a higher paying capacity (richer people). When progressive tax was applied in Albania, different rates applied to different income groups. In this case progressivity described a distribution effect on income or cost referring to the progression of tax rate percentage. At first glance, it seemed that progressive tax made all citizens sacrifice equally and that state exercised the same pressure on all of them. Progressive tax intended to wrongly fight against inequality among people by trying to generate greater equality.

### 5. Conclusion and Recommendations

Flat tax policy is a doubled-edged sword likely to produce either positive or negative consequences.

The benefits of a lower flat tax may be a short term if not associated with other advantages. Progressive tax systems are designed to subject a larger percentage of income to taxation for individuals, households and businesses with larger incomes, while lowering the tax burden on those with lower incomes. According to Progressive Policy Institute, the debate between flat and progressive tax systems is robust, with valid arguments on each side. Progressive taxes carry significant benefits to economically disempowered households and society as a whole.

A progressive tax system would also encourage small local businesses, which would expand the economy. It would also increase the purchase power of a great majority of the population.

There are many versions and formulas for applying progressive or flat tax, or a combination of both, and they require a thorough study based on best statistics and experiences of other European and World countries.

### References

- World Bank raport no.3 for Southeast Europe BC Chamber of Commerce.  
PROVINCIAL BUDGET. 15 March 2005. < [http://www.bcchamber.org/publication...al\\_budget.html](http://www.bcchamber.org/publication...al_budget.html) >  
BC Liberals. Premier Pledges \$150-Million More for B.C. Schools. 14 March 2005. < <http://www.bcliberals.com/309/2144> >  
BC NDP. Liberal Throne Speeches: promises made, promises broken. 7 February 2005. 14 March 2005. < <http://nid-1611.newsdetail.bc.ndp.ca/> >  
BCTF. Our Students. Worth Speaking Out For. 14 March 2005. < <http://www.bctf.ca/WorthSpeakingOutFor/> >  
Canada. Department of Finance. Tax Expenditures and Evaluations 2003. 2003. 15 March 2005.  
CFS. The Story so far.... 2003. 14 March 2005. < <http://www.reducefees.ca/CA30.php> >  
Epland, Jon. Statistics Norway. Income Distribution Data for Norway: Robustness Assessment Report. 21 Dec. 1998. 12 March 2005. < <http://www.lisproject.org/links/canberra/rar/rarnw.pdf> >  
James, Carole. Budget Surplus Achieved By Neglecting Seniors, Breaking Long-Term Care Promise, says James. 14 Feb. 2005. 13 March 2005. < <http://nid-1635.newsdetail.bc.ndp.ca/> >  
Layton, Jack. Issues: Jack Layton on fair taxes. 13 March 2005. < [http://ndp.ca/uploaded/20040526145147\\_FairTaxes.pdf](http://ndp.ca/uploaded/20040526145147_FairTaxes.pdf) >  
Hallam, Bryna. "Students left out of federal budget say NDP, CFS". Martlet 3 March 2005 <<http://www.martlet.ca/archives/050303/news3.html> >  
Ragan, Christopher, and Richard Lipsey. Macroeconomics. 11th ed. Toronto: Pearson, 1966.  
Ramsey, Paul. BC Budget 2000. 15 March 2005. [http://www.legis.gov.bc.ca/2000/bgt2...\\_table\\_h02.htm](http://www.legis.gov.bc.ca/2000/bgt2..._table_h02.htm)  
Reality Check. 31 January 2005. 14 March 2005 < <http://nid-1561.newsdetail.bc.ndp.ca/> >  
[www.minfinn.gov.al](http://www.minfinn.gov.al)  
[www.tatime.gov.al](http://www.tatime.gov.al)  
<http://www.fraserinstitute.org/research-news/research/display.aspx?id=16613>  
<http://www.heritage.org/index/explore>  
<http://reports.weforum.org/global-competitiveness-2011-2012>  
[http://www.investmentcompact.org/pages/0,2987,en\\_35424885\\_35425005\\_1\\_1\\_1\\_1,00.html](http://www.investmentcompact.org/pages/0,2987,en_35424885_35425005_1_1_1_1,00.html)  
Hall, Robert, E and Rabushka Allin "The route to a progressive flat tax" 1985 pp 467-470