

Ministry of Finance

General Directorate of Macroeconomic and Fiscal Policies

Challenges for Fiscal Policies in the Future

Tirana, 14 May 2008

A decorative graphic consisting of several sets of concentric circles, resembling ripples in water, is positioned in the bottom right corner of the slide. The circles are light blue and vary in size, creating a subtle background element.

CONTENT

I. Macroeconomic and Fiscal Development

II. Macroeconomic Forecast and Fiscal Approach

Macro-economic development: history and facts

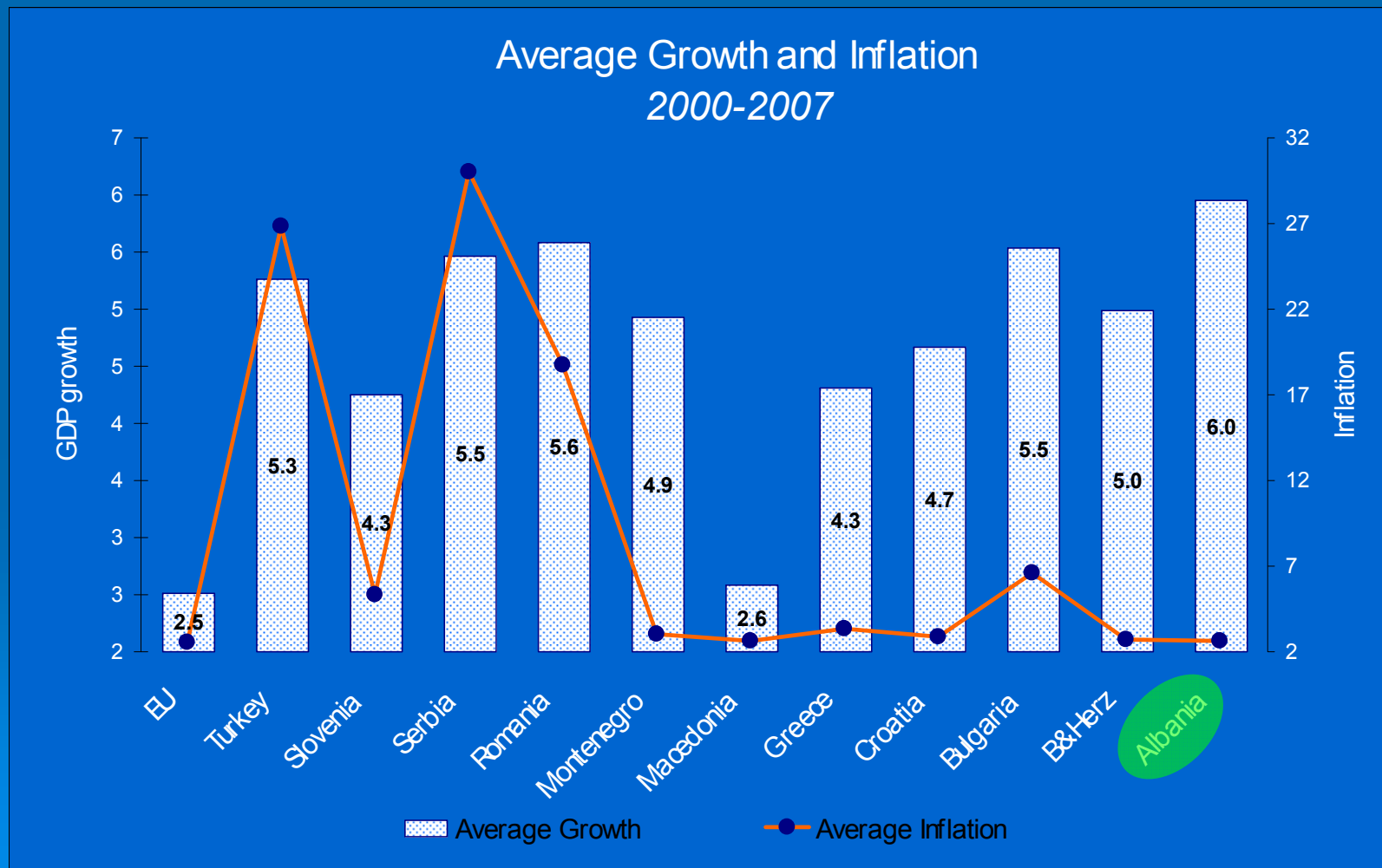
➡ Toward an open market in early years of 1990:

- From centralized economy to an open market
- Radical reforms were needed
- Macroeconomic restructure

Macro-economic development: history and facts

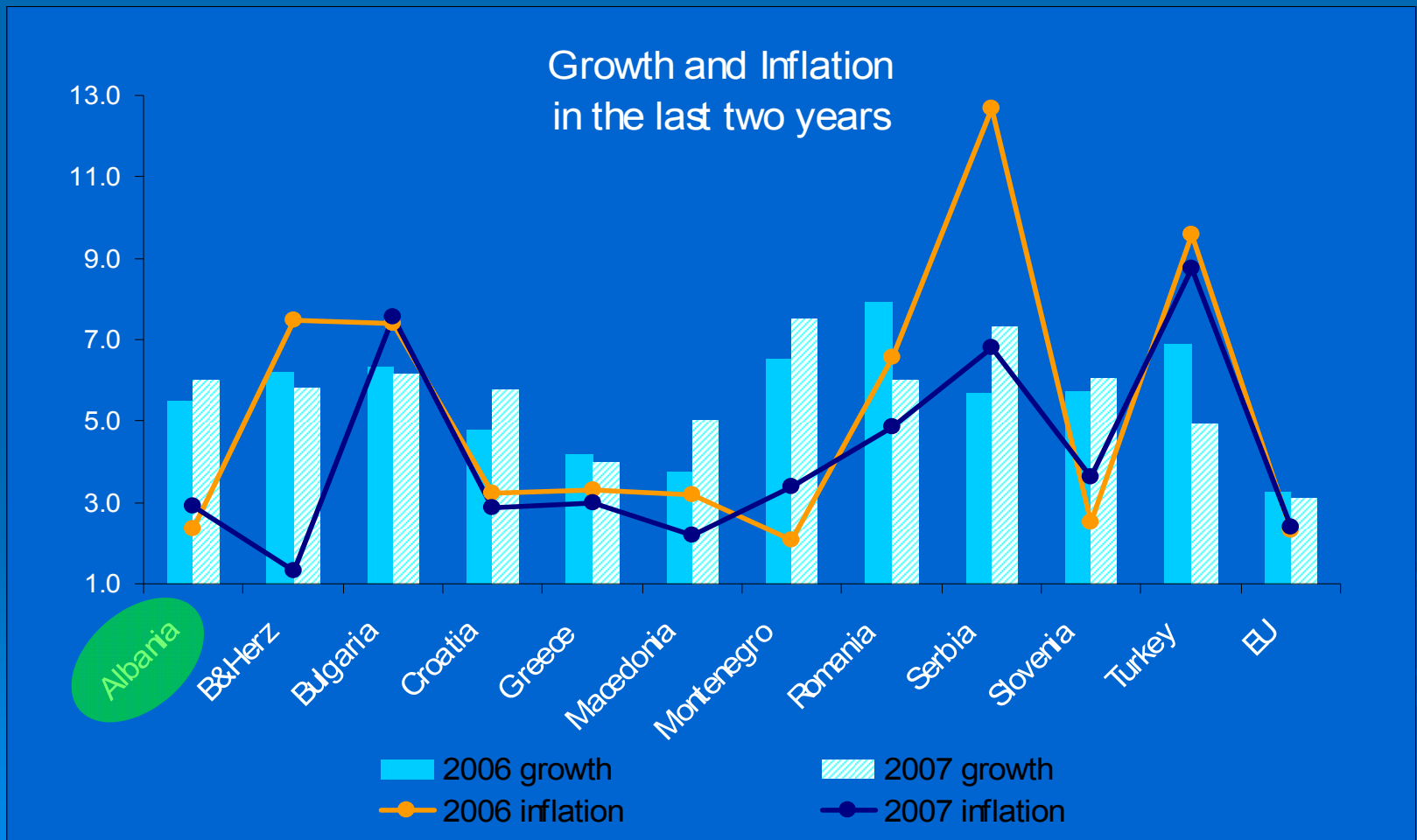
... after two decades:

- Average economic growth: Highest. Inflation: low



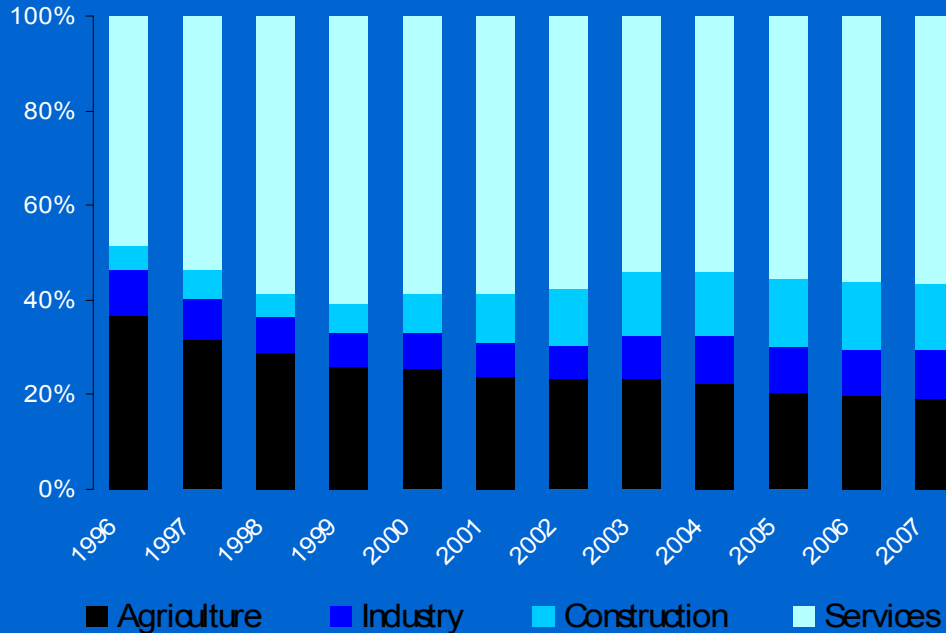
Macro-economic development: history and facts

- In the last two years: economic growth 5.5 % and 6 %; inflation 2.4 and 2.9 %



Macro-economic development: History and Facts

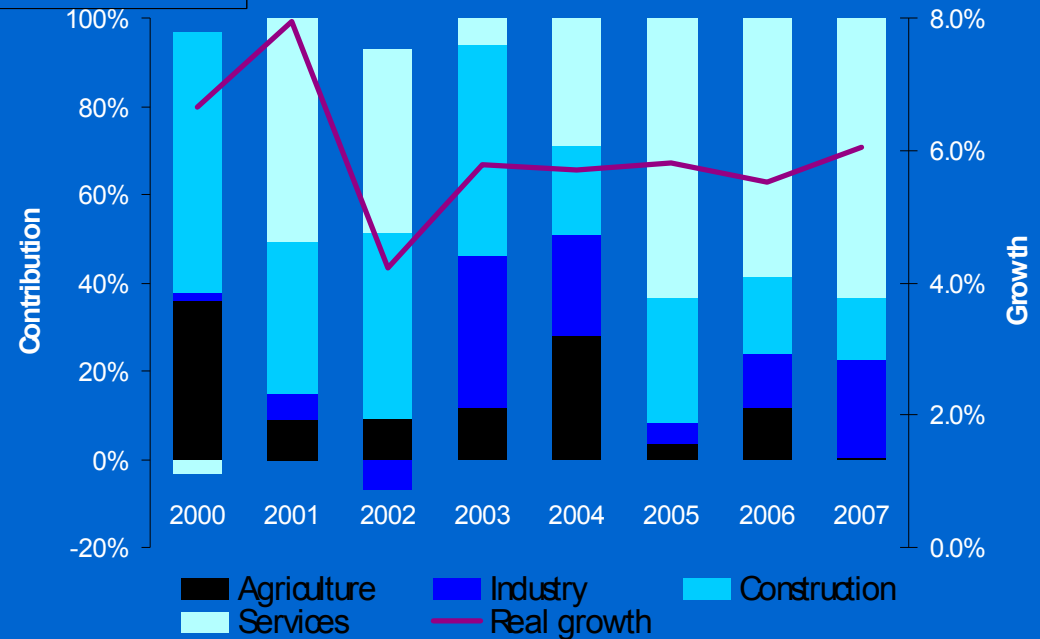
GDP Stucture



Structural changes in the last ten years:

- Agriculture from 35 % to 18 %
- Construction from 5 % to 13 %
- Services from 47% to 52 %

Contribution in growth

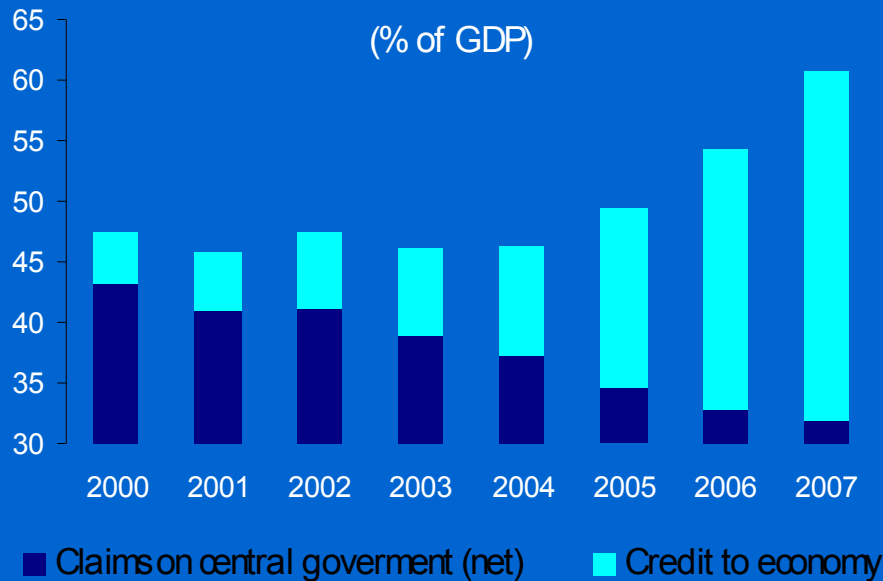


Macro-economic development: History and Facts

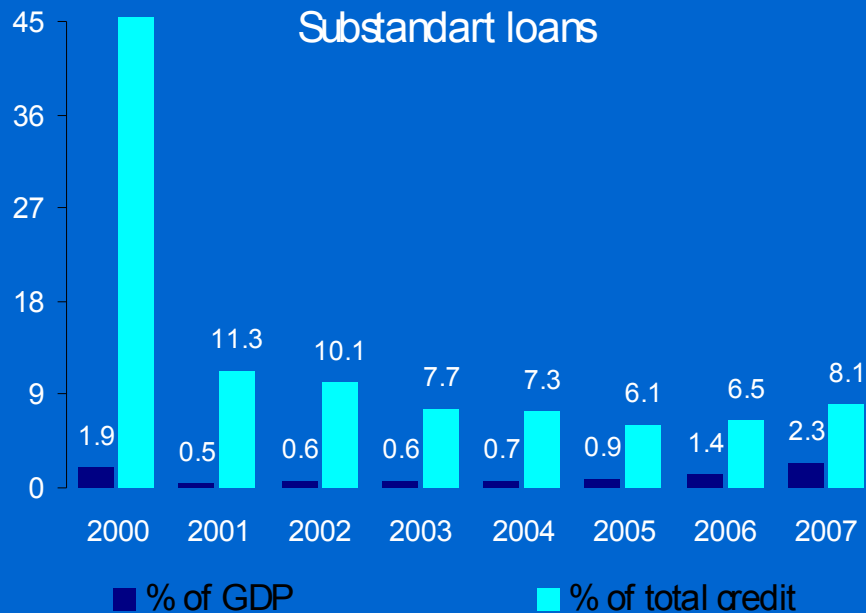
Changes in the monetary and financial sector:

- Monetary and financial stability
- Private credit acceleration
- Low level of “bad loans”
- Low inflation

Domestic credit
(% of GDP)



Substandard loans



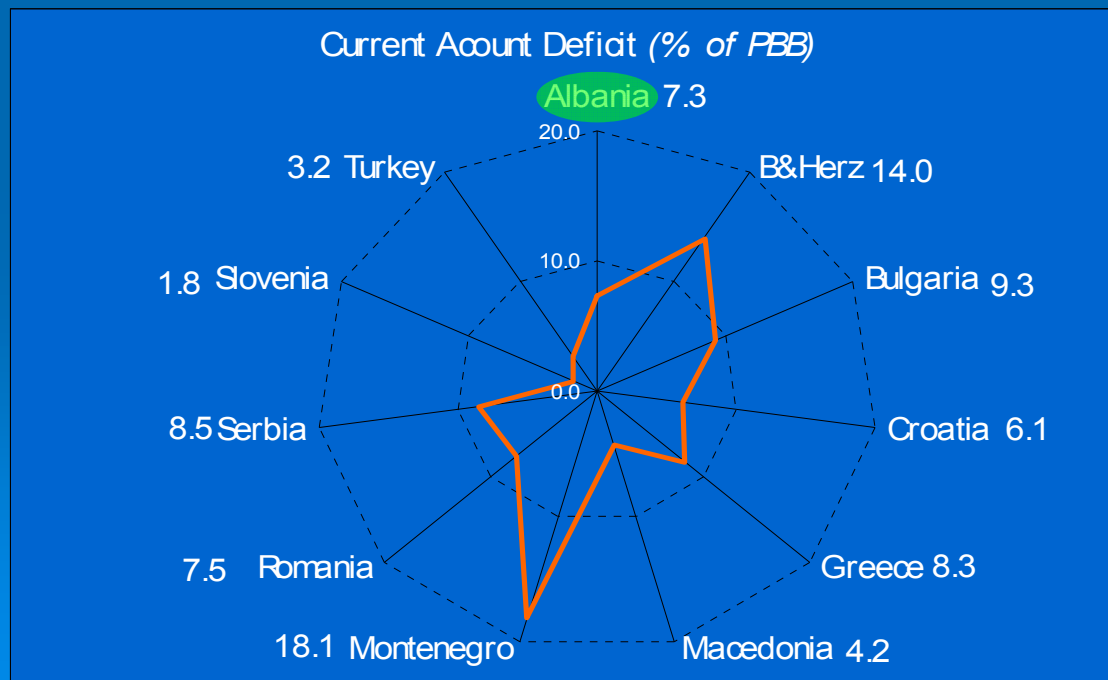
Average annual inflation



Macro-economic development: history and facts

➤ Foreign sector

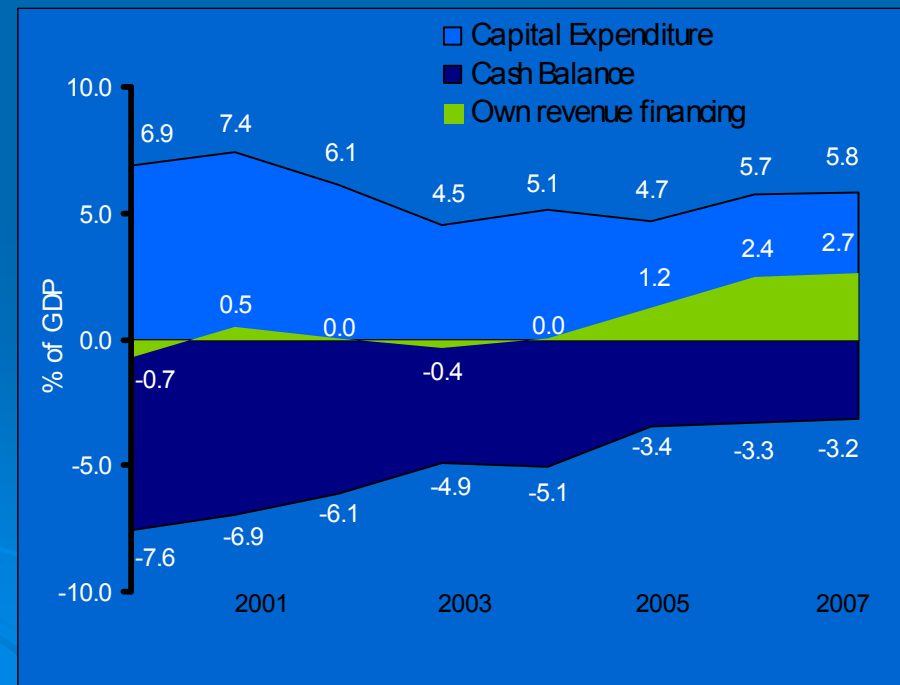
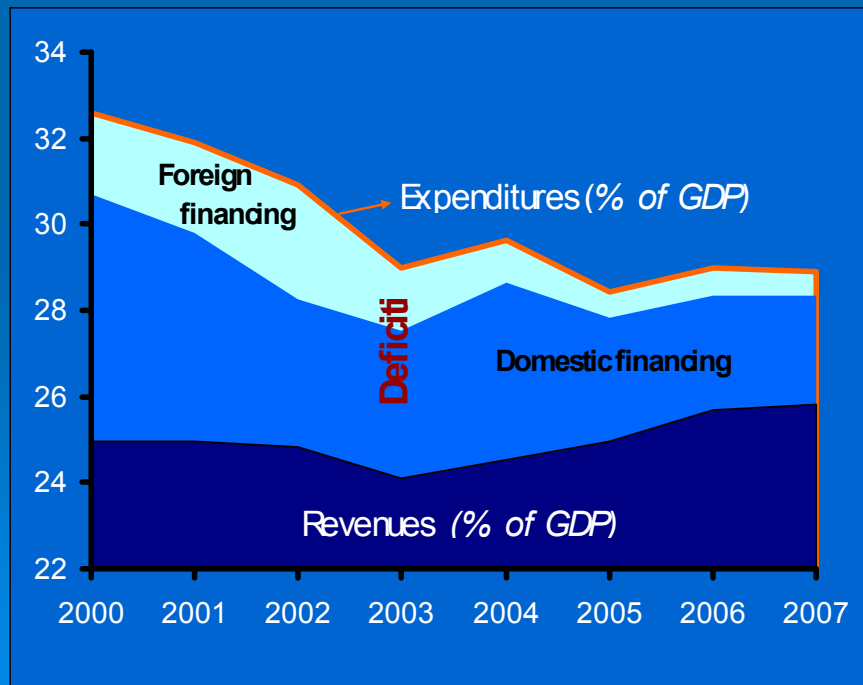
- Exports increased: average by 2 % points more than imports, but Albania is still a net importer
- Remittances still play an important role in the current account financing
- Current account In % of GDP is low compared to other countries
- Foreign direct investments in Albania increased by 85% in the FY 2007
- Foreign currency reserves of BoA increased by 26% annual on average. End of 2007, equal to 4.2 months of importation.



Macro-economic development: history and facts

➤ Fiscal

- Ongoing Fiscal Consolidation
- Higher revenues, lower expenditure and lower fiscal deficit
- Deficit mostly financed by domestic funds (borrowing and privatization receipts)
- Growing public investments: higher percentage of domestic financing.



Fiscal Policy

I. Tax policy and fiscal development

- *Main objective of tax policy: create a feasible and effective tax system, in which the main fiscal aims, ensuring state budget revenues, are balanced with the use of tax policy as an instrument for economic development*
- The Albanian taxation system is very young-created “from the start” in the early 1990. New tax laws were developed based on the developed democratic countries experience and best practice.
- Tax policies in some cases did not fit well in the specific social and economic features in Albania. This, together with weak administration, were the main reasons for narrow tax bases and deforming tax systems.
- Reforms in the tax policy were made, especially in the last years.

Fiscal Policy

I. Tax policy and fiscal development

- Year 2007-Important Tax Reforms: create a tax system with the lowest tax burdens

Goal: Development a tax system that supports the formulation of right fiscal policies that stimulate the business and economic development

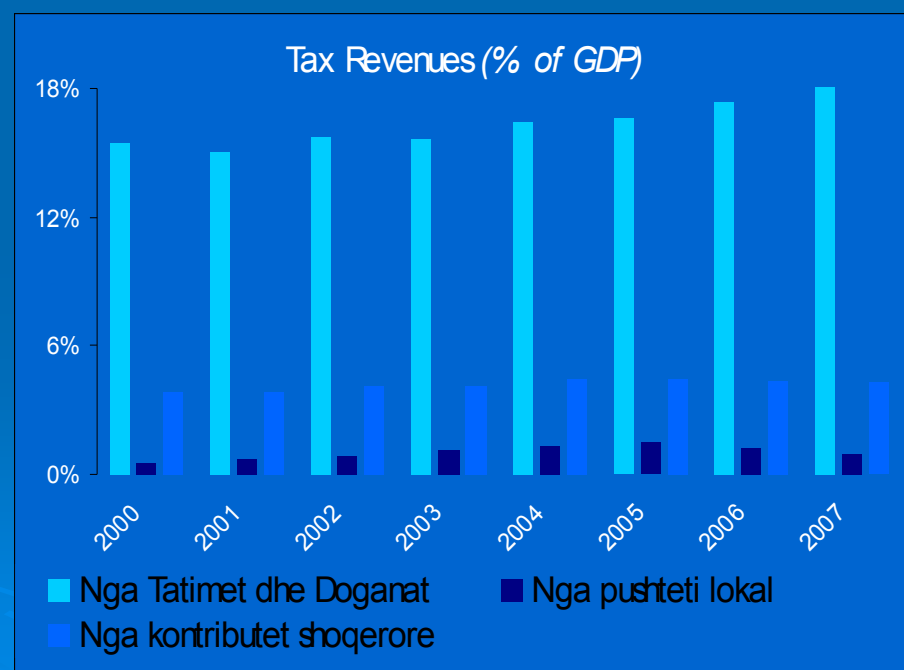
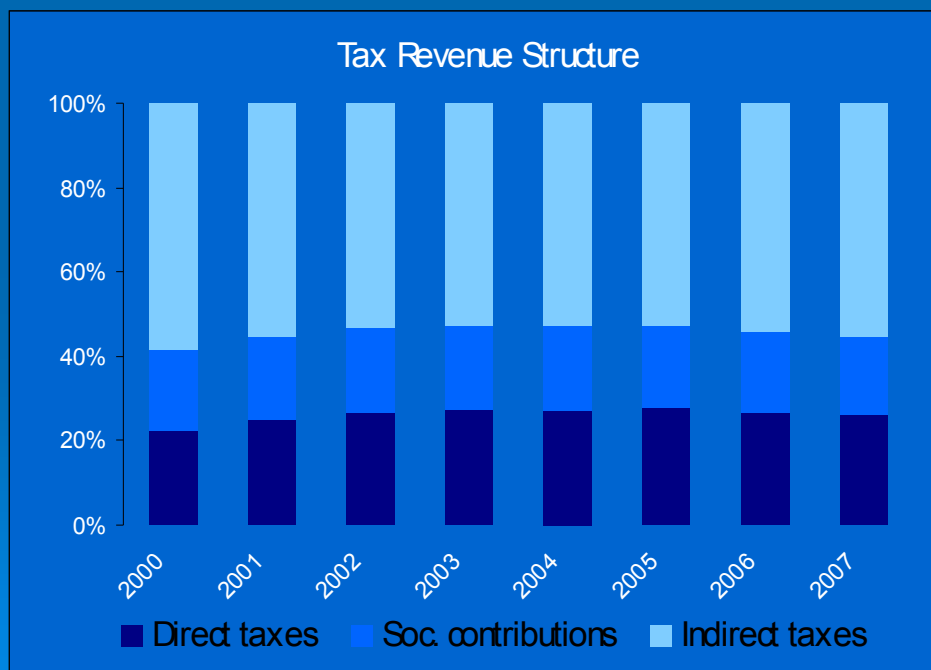
- Tax policies in line with social and economic strategic objectives of the government.
- The reform in the year 2007:
 - Flat tax (PT, PIT)
 - Eliminate of all exemptions
 - Fiscal Facilities (energy and agriculture)

Fiscal Policy

I. Tax policy and fiscal development

➤ Tax revenues:

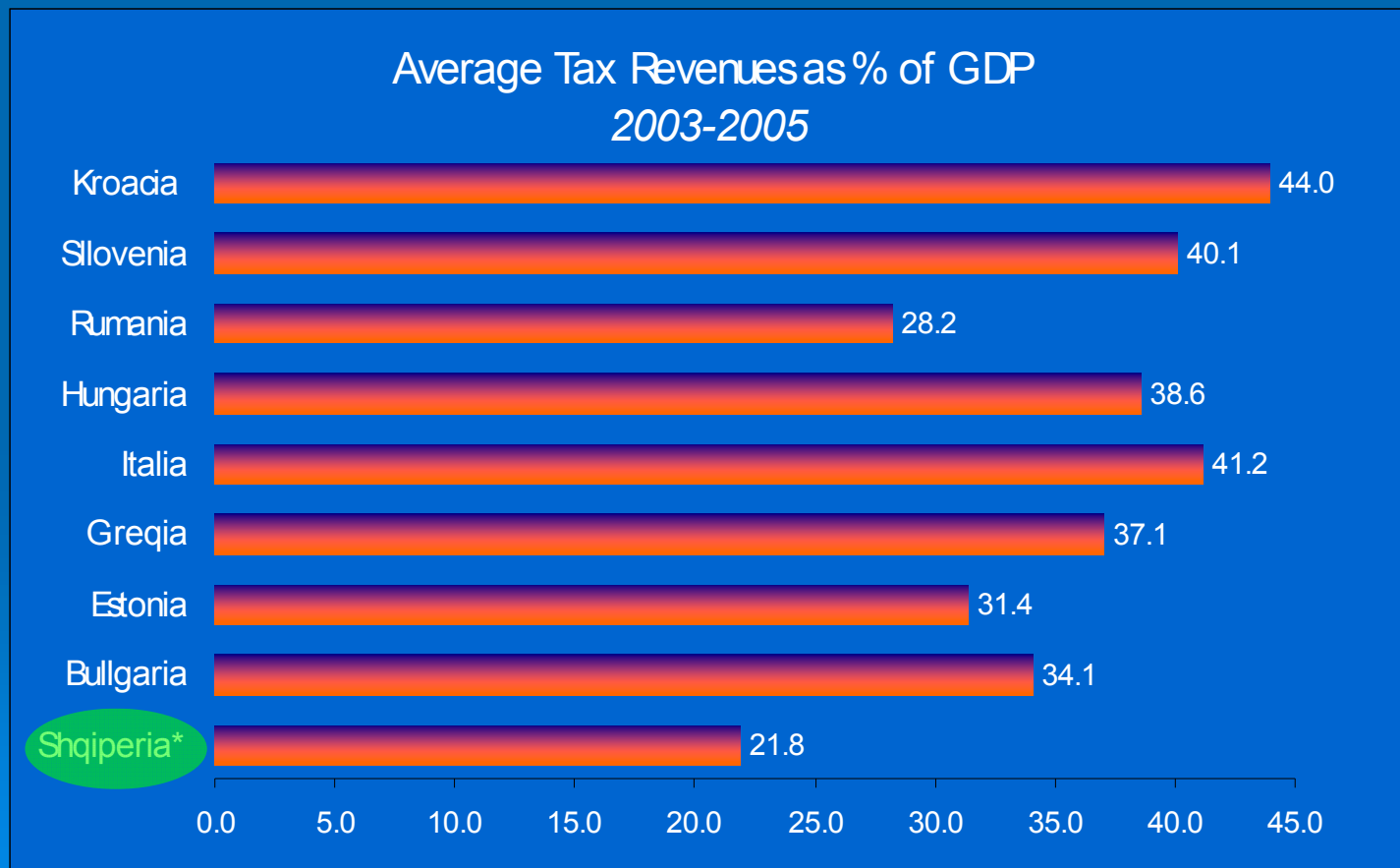
- Increase weight of Indirect taxes: 50 % of the total
- Good performance of tax revenue in the last years reflects, among other factors, improvements of the investment climate and private sector development, supported by the tax policy.



Fiscal policy

I. Tax policy and fiscal development

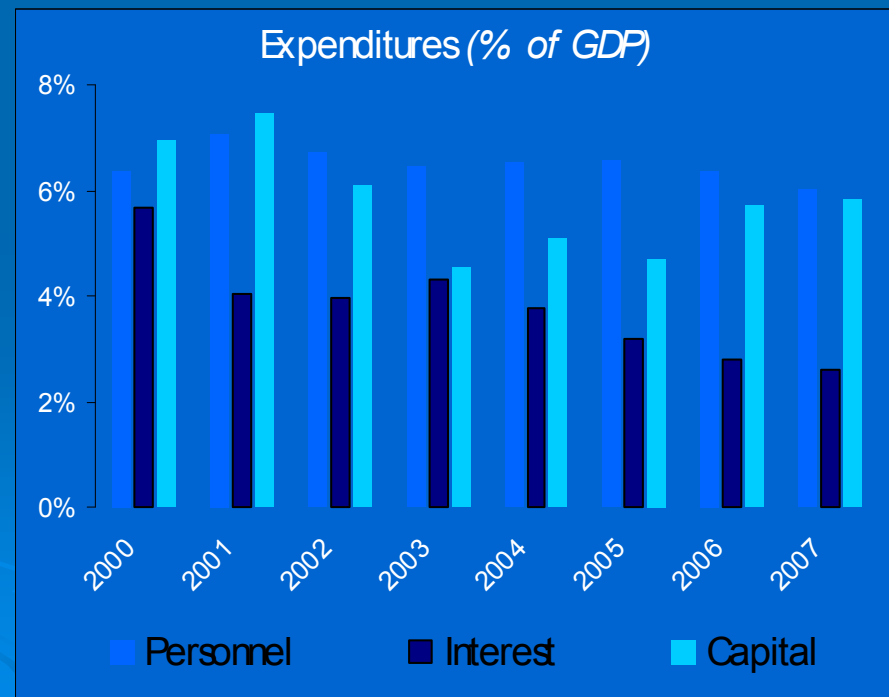
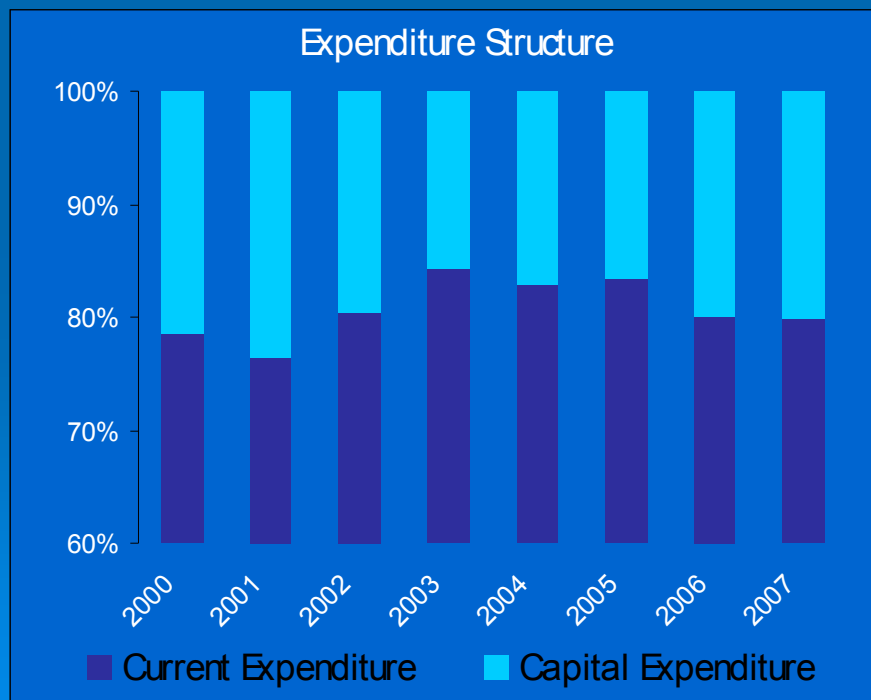
- Tax revenues lower than regional countries



Fiscal policy

II. Expenditure Policy

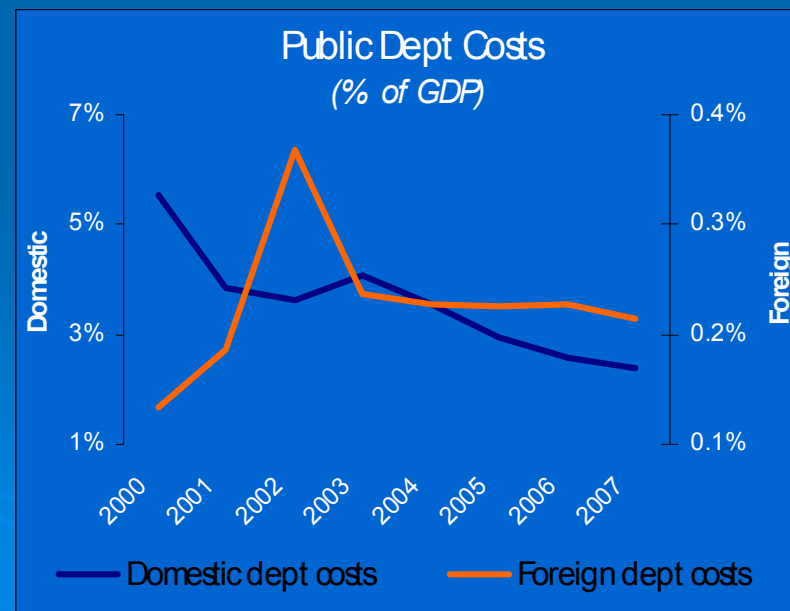
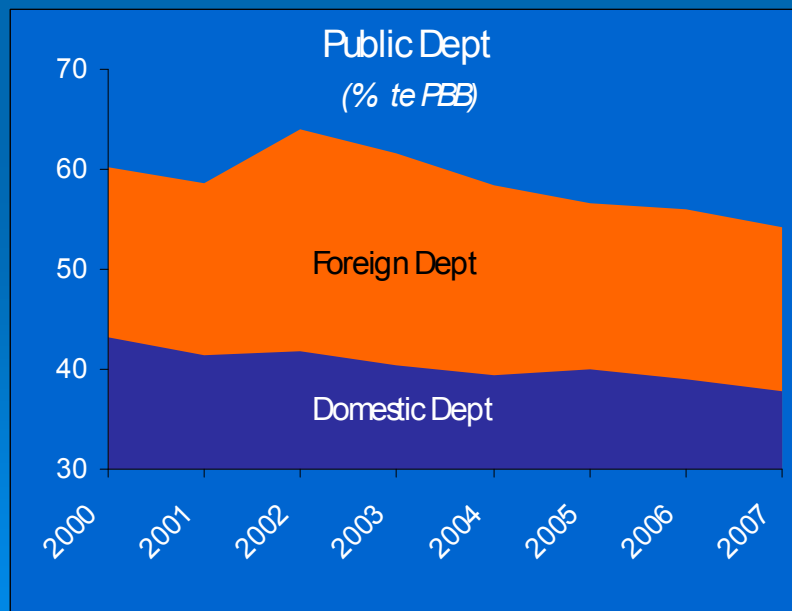
- Total expenditure: 33% of GDP in 2000 to 29% in 2007
- In the last years: reduction of current expenditure, while the capital expenditures is increasing. This indicator reflects the orientation toward small, but efficient government.



Fiscal policy

III. Debt Management

- Reduction of total debt: 60% of GDP in 2000 to 54% in 2007
- Debt Structure: 70% domestic and 30% foreign
- Structure has slightly changed toward foreign debt, creating more financial opportunities for businesses. Albania has a lower foreign debt compared to other regional countries.
- Debt service is decreasing, and is increasing the long term financial instruments.



Macroeconomic Forecast and Fiscal Approach

- The main objectives of macroeconomic and fiscal policies are:
- Average economic growth higher than 6% per year, reaching a 7 % of GDP
- Macroeconomic stability through:
 - Fiscal consolidation
 - Reduction of the domestic debt
 - Improving current balance
 - Fiscal policies compatible with monetary policies
- Lowering the tax level but keeping total revenues in the 27-29% of GDP
- Budget expenditures will continue to be in the interval between 30-32% of GDP

Macroeconomic Forecast and Fiscal Approach

Main macroeconomic indicators

Indicator	2008	2009	2010	2011	2012	2013
Population	3,173,825	3,184,697	3,194,538	3,205,894	3,217,290	3,228,726
Average inflation	3.5	3.2	3.0	3.0	3.0	3.0
GDP Deflator	3.3	3.3	2.5	2.7	2.8	3.0
Exchange rate (<i>lekë/usd</i>)	89.0	90.0	92.0	92.0	93.0	93.0
Exchange rate (<i>lekë/euro</i>)	122	123	123	122	122	122
Nominal GDP (<i>in million lekë</i>)	1,073,000	1,178,000	1,291,000	1,419,000	1,563,000	1,723,000
Real Growth of GDP (<i>në %</i>)	6.1	6.3	6.9	7.0	7.1	7.0
GDP per capita (<i>në lekë</i>)	338,078	369,894	404,127	442,622	485,813	533,647
GDP per capita (<i>në usd</i>)	3,799	4,110	4,393	4,811	5,224	5,738
Total investment (<i>në % GDP</i>)	31.2	30.2	32.3	32.0	31.8	29.1
<i>public</i>	9.3	7.0	6.9	6.6	6.6	6.5
<i>private</i>	21.9	23.2	25.4	25.4	25.2	22.6
Total revenue (% GDP)	28.2	28.2	28.5	28.6	28.7	28.7
<i>Tax office and customs (% GDP)</i>	19.5	19.6	19.6	19.7	19.8	19.8
Total expenditure (% GDP)	33.4	32.1	32.0	31.8	31.8	31.6
Overall balance (% GDP)	-5.2	-3.9	-3.5	-3.2	-3.1	-3.0
Domestic borrowing (% GDP)	0.4	2.3	2.2	2.1	2.0	2.0
Privatization (% GDP)	0.9	0.1	0.1	0.0	0.1	0.1
Net foreign financing (% GDP)	4.0	1.5	1.2	1.1	1.0	0.9
Public debt (% GDP)	53.8	52.8	51.6	50.1	48.6	46.9
<i>Domestic (% GDP)</i>	34.8	34.0	33.2	32.3	31.4	30.4
<i>Foreign (% GDP)</i>	19.0	18.8	18.4	17.8	17.2	16.5
Private Saving (% DGP)	22.0	22.8	23.2	23.9	23.7	24.1
Private credit (% GDP)	28.8	31.3	33.1	34.7	36.0	37.1
Broad money (% GDP)	80.1	82.2	82.8	83.0	83.2	83.8
Trade balance (% GDP)	-25.8	-21.4	-20.6	-20.1	-19.2	-18.9
Current account balance (% GDP)	-8.9	-7.2	-5.8	-5.4	-5.2	-5.0
Payment balance (<i>million euro</i>)	0.7	1.1	1.4	1.9	1.8	2.1

Fiscal Approach

- *The main objectives of fiscal policies: macroeconomic stability and to design fiscal policies will create incentives for the private sector creating a favorable business climate.*
- *Medium term fiscal policies will be supported by:*
 - *Public Finance Strategy 2007-2013.*
 - *National Strategy for Development and Integration 2007-2013.*
 - *Macroeconomic and fiscal Framework 2009-2011.*
 - *The new law “Budgetary System Management”*
- *Medium term fiscal policies will follow the agreement for fiscal policies: IMF and Albanian Government.*

Fiscal Approach

- Tax policies
 - Review the Albanian tax system: short tax list
 - Transferring some national taxes from central to local government
 - Gradually approximate the indirect taxation system with European Acquis;
 - Reform the Social Insurance System

Strategic objective of tax policy for the coming years: promote formal economy, employment and investments.

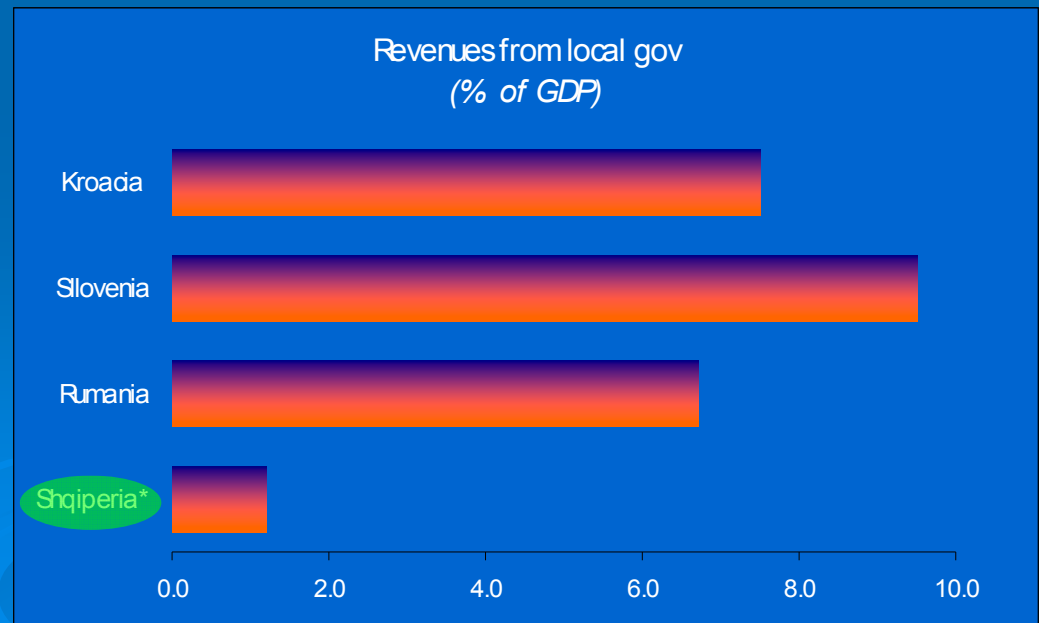
Fiscal Approach

- II. Tax administration and tax compliance
 - Simplify tax system and regulations
 - Increase efficiency in tax administration and lower the bureaucratic burdens
 - Avoid contacts between taxpayers and tax inspector
 - Introduction of e-filing
 - Analyzing risk using ASYCUDA module
 - Improving the refund system for VAT

Fiscal Approach

➤ III. Fiscal decentralization

- Albania: % of local revenues and expenditure is lower than neighbor countries.
- Improve fiscal framework for local government
- Increase fiscal autonomy, tax administration, and capacities to execute projects
- Strengthen the local administration



Fiscal Approach

IV. Revenue forecasting

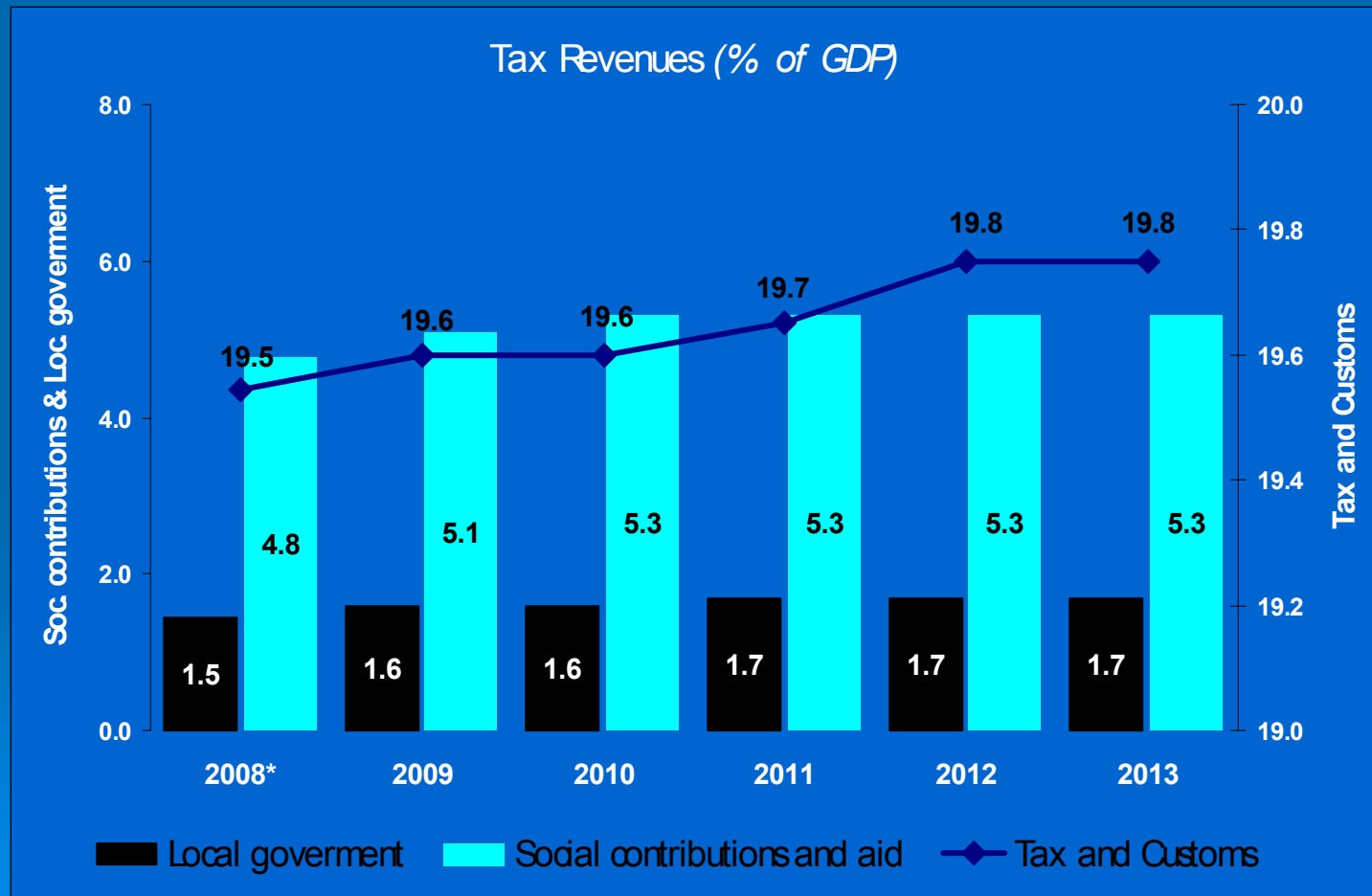
Revenue forecasting: macroeconomic projections, changes in tax policies, administrative improvements and historical trends.

➤ A) Main elements of tax policies

- VAT will remain in the same level
- Review the national taxes, in line with the fiscal decentralization process
- Review excise tax
- Reduce custom tariffs, in line with the agreements between Albania and EU, CEFTA and Free Trade Agreement with Turkey
- Social insurance contribution will stay the same as applied in September 2006

Fiscal Approach

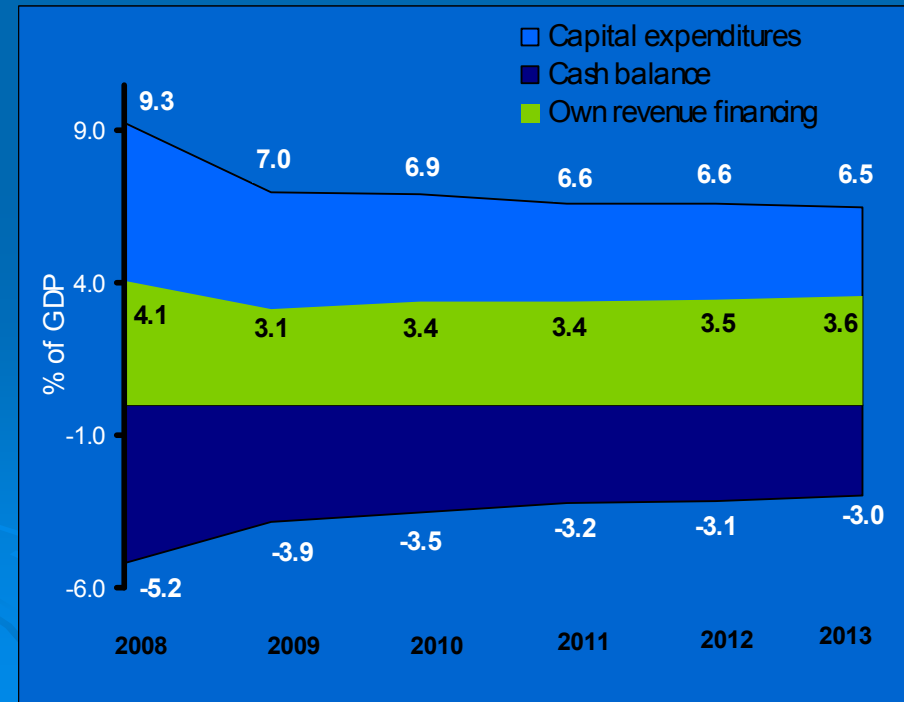
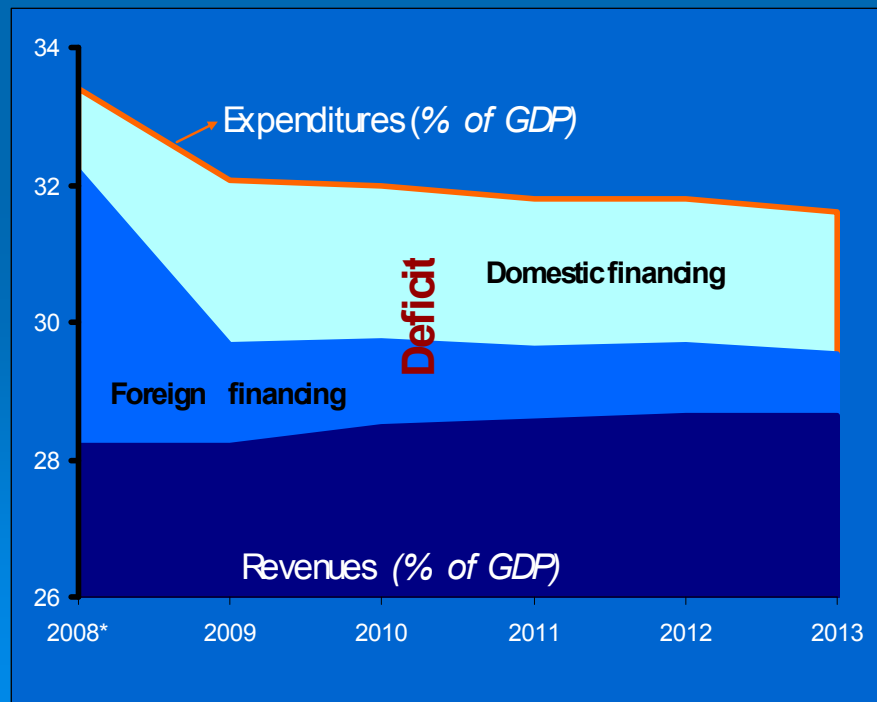
- Total revenues are expected to be around 28-29% of GDP



Fiscal Approach

V. Expenditures

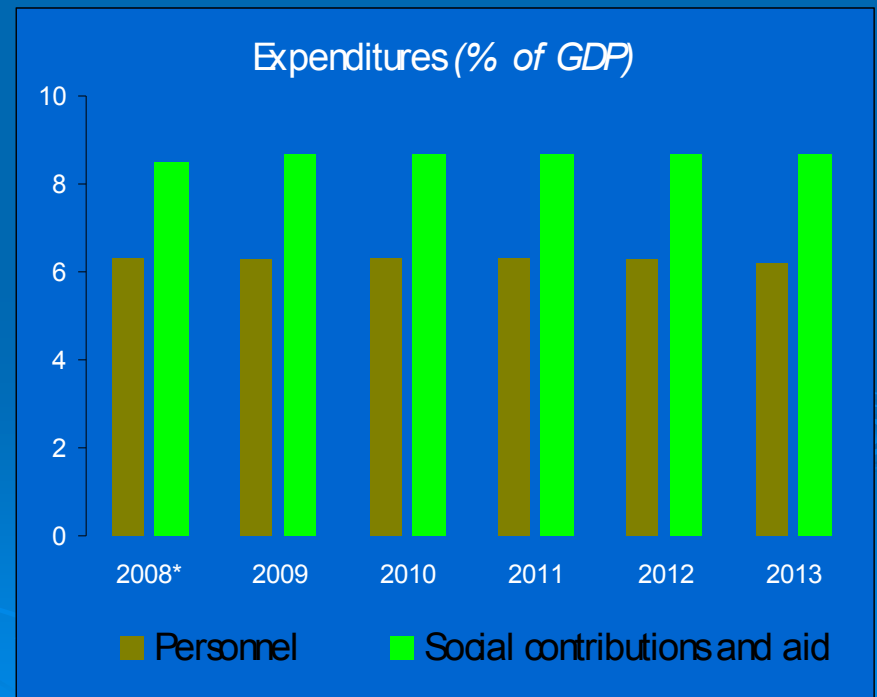
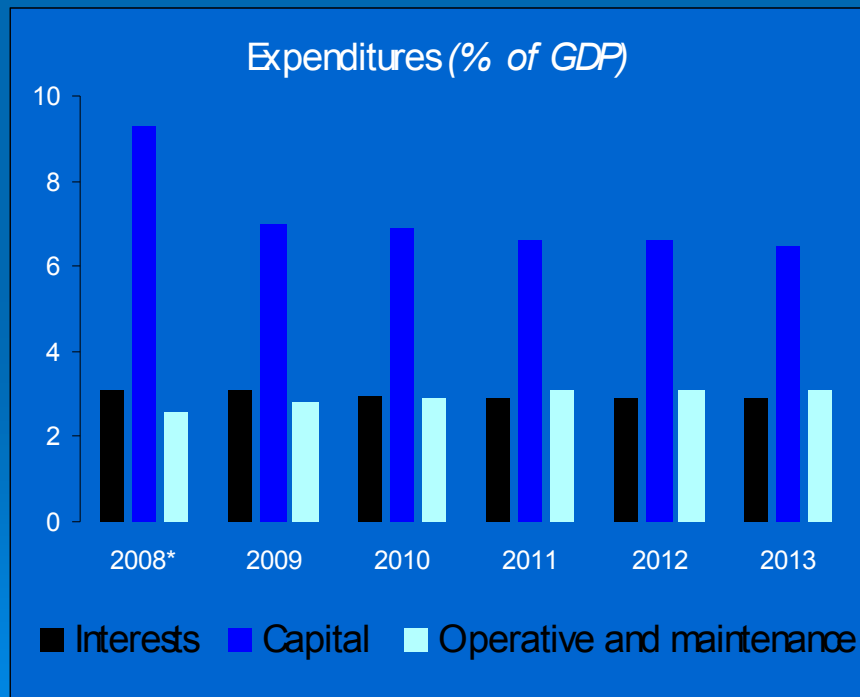
- The main priorities:
 - Improvement in the Annual and Medium-Term Budgeting Program
 - Improvement in the Planning and Management of Public investments
- Budgetary expenditures: remain within the interval 30 - 32% of GDP
- Decreasing Cash Balance, and 6 – 7% of GDP Capital expenditures



Fiscal Approach

➤ V. Expenditure

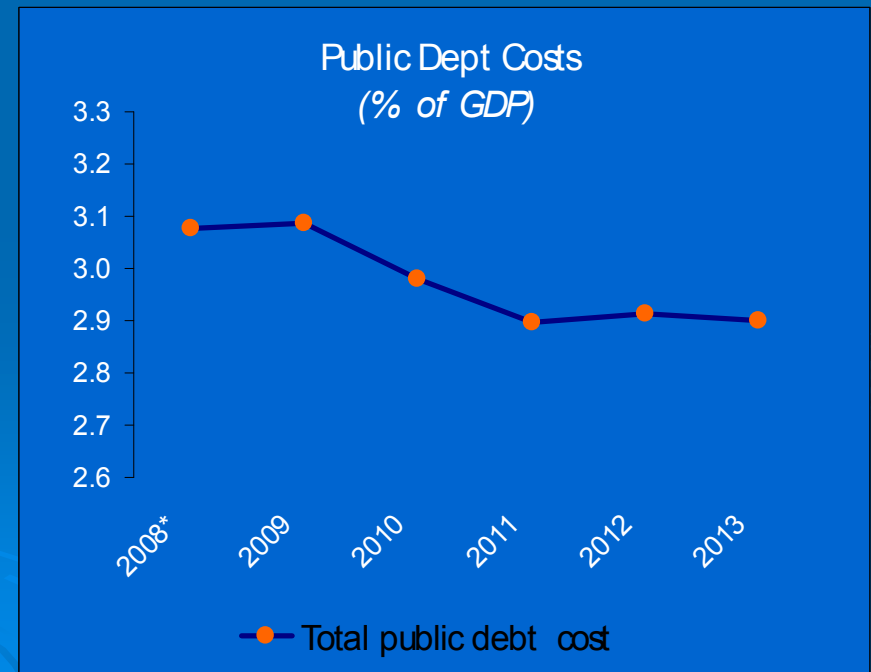
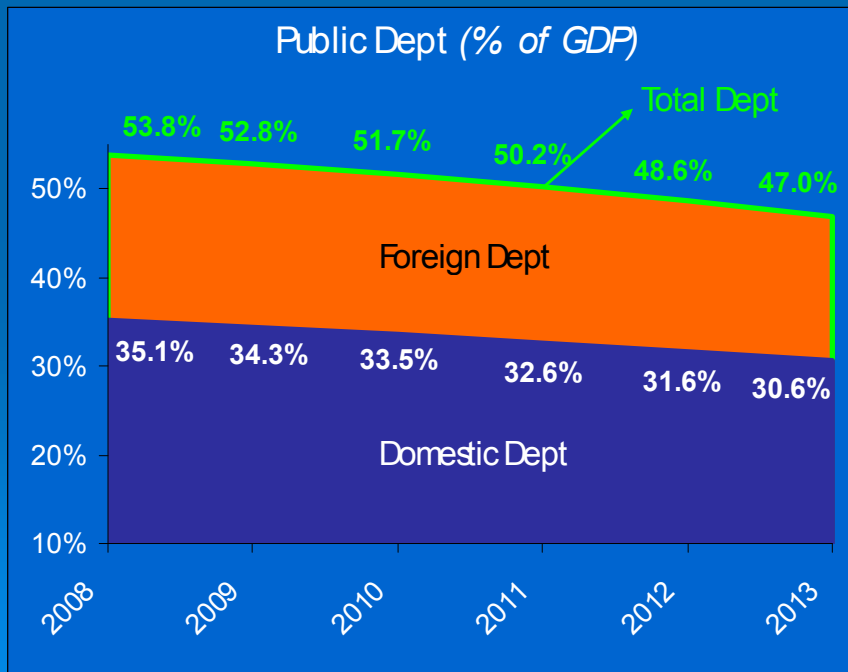
- Personnel expenditures will be around 6.3% of GDP
- Operational and maintenance expenditures will go up slightly
- Capital expenditure be around 6-7% of GDP



Fiscal Approach

VI. Debt

- Public debt/GDP will be reducing (deficit $\frac{1}{2}$ of growth)
- Broaden financial opportunities for businesses; debt structure will shift more toward foreign debt
- Focusing in the long term financial instruments; reduction of debt service (decreasing the risk of high interest rates and refinancing)



Conclusion

- Structural reforms and economic growth in Albania in last years have been successful.
- Implementation of policies and macroeconomic reforms in the last years: philosophy of “supply side”
- Economic growth and stability will continue in the future, based on the persistence of fiscal consolidation and public finances improvement.
- Based on the effect of fiscal reforms: total budget balance is expected to be 3% of GDP; public debt will be reducing, ensuring a macroeconomic stability.

Conclusion

- Fiscal development will create better financing opportunities for the private sector.
- Debt service: decrease

Next challenges

- Market liberalization and integration of Albania in the regional and world markets
- Creating an appropriate business climate, progress in the financial sector (banking and non-banking)-it is an important key factor in investment growth and economic growth for the country.
- Reforms in the Social insurance will improve the stability of financial systems.

Conclusion

- **Macroeconomic stability is still threatened from:**
 - Expectation: reduction of global economy growth
 - Financial problems in the international markets
 - Energy and oil prices around the world
 - Growth of food prices in the international markets
 - Increasing of loans in the economy

A combine fiscal and monetary policies will be a key factor to prevent unexpected crises

THANK YOU!

