Could fiscal amnesty reduce informality? The case of Albania

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Abstract

Purpose: Fiscal amnesty is a policy tool that has been used in various countries as a means to reduce the level of informality in their respective economies. It's been successful in some countries, but not always. As a measure against informality, the Albanian government has recently proposed the law for fiscal amnesty. The purpose of this paper is to conduct an analysis of the factors that could lead to the success of fiscal amnesty programs and to identify the ways on which this measure can succeed to reduce the level of informality in the Albanian economy.

Methodology: A qualitative approach was adopted to analyze the appropriate data, policy documents and reports relevant to this study.

Findings: The findings among other things, showed that the economic and political context, as well as the previous experience of fiscal amnesties in Albania, do not guarantee an effective and appropriate solution for Albania, such as the fiscal amnesty.

Value: By evaluating the economic and political context and program design, together with the long-term impact of the fiscal policy programs in Albania, this paper contributes to an ongoing discussion of the factors that could lead to a successful fiscal amnesty.

Keywords: fiscal amnesty, informality, European integration, Albania.

Introduction

Informality and EU integration in Albania is a complex issue that has been the subject of much discussion and debate in recent years. Albania's path to EU accession began in June 2006, when the government signed the Stabilization and Association Agreement (SAA), and since (2014), Albania is a candidate country for EU membership. However, the issue of informality has been identified as one of the major obstacles to Albania's EU integration process. One of the main concerns of the EU regarding informality in Albania is the impact it has on the country's economy. Therefore, addressing informality is a crucial step in Albania's EU integration process, as it will contribute to the country's economic growth and development and strengthen its legal system and rule of law. At the same time, the process of integration into the EU itself can influence the reduction of the levels of informality in Albania. The standard conditions necessary for integration in the European Union can change the culture of informality and a better environment for business growth.

According to a report by the World Bank (2021), the level of informality in Albania accounts for one fourth of the gross value added, making it one of the countries with the highest level of informality in the Western Balkans region. Reducing the level of informality in the Albanian economy has been a policy priority for governments. Various measures have been introduced to tackle the problem, including tax reforms, improved enforcement of labor regulations, and efforts to improve the business environment. However, the problem persists, and there is growing recognition of the need for more innovative approaches to address it. One potential solution that has been recently proposed is the use of fiscal amnesty, which will be the focus of this paper.

Fiscal amnesty is a policy tool that allows taxpayers who have previously engaged in informal economic activity to come forward and declare their income and assets without facing penalties or legal consequences (Meka, 2021). The aim of fiscal amnesty is to encourage tax compliance by offering incentives for individuals and businesses to enter the formal economy (Baer & Borgne 2008).

Fiscal amnesty programs typically involve a temporary suspension of penalties and interest for past non-compliance, as well as reduced tax rates for a certain period. In some cases, taxpayers may also be granted amnesty from criminal prosecution for tax evasion. Fiscal amnesty programs have been used in various countries around the world as a means of reducing informality and increasing tax revenues (OECD, 2015). Proponents argue that fiscal amnesty can provide a one-time boost to government revenue while also encouraging previously informal economic actors to enter the formal economy and contribute to sustainable economic growth.

However, critics of fiscal amnesty argue that it can create moral hazard by rewarding past non-compliance and encouraging individuals and businesses to continue engaging in informal economic activity in the expectation of future amnesties. Additionally, fiscal amnesty programs may be expensive to administer and may not be effective in the long-term unless accompanied by broader tax and regulatory reforms. International experience demonstrates that tax amnesties severely damage democracy, creating a sense that there is one rule for the rich and powerful, and another rule for everyone else (Tax Justice Network, 2016)

In the context of the Albanian economy, fiscal amnesty has been proposed as a potential tool for reducing informality and increasing government revenue. The government has previously introduced partial fiscal amnesty programs in 1996, 2007, and 2011, with varying degrees of success. As such, an analysis of the potential role of fiscal amnesty in reducing informality in Albania is warranted.

The study aims to answer the following research questions:

- What is the current state of informality in Albania and the challenges it poses for EU integration?
- What are the potential benefits and drawbacks of implementing fiscal amnesty measures in Albania?
- What factors are critical in designing an effective fiscal amnesty program in Albania?

For this purpose, this paper aims to analyze some elements that can identify the current general situation of the informal economy in Albania, and to present an analysis of the ways that fiscal amnesty can serve to reduce the level of informality in the context of the Albanian economy.

The importance of this paper is:

- Addressing informality is a crucial step in Albania's EU integration process, as it will contribute to the country's economic growth and development.
- This paper can serve to increase the understanding of the factors that could lead to the success of fiscal amnesty as an instrument to reduce the level of informality, in the context of the Albanian economy.

The findings of this study will contribute to the existing literature on informality and provide insights for policymakers in Albania and other countries facing similar challenges.

Literature Review

Fiscal amnesty or as it is known otherwise tax amnesty, is a government program that allows individuals or businesses to come forward and declare previously undisclosed or underreported income or assets without facing penalties or prosecution for past noncompliance (Alm, Vazquez &Wallace,2009). The goal of fiscal amnesty is to encourage voluntary compliance with tax laws and increase government revenue.

The extensive literature in this field shows that fiscal amnesty, either complete or partial, has been applied in many developed and developing countries. Of course, every fiscal amnesty program is accompanied by benefits and costs depending on the economic and political context of each country, therefore policymakers should carefully consider the potential costs and benefits of fiscal amnesty programs before implementing them.

Although there are no golden rules that fully guarantee the effectiveness of fiscal policy programs when they are implemented, there is a considerable number of *empirical studies on the possible effectiveness of fiscal amnesty program*. This analysis will focus on the various factors that could lead to the success of fiscal amnesty programs countries, as well as analyzing the context of the Albanian economy in relation to these factors.

Economic Context. Fiscal amnesty programs tend to be more successful in countries with relatively stable economic conditions, as taxpayers may be more willing to participate when they have a certain level of economic security. In contrast, in countries with high levels of economic instability, taxpayers may be more skeptical of the government's ability to maintain fiscal discipline, which can limit the effectiveness of fiscal amnesty programs. In a study Mookerjee and Bhattacharya (2010) analyzes the impact of economic development on the success

of fiscal amnesty programs in India, finding that programs are more effective in states with higher levels of economic development. Alm, Bahl, and Murray (2017) examines the impact of economic development on the success of fiscal amnesty programs in Latin America and the United States and concluded that programs tend to be more successful in countries with higher levels of economic development.

Political Context. The political context can also influence the success of fiscal amnesty programs. If the government is perceived as being corrupt or if there is a lack of trust in the government's institutions, taxpayers may be less likely to participate in a fiscal amnesty program. In addition, if there is a lack of political will to enforce tax laws, a fiscal amnesty program may not be effective in the long term. Koester and Pomerleano (2006) analyzes the political economy of fiscal amnesty programs, finding that political factors can play a significant role in the design and implementation of these programs.

A study by Gemmell and Morrissey (2005) examined the impact of political factors on the success of fiscal amnesty programs in sub-Saharan Africa. The authors found that the success of fiscal amnesty programs was influenced by the political context, including the level of political stability and the quality of governance.

Design of the Program. The design of the fiscal amnesty program can also impact its success. For example, programs that offer a short window of opportunity for taxpayers to participate may generate greater participation rates. Similarly, programs that provide incentives to taxpayers, such as reduced penalties or interest rates, may be more effective than those that simply offer amnesty. Torgler, Schneider & Schaltegger (2011) analyzes the impact of tax amnesty programs on taxpayer behavior in Latin America, finding that programs that offer reduced penalties and interest rates are more effective in encouraging compliance than those that simply offer amnesty. Analyzing the impact of tax amnesty programs on tax competition among countries Kanbur and Keen (1993) found that the design of these programs can significantly influence their effectiveness.

Long-Term Impact. While fiscal amnesty programs can generate short-term revenue gains, their long-term impact on tax compliance can be uncertain. Some studies suggest that frequent use of amnesty programs can lead to a culture of noncompliance. That is because if tax amnesties are frequently repeated, taxpayers tend not to comply with their tax obligations in anticipation for the benefits of the next tax amnesty (Bird,2015). Bird and Gendron (2007) examined the long-term impact of fiscal amnesty programs on tax compliance in developing countries. The authors found that while fiscal amnesty programs can generate short-term revenue gains, they can also send a signal to taxpayers that noncompliance is acceptable, which can undermine future tax compliance efforts.

Overall, the success of a fiscal amnesty program in a country can depend on various factors, such as the country's economic and political context, the design of the program, and the long term impact. Policymakers should carefully consider these factors when designing and implementing fiscal amnesty programs. Albania, taking into account the context of current developments first of all, should be necessary focus on strengthening the tax system and enforcement mechanisms, providing taxpayer education, and increasing transparency and accountability in the tax administration, because no matter how clearly drafted a fiscal amnesty program cannot have the expected positive effects.

Research Methodology

To identify the current general situation of the informal economy and the ways that fiscal amnesty can serve to reduce the level of informality in the context of the Albanian economy, this paper is based on a qualitative analysis. The qualitative analysis involves a review of relevant data, policy documents, reports, and academic literature relevant to the study. To answer the main questions, the study implies the method of analyzing theories and empirical work of the factors that can lead to positive results of fiscal amnesties in order to reduce informality.

Analysis And Findings

From the reports of official institutions, or in the various studies in this field, it does not seem to have been done a comprehensive analysis of the effects on the economy of past programs of fiscal amnesties in order to conclude on their effectiveness in Albania. But based on the analysis of some factors that extensive literature suggests which can be considered favorable for the application of a fiscal amnesty, we can consider its successful application or not in Albania.

The first proposal for a general fiscal amnesty in Albania dates back to 1999, on the initiative of former President Rexhep Mejdani, but was not accepted by the government or the opposition of that time. During the last two decades, in Albania there have been at least two initiatives for fiscal amnesty based on voluntary declaration of assets (2011 and 2017) in the sense of the legal approach, but none of the proposals have found the political consensus and the international factor (Meka,2021).

The 2020 proposal remains a draft, amended in 2022 and currently under discussion for the agreement of stakeholders and international institutions.

Economic Context. Albania is classified as an upper-middle-income country, with a Gross Domestic Product of approximately $42 billion at the end of 2022 in purchasing power parity terms (World Bank, 2022). However, Albania still faces significant economic challenges, such as a large informal sector, high unemployment rates, and low productivity. These factors can make it difficult to enforce tax compliance and may make fiscal amnesty programs less successful. The phenomenon of informality is complex and can be analyzed in terms of the factors that can potentially cause it. Some elements that are essential in causing the informational economy are: the labor market, cash economy, corruption, the tax system, etc.

The World Bank study (2021) showed that the level of informality in Albania accounts for one fourth of the gross value added, making it one of the countries with the highest level of informality in the Western Balkans region, concluding that informality hinders thus the development of Albania. Another ILO report for 2021 shows that the informality rate in Albania in the work environment sector is about 51.3%, while about 45.5% of employees in Albania work in the informal sector.

An indicator of *informality in the labor market* is the number of social security contributors in relation to the number of total employees. If we compare the data on the number of employees reported by INSTAT and the number of social insurance contributors reported by SII, it is noticed that there is a significant discrepancy between them, proving a high degree of evasion.

| Years	Contributor in total	Employed
2018	778.111	1.230.000
2019	781.924	1.266.000
2020	747.872	1.243.345
2021	790.835	1.248.749
2022	801.48	1.230.000

Source: INSTAT and SSI

The informality of work in Albania seems to have increased. According to the SELDI Hidden Economy Monitoring System (2022), the share of workers without written contract on the main job is the largest in Kosovo* (19%) and in Albania (16%) and compared to a previous period there was a 3% increase in the "no written contract" share in Albania.

According to the World Bank, the Hidden Employment Index shows that 47 percent of employment in Albania has a level of informality and Albania has a high

level of informality in the wage sector compared to the Region. With only 5.2% of GDP, our country collects income from social and health insurance half of the regional average. In Serbia and Montenegro, this indicator exceeds 12% of GDP. This is an indicator of the high informality of work in the country, as a large part of employees declare minimum wages, but also of the fact that Albania has a high number of employees in the agricultural sector, who pay minimal contributions, or they don't pay at all.

Numerous studies in the field of informality show that *the amount of cash that circulate outside the banking system* is also an indicator of informality in an economy. If a large number of transactions in a sector are carried out in cash without being reported in taxes, this can be another indicator of informality. Referring to the data of the Bank of Albania (2022), over 387 billion ALL "CASH" circulated in the Albanian economy. Compared to the same period a year ago, it turns out that the cash has increased by 21 billion ALL (BOA,2023).
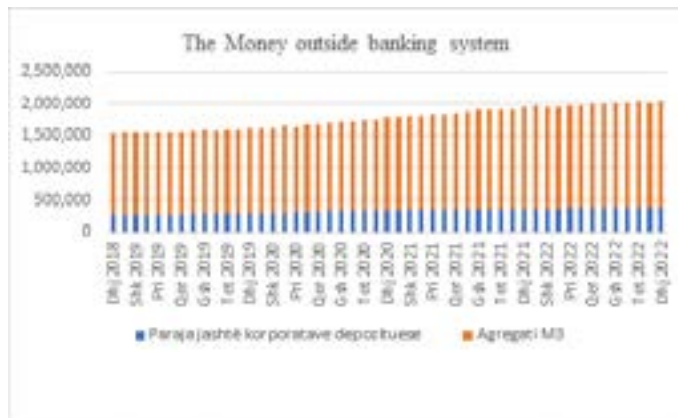
Source: Bank of Albania

Although for years the Bank of Albania has been engaged in encouraging and promoting the use of formal and secure channels for money transactions, through the improvement of payment systems, the increase of financial education and the digitization of financial services in order to address the high level of the use of cash, the reduction of informality still remains a current problem and a challenge. According to the World Bank (2022) only 40 percent of adults and about 75 percent of SMEs have access to a bank account.

The tax system is also considered as one of the main pillars that can facilitate or hinder the formalization of the economy. This is because often the high costs and difficulties in the tax administration , push many businesses not to declare their income or even worse to leave the market.

Years	Businesses that have gone into passive status
2019	7049
2020	6292
2021	8071
2022	12433

Source: General Directorate of Taxes

Meanwhile, Albanian Center for Economic Research (ACCER 1999) showed that 73% of evaluated enterprises do not report full profits. The fiscal burden and high informality are two of the main problems that businesses in Albania consider as hindering factors for business development (Worl Bank, 2022).

At the end of 2022, tax revenues for Albania were 494.7 billion ALL, of which tax debt was 146 billion or 29% of total revenues. Compared to the data of a year ago, there is an increase in the total tax debt in relation to the total income.

Years	Tax debt
2018	108.000.000
2019	117.000.000
2020	123.000.000
2021	135.000.000
2022	146.000.000

Source: General Directorate of Taxes

The International Monetary Fund (IMF) has analyzed Albania's fiscal system, in a technical assistance report (IMF, 2020). The report emphasizes the complicated tax system that the country has with degrees of progressivity and fiscal exemptions, which create a path for evasion, while giving some recommendations for its simplification.

The analysis shows that the situation of informality in Albania is disturbing. Governments in Albania as in other countries of the region, have undertaken a lot of different measures to tackle informality, ranging from dedicated initiatives to more general structural reforms within the framework of EU accession. Yet, the lack of unequivocal long-term political commitment to EU accession and related reforms across the region, makes sustainable progress on informality difficult (SELDI, 2022).

Political Context. Even though Albania has made significant progress in recent years towards strengthening its democratic institutions and governance structures, *corruption* remains a significant challenge in the country. Studies show that the

level of corruption is also an indicator of informality in the economy. A one-point rise in the index of corruption is associated with an increase in the level of hidden economy by 0.253% points (Borlea, Achim and Miron 2017). Where there is informality, there is a great increase in corruption. According to the Transparency International Report (Annual Report, 2021) Albania, Serbia and Bosnia-Herzegovina are the most corrupt countries in Europe. Albania's score in Transparency International's Corruption Perception Index has continuously deteriorated since 2016, decreasing from a score of 39 to 35 (out of a possible 100) in 2021 (TIR,2022). Meanwhile, according to the OECD report (OECD 2020), corruption is one of the main causes of informality in Albania, creating unfair conditions for legally registered businesses and encouraging the activity of illegal businesses. This can undermine taxpayer trust in the government and tax system, potentially making it more difficult to encourage participation in fiscal amnesty programs.

The long-term impact of fiscal amnesty programs on tax compliance in Albania is uncertain, cause it does not appear that a comprehensive analysis of the economic effects of past amnesty programs has been done (mainly tax debt forgiveness), but referring to the data on the tax debts where amnesty or tax forgiveness was announced by political forces, it appears that this debt has deepened. According Open Data Albania (Albanian Institute of Science, 2022) after the implementation of the first fiscal debt forgiveness program in 2008, there was a very high increase in fiscal debt, from ALL 8.4 billion liabilities to ALL 19.8 billion liabilities in 2009, increasing the cost of informality in the economy.

Source: SSA 2012; Report for the implementation of the 2011 state budget

The two previous amnesties, in 2010 and 2017, which were partial, failed to achieve the intended results. At the end of 2011, the fiscal obligations in total were about 65 billion ALL, which have been increasing since the attempt for partial forgiveness of customs and tax obligations in 2008. During 2015, the value of the debt has increased by the amount of 12,630,410 thousand ALL or 14% of the debt balance at the beginning of 2015, as well as 13% of the total debt

These results show that the repetition of amnesties can lead to the loss of confidence of tax payers in the system, therefore the avoidance of tax obligations while waiting for the forgiveness of unpaid obligations.

Design of the Program. The participation rates in fiscal amnesty programs in Albania have generally been lower than in other countries. For example, a fiscal amnesty program introduced in 2018 generated less revenue than expected, with only a small percentage of eligible taxpayers participating. This may be due to a lack of trust in the government and tax authorities, as well as the perception that the program did not provide significant benefits to participants. On the other hand, it seems that these partial tax amnesties have not been accompanied by other ongoing reforms. As (Meka, 2023) emphasizes for a tax amnesty to be successful in the long run, must, unavoidably, strive to be intertwined with other indispensable and follow-up reforms.

Analysis of these data shows that fiscal amnesty has had a limited impact on reducing informality in Albania. The weak legal and institutional framework, lack of enforcement of tax laws, and the existence of a culture of informality have hindered the effectiveness of fiscal amnesty programs. The incentives provided by the programs were not significant enough to encourage taxpayers to participate, and the penalties for non-compliance were not severe enough to constrain informal economic activities.

Conclusions

Reducing the informal economy is a critical priority for Albania's EU accession process. Addressing this issue requires a concerted effort by the government to simplify regulations, reduce the administrative burden on businesses, and improve tax compliance. The success of these efforts will depend on the government's ability to build trust in institutions, enforce regulations effectively, and create a culture of compliance.

- The findings suggest that informality remains a significant challenge for Albania's EU integration, as it contributes to tax evasion, corruption, and unfair competition.
- Fiscal amnesty can be undertaken when it is estimated that the state through its policies can control informality and all other problems related to it, such as corruption, evasion, prevention of money laundering, etc.
- The economic and political context, as well as the previous experience of fiscal amnesties in Albania, do not guarantee an effective and appropriate solution for Albania, such as the fiscal amnesty.

- We can estimate that the fiscal amnesty programs (tax debt forgiveness) in Albania have not been successful in the results achieved for the normalization of the economy, even unpaid fiscal obligations have increased year after year, an increasing trend after each fiscal amnesty program, or waiting for a new amnesty.

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