Assessing the impact of fiscal policy on poverty and inequality in Albania

presented at
The Future of the Welfare State in the Western Balkans
Policy Analysis Laboratory School
Montenegro, October 21-25, 2019

presented by
Aida Gjika

a paper of María E. Dávalos, Monica Robayo, Esmeralda Shehaj, Aida Gjika*
Assess the impact of the fiscal system on poverty and inequality in Albania, and benchmark to other countries that have applied a similar methodology.
Compared to other countries in the region, poverty rates remain high in Albania.

Source: World Bank, ECAPOV.
Reigniting poverty reduction and making faster progress requires:

1. Accelerating and sustaining economic growth → Growth recovering

2. Accentuating the inclusiveness and poverty reduction impact of any growth by increasing the **income generating capacity of poor households**
Sound fiscal policies are also a priority for Albania

Given high reliance on public transfers by households, fiscal pressures and inequalities in service delivery, it is key to implement sound fiscal policies in Albania

→ For faster and sustainable progress in poverty reduction and shared prosperity, the design of fiscal policies should be informed by the impact they have on poverty and inequality

Source: Albania Systematic Country Diagnostic
The Commitment to Equity (CEQ) methodology for Albania
The Commitment to Equity Methodology can help assess the distributional role of fiscal policy...

Key Questions of the CEQ Assessment

- What is the impact of taxes and transfers on inequality and poverty?

- How effective is the fiscal system in reducing inequality and poverty?

- Who bears the burden of taxes and receives the benefits?

- How equitable is the use of education and health services?

- Identify areas of potential policy reform to enhance the capacity of the state to reduce inequality and poverty through taxes and transfers

→ The CEQ methodology has or is being applied in around 38 countries around the world, allowing for benchmarking and sharing lessons across countries

This approach is based on the methodology and findings of the Commitment to Equity project (CEQ) led by Nora Lustig, Professor of Economics at Tulane University.

www.commitmenttoequity.org
...by looking at poverty and inequality across various household income concepts affected by fiscal policies

Households’ Market Income: Wages and salaries, income from capital, private transfers; before government taxes, social security contributions and transfers.

Remove direct taxes and add direct transfers

Disposable income

Remove indirect taxes and add indirect subsidies

Consumable income

Add in-kind transfers (education, health) and remove fees, copays

Households Final income
CEQ Methodology

• Standard incidence analysis without behavioral, lifecycle or general equilibrium effects.

• The focus is on average incidence rather than incidence at the margin.

• Does not take into account the quality of education and health services delivered by the government.

• Does not include some important taxes and spending.
  • Corporate profit taxes, property taxes, VAT paid by institutions
  • Spending on infrastructure investments, ...
Data: The Household Budget Survey

- Household Budget Survey (HBS) 2015
- Sample: 7,335 households
- Representativeness by urban/rural, 4 regions, and 12 prefectures
- Not officially used for poverty measurement yet

Questionnaire includes (i) core face-to-face interview; (ii) diary of purchases and self-consumption (14-day recall)

Core questionnaire includes information on household roster; and (i) labor; (ii) dwelling characteristics and spending; (iii) spending on furniture, appliances, services; (iv) garments and footwear; (v) health; (vi) transport and communication; (vii) spare time, culture, education and travel; (viii) Others; (ix) Income and savings; (x) dwelling not in use; (xi) subjective questions.
What is the best starting point of the CEQ analysis for Albania?

Disposable income seems to be largely underreported in HBS (i.e. consumption is 2.5 higher than reported income)

HBS Consumption Aggregate
- Includes new durables only
- Excludes imputed rent (only paid rent is included=3.69% renting)
- 56% of national accounts’ private consumption
CEQ’s approach for Albania

Disposable income = Consumption Aggregate

Gross Households’ Market Income

Net Household Market Income

Remove direct transfers

Remove indirect taxes and add indirect subsidies

Add in-kind transfers (education, health) and remove fees, copays

Add direct taxes

Consumable income

Households Final income
The CEQ focuses on 70% of Government revenues.
The CEQ focuses on 45% of Government spending (social spending)
Key Concepts
Three dimensions for interpreting the results

- Progressivity (Kakwani index)
- Redistributive effect (Marginal contribution to Gini)
- Poverty reduction effect (Marginal contribution to poverty headcount)
Results
Impact of Fiscal Policies on Poverty and Inequality in Albania
Emerging messages

The fiscal system in Albania contributes to reducing inequality.

Before any fiscal intervention, the Gini coefficient stands at 0.37 and goes down to 0.32 after the combined effect of taxes and contributions, and social spending.

Figure 1. Albania: Change in Inequality from Market to Final Income (Gini coefficient)
Albania: Poverty Headcount at $2.5/day (a) and $4/day (b) from Market to Consumable Income
The effect of direct taxes and social spending (direct transfers, health and education) helps to reduce poverty and inequality.

- Direct taxes are progressive, particularly PIT, with very small impact on inequality (reduce inequality) and poverty (increase poverty).
- Direct transfers are progressive, poverty-reducing and equalizing
- Education and health are progressive and equalizing

Indirect taxes are regressive, poverty- and inequality-increasing.

Indirect taxes reverts the poverty effect achieved with direct taxes and transfers
Benchmark scenario is pensions as deferred income; if pensions are considered as transfers the impact on poverty and inequality is larger.
Across many countries, including Albania, direct taxes are progressive.

### In addition:
- Very small impact on inequality and poverty
  - reduce Gini coefficient by 0.009 points
  - increase poverty by 0.3 pp

---

Sources: Armenia (Younger et al, 2014), Brazil (Higgins and Pereira, 2014), El Salvador (Beneke et al, 2015), Ethiopia (Woldehanna et al, 2014), Georgia (Cancho and Bondarenko, 2015), Guatemala (Cabrera et al, 2014), Mexico (Scott, 2014), Peru (Jaramillo, 2014), Russia (Lopez Calva et al, 2015), Uruguay (Bucheli et al, 2014), and South Africa (Inchauste et al, 2015). Note: contributory pensions treated as part of market income.
PIT is the most progressive and redistributive direct tax in Albania

This is partly due to its relatively large size

Sources: Staff estimations based on 2015 HBS
All direct transfers are progressive, redistributive and poverty-reducing

Progressivity of Direct Transfers (Kakwani Index)

<table>
<thead>
<tr>
<th>Program</th>
<th>Redistributive effect</th>
<th>Poverty reduction effect (percentage points, $2.5/day PPP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disability pension</td>
<td>0.008</td>
<td>1.2</td>
</tr>
<tr>
<td>Survivor Pension</td>
<td>0.001</td>
<td>0.2</td>
</tr>
<tr>
<td>Unemployment Benefit</td>
<td>0.000</td>
<td>0.2</td>
</tr>
<tr>
<td>Social care/Services for elderly, disabled</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ndihma Economike</td>
<td>0.001</td>
<td>0.1</td>
</tr>
<tr>
<td>Energy Subsidy</td>
<td>0.003</td>
<td>0.4</td>
</tr>
<tr>
<td>All direct transfers excl pensions</td>
<td>0.014</td>
<td>2.4</td>
</tr>
</tbody>
</table>

Sources: Staff estimations based on 2015 HBS
Ndihma Ekonomike spending is mostly concentrated on the poorest

Sources: Staff estimations based on 2015 HBS
Indirect taxes in Albania are regressive, unequalizing and poverty increasing

Indirect taxes in Albania (for now excluding indirect effects of fuel excises) are un-equalizing, slightly increasing Gini by 0.1 points

They contribute to increasing poverty ($2.5/day) by 4.7 percentage points

Sources: Staff estimations based on 2015 HBS
This is driven by VAT, although once indirect effect of excises are included the picture may change.

VAT alone contributes to increasing poverty by 4.4 percentage points, out of a total of 4.7 percentage points.

This large impact is partially attributed to its relatively large size, comparable to all direct taxes and contributions combined.

Sources: Staff estimations based on 2015 HBS
The poverty-reducing effect of direct taxes and transfers is more than compensated by the poverty-increasing effect of indirect taxes.
Education and health spending are progressive and redistributive

Sources: Staff estimations based on 2015 HBS
Overall, the fiscal system contributes to addressing inequality in Albania.
The fiscal system has a poverty-increasing impact

Poverty reduction effect of Fiscal Policy
(poverty at market income minus poverty at consumable income)
(Change in Poverty Headcount, US$ 2.5 PPP)

The effect of **direct taxes and social spending** (direct transfers, health and education) helps to reduce poverty and inequality.

- Direct taxes are progressive, particularly PIT, with very small impact on inequality (reduce inequality) and poverty (increase poverty).

- Direct transfers are progressive, poverty-reducing and equalizing

- Education and health are progressive and equalizing

- Indirect taxes are regressive, poverty- and inequality-increasing.

- Indirect taxes reverts the poverty effect achieved with direct taxes and transfers
The Albanian fiscal system appears to:
  • Play a positive role in reducing inequality
  • Have a moderately poverty-increasing effect

Taxes and Social protections contributions have a poverty increasing effect
Indirect taxes (VAT) contributes the most to increasing poverty
Effect compensated somewhat by government transfers, though unable to offset

Ongoing reforms aimed at improving the efficiency and targeting of social assistance can contribute at enhancing the pro-poor impact of the fiscal system
1. Agenda to improve the coverage and targeting of direct transfers
2. Agenda to improve tax administration and compliance
3. Agenda to strengthen the institutional set up to assess and monitor distributional impacts
Thank you!

Questions & Suggestions?

aida.gjika@gmail.com

University of Tirana, Albania
Development Solutions Associates
CERGE-EI Fellow