

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

*presented at*

The Future of the Welfare State in the Western Balkans  
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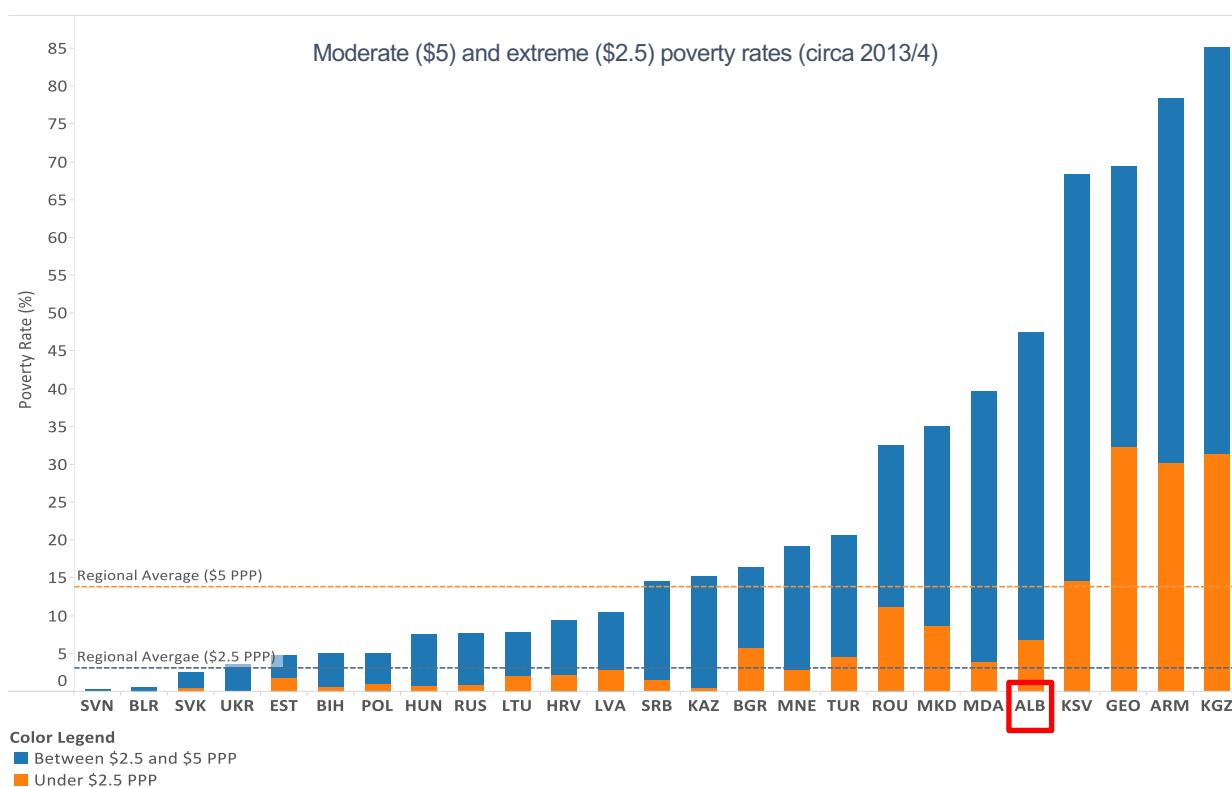
*presented by*  
Aida Gjika

*a paper of María E. Dávalos, Monica Robayo, Esmeralda Shehaj, Aida Gjika\**

## Objective

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



## 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**

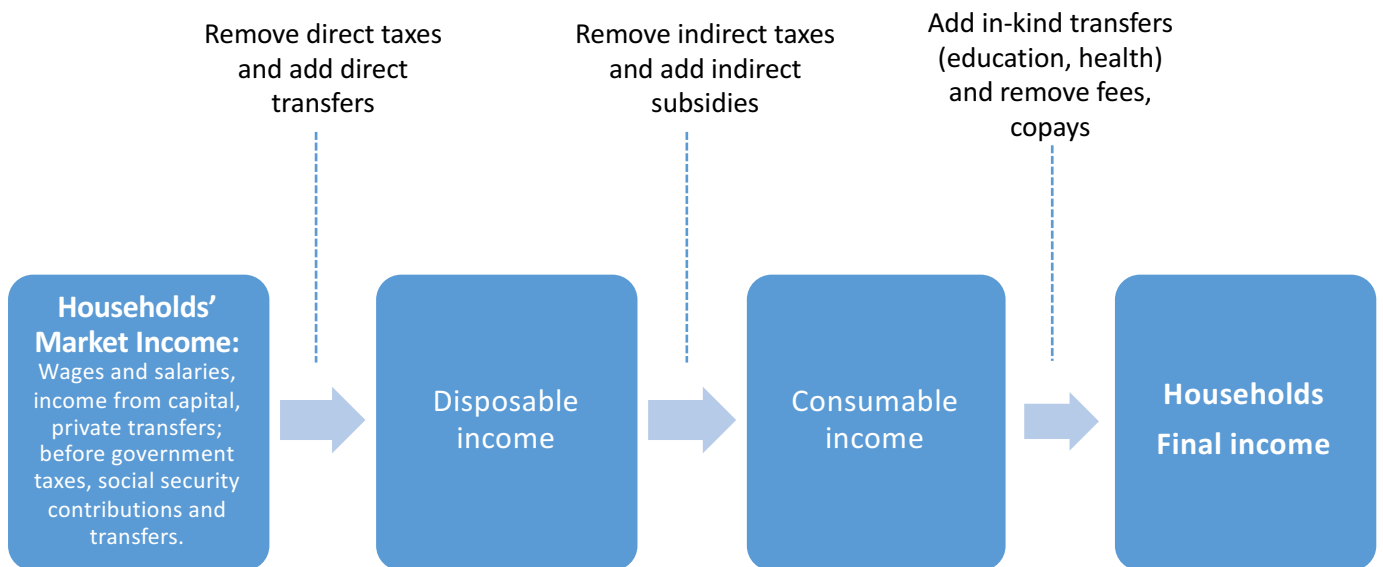
# The Commitment to Equity (CEQ) methodology for Albania

# 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

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





## CEQ Methodology

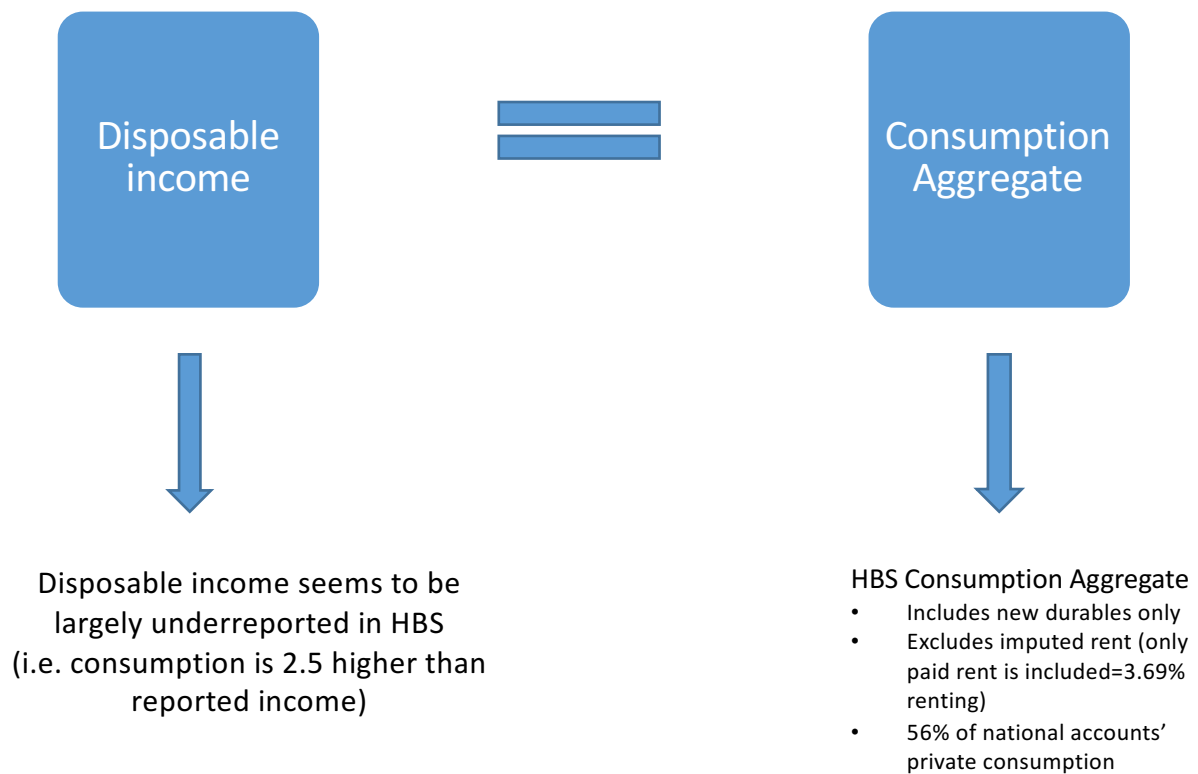
- Standard incidence analysis without behavioral, lifecycle or general equilibrium effects.
- The focus is on average incidence rather than incidence at the margin.
- Does not take into account the quality of education and health services delivered by the government.
- Does not include some important taxes and spending.
  - Corporate profit taxes, property taxes, VAT paid by institutions
  - Spending on infrastructure investments, ...

## Data: The Household Budget Survey

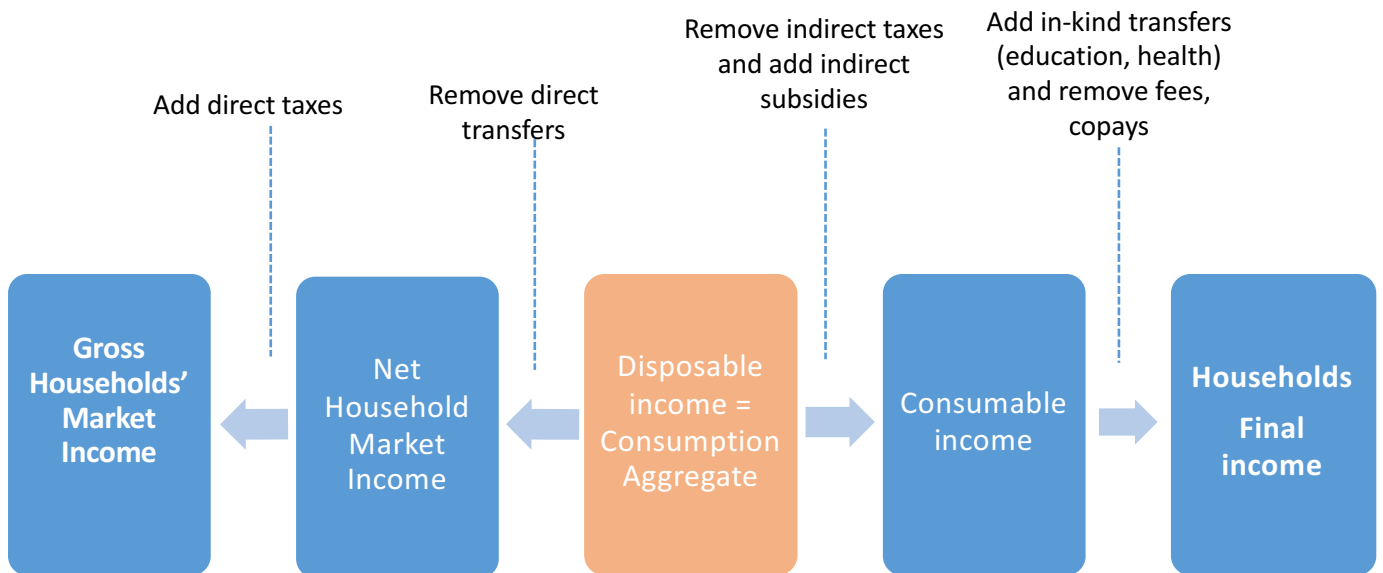
- Household Budget Survey (HBS) 2015
- Sample: 7,335 households
- Representativeness by urban/rural, 4 regions, and 12 prefectures
- Not officially used for poverty measurement yet

- 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.

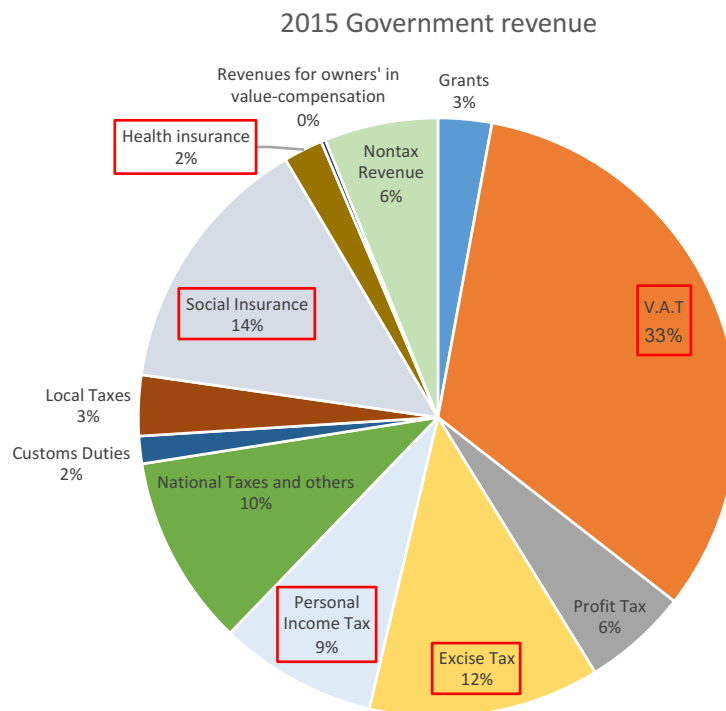
# What is the best starting point of the CEQ analysis for Albania?



## CEQ's approach for Albania

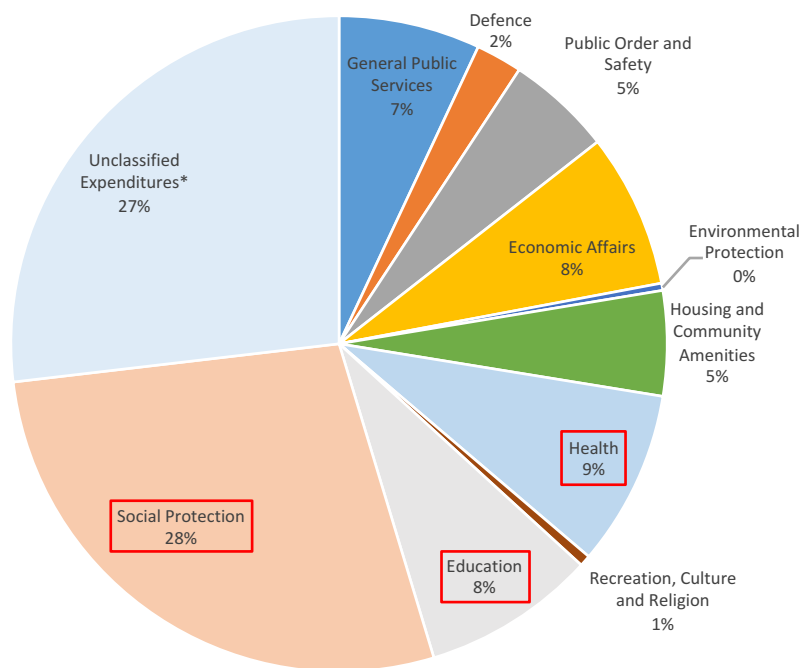


# The CEQ focuses on 70% of Government revenues



# The CEQ focuses on 45% of Government spending (social spending)

2015 Government expenditures



# Key Concepts

## Three dimensions for interpreting the results

Progressivity (Kakwani index)

Redistributive effect (Marginal contribution to Gini)

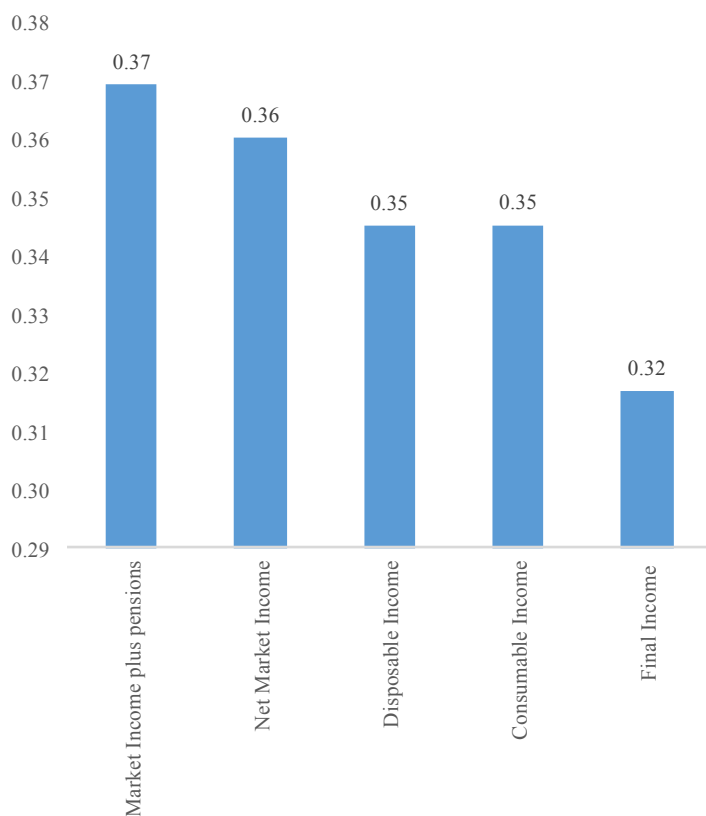
Poverty reduction effect (Marginal contribution to poverty headcount)



# Results

## Impact of Fiscal Policies on Poverty and Inequality in Albania

## Emerging messages

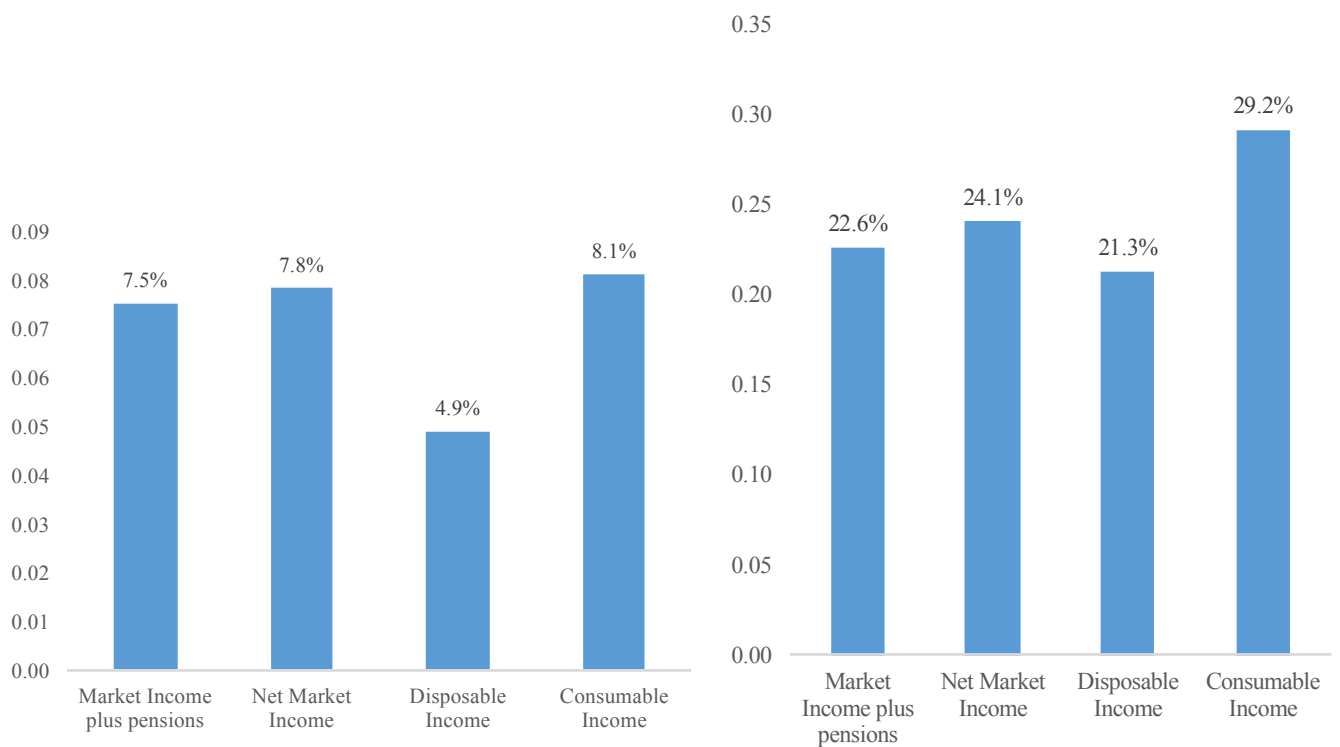


**The fiscal system in Albania contributes to reducing inequality.**

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)**

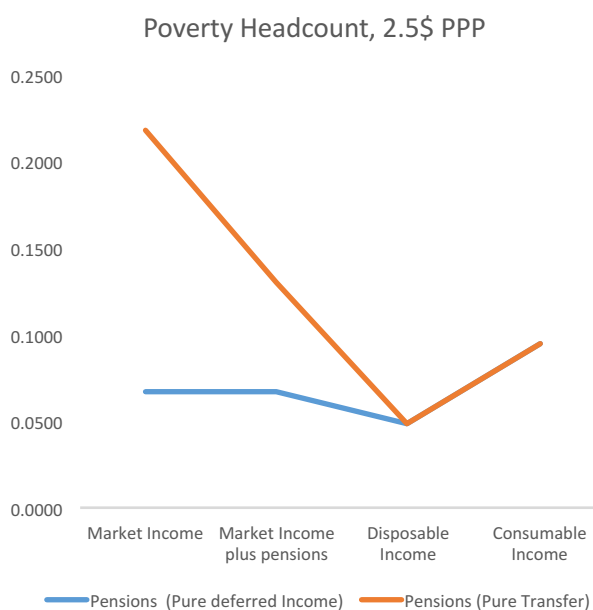
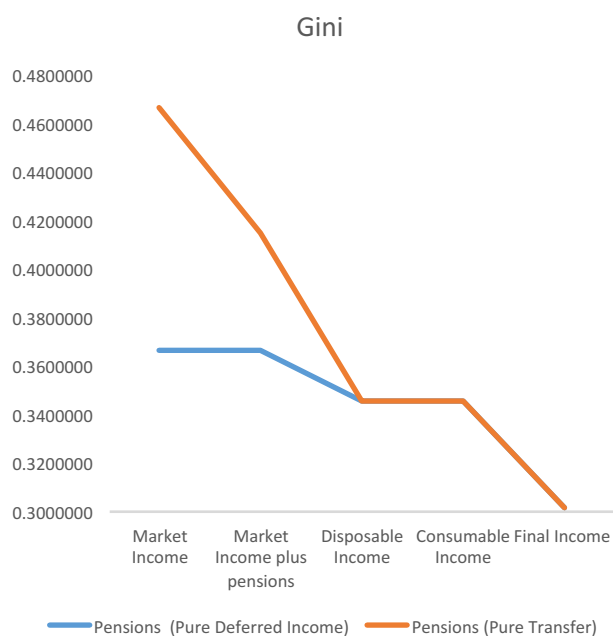
## Albania: Poverty Headcount at \$2.5/day (a) and \$4/day (b) from Market to Consumable Income



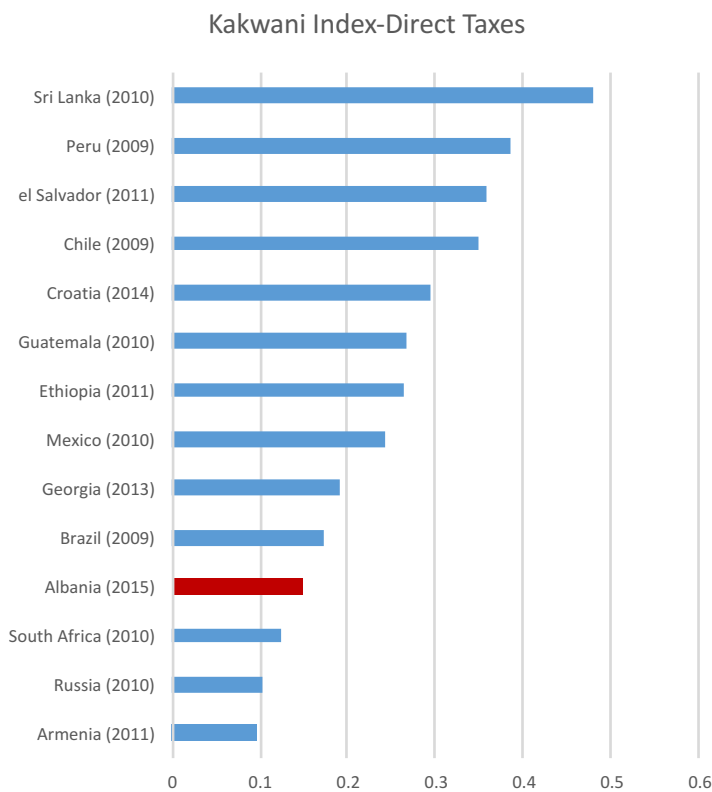
## Emerging messages

- 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:

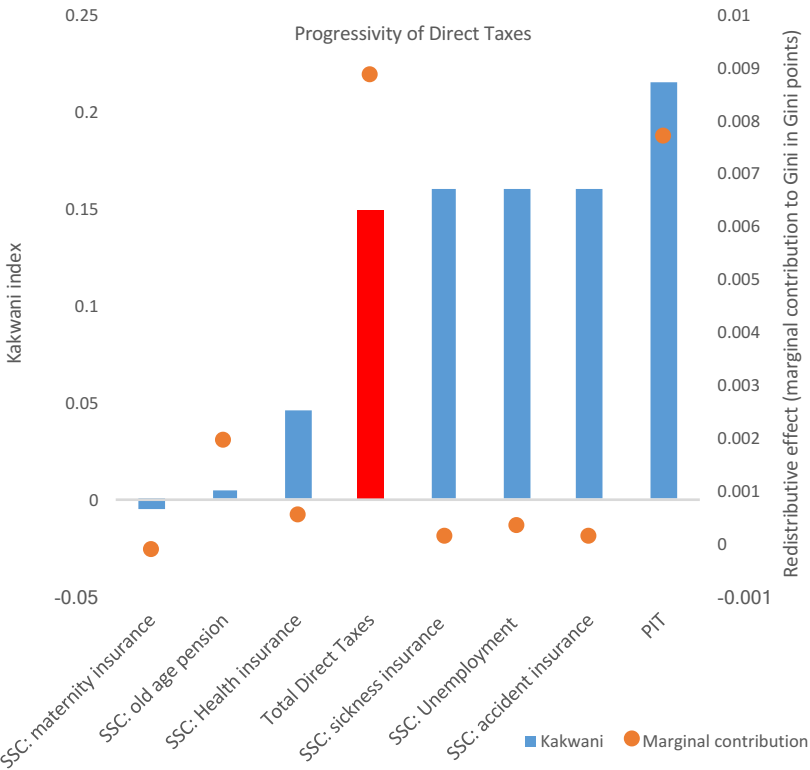
Very small impact on inequality and poverty

→ 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



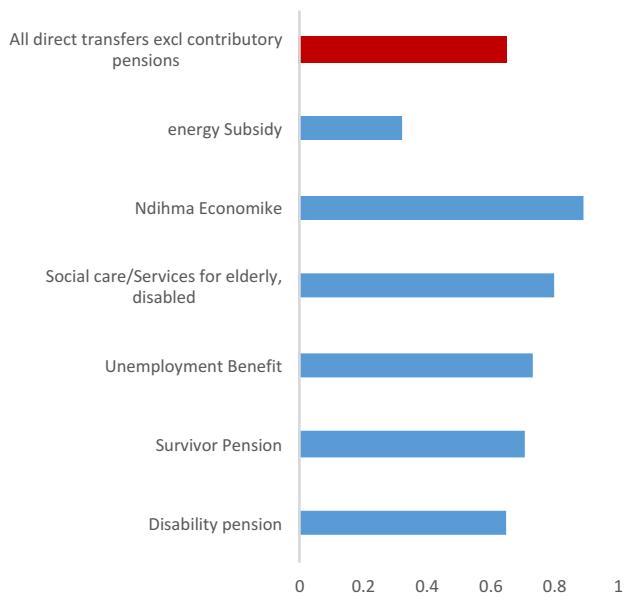
PIT is the most progressive (highest Kakwani) and redistributive (highest marginal contribution to Gini)

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)



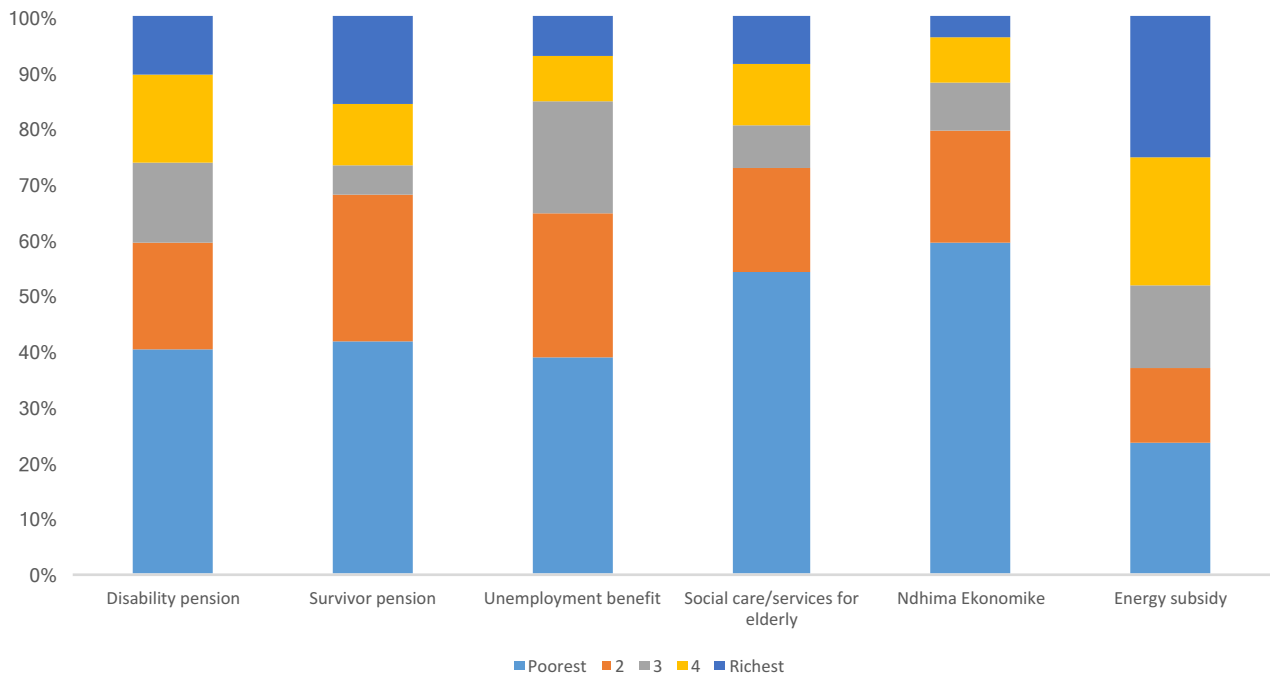
Program	Redistributive effect	Poverty reduction effect (percentage points, \$2.5/day PPP)
Disability pension	0.008	1.2
Survivor Pension	0.001	0.2
Unemployment Benefit	0.000	0.2
Social care/Services for elderly, disabled	0.001	0.1
Ndihma Economike	0.003	0.4
Energy Subsidy	0.001	0.2
<b>All direct transfers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

Sources: Staff estimations based on 2015 HBS



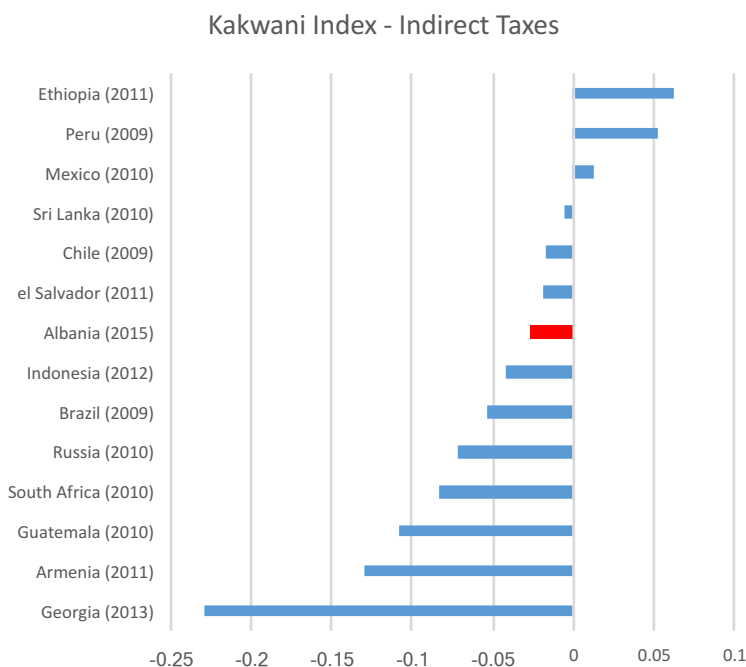
# Ndihma Ekonomike spending is mostly concentrated on the poorest

Concentration of social spending (by market income plus pensions, by quintiles)



Sources: Staff estimations based on 2015 HBS

# Indirect taxes in Albania are regressive, unequalizing and poverty increasing

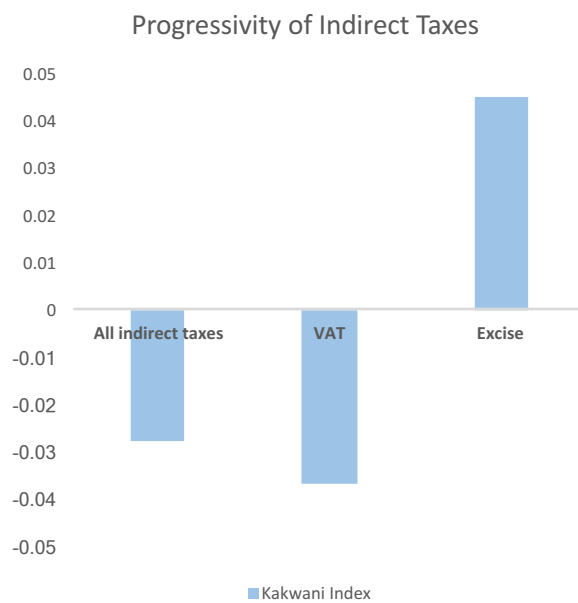


Indirect taxes in Albania (*for now excluding indirect effects of fuel excises*) are un-equalizing, slightly increasing Gini by 0.1 points

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

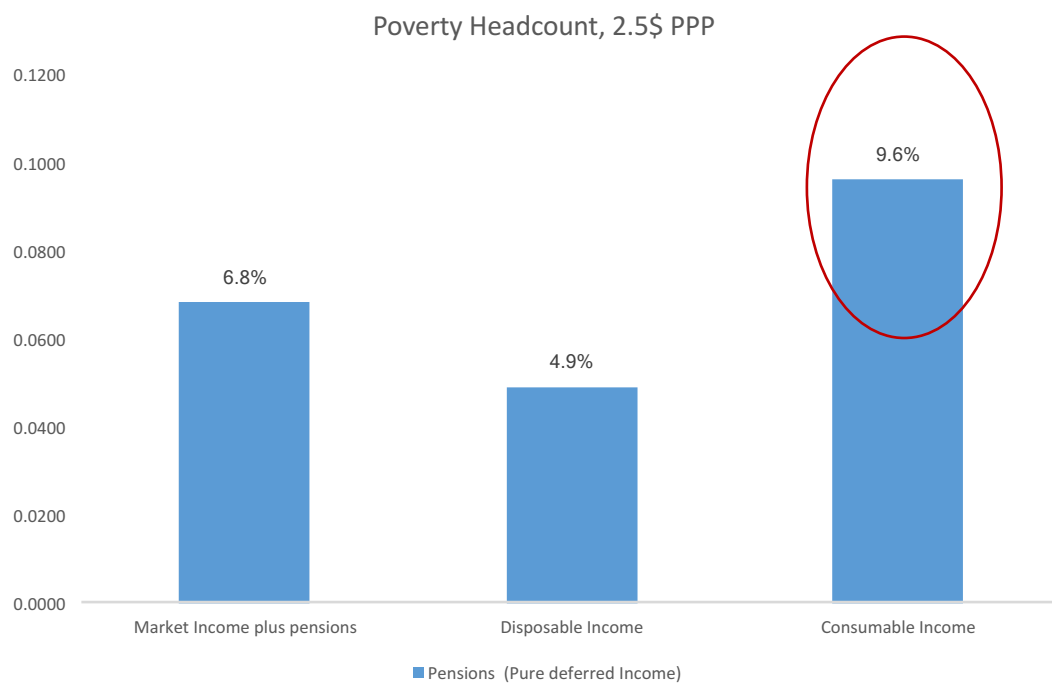


VAT alone contributes to increasing poverty by 4.4 percentage points, out of a total of 4.7 percentage points

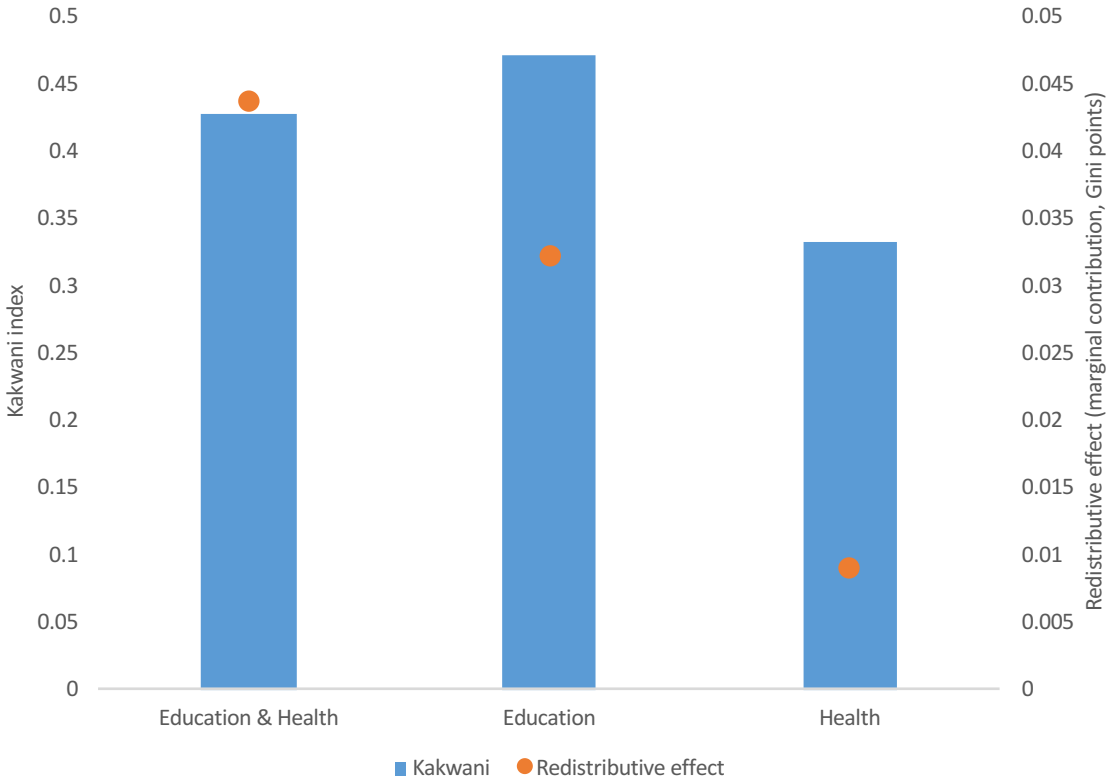
This large impact is partially attributed to its relatively large size, comparable to all direct taxes and contributions combined

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

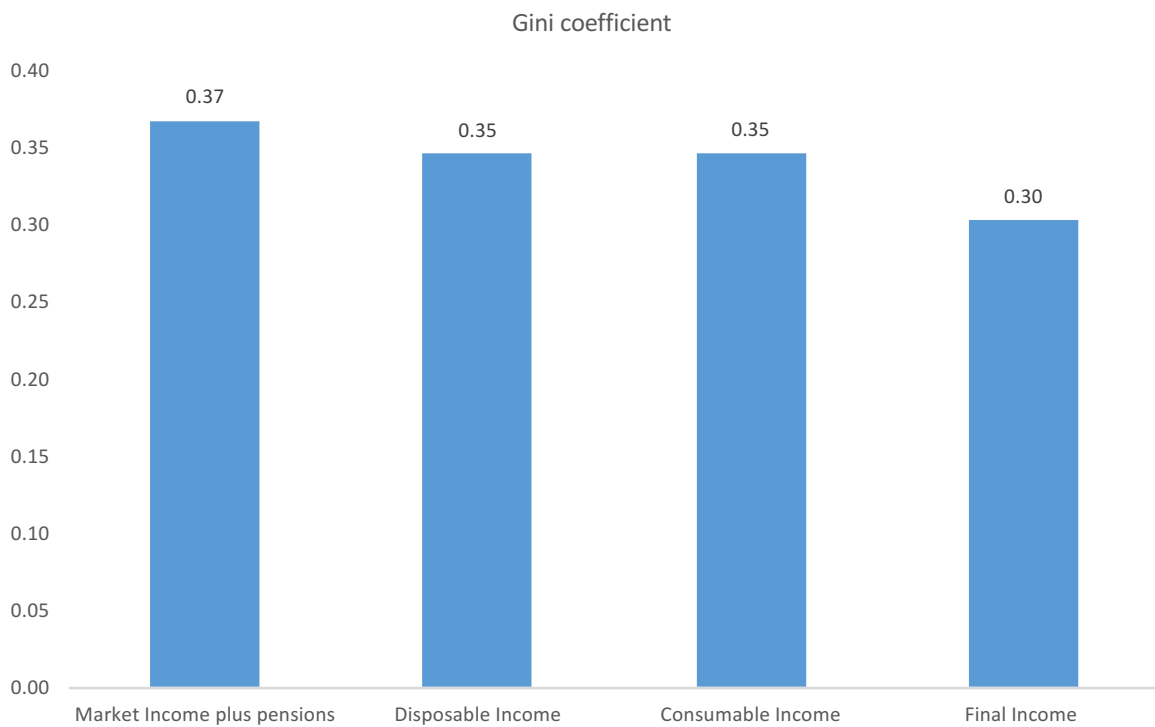


# Education and health spending are progressive and redistributive



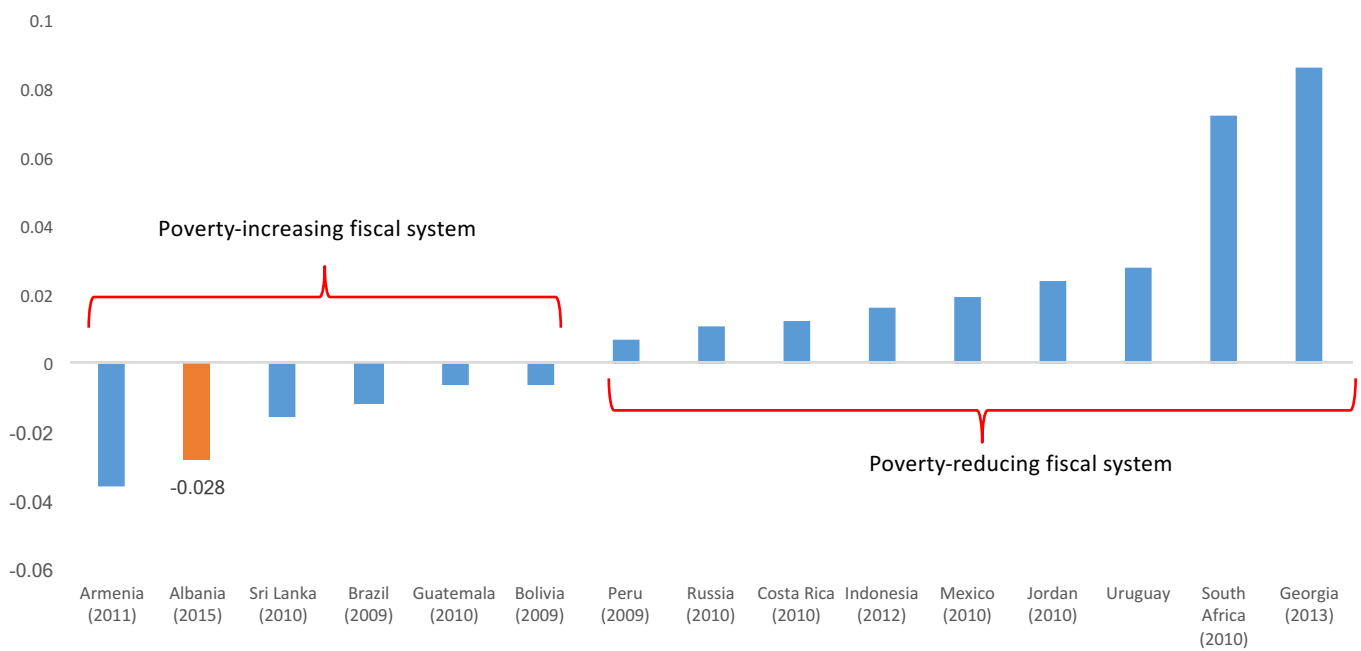
Sources: Staff estimations based on 2015 HBS

# 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)



Sources: Armenia (Younger et al, 2014), Brazil (Higgins and Pereira, 2014), Bolivia (Paz Arauco et al, 2014), El Salvador (Beneke et al, 2015), Ethiopia (Woldehanna et al, 2014), Georgia (Cancho and Bondarenko, 2015), Guatemala (Cabrera et al, 2014), Indonesia (Afkar et al, 2015), Mexico (Scott, 2014), Peru (Jaramillo, 2014), Russia (Lopez Calva et al, 2015), Uruguay (Bucheli et al, 2014), South Africa (Inchauste et al, 2015), and Sri Lanka (Arunatilake et al, 2014).

## Emerging messages

- 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
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- Indirect taxes reverts the poverty effect achieved with direct taxes and transfers



## Emerging messages

- 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

# Agenda for the Government

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](mailto:aida.gjika@gmail.com)

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