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# FISCAL PRESURE ON SME IN ALBANIA AND ITS IMPACT ON ECONOMIC DEVELOPMENT

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## Abstract:

Starting a new business is everyone’s dream. It brings unlimited opportunities and challenges as well, especially in transitional economies. Our country has undergone tremendous changes since the fall of centralized economic system till now. The role of SME in economic development and shortening transitional period is great. SME sector has evolved tremendously but many challenges lay ahead. In our paper we will give a presentation of the role of SME in economic reality in Albania and the region, its trend and challenges. Today SME face many challenges like decrease of demand from market destabilizations, poor infrastructure, poor access to credit, fiscal policy pressure etc....We will emphasize the role of fiscal policy in SME development. The role of fiscal policy should be considered more carefully in today’s global market, in short of perspective development. We believe that fiscal pressure has been a major reason of the set back in SME development. We will analyze Albanian fiscal evolution and its impact in SME development.

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**Keywords:** SME, fiscal policy, global market, sustained economic growth, fiscal evolution.

## 1. SME development, its characteristics and challenges

Since '90 Albanian governments have continuously undertaken structural reforms including reform of land, price liberalization, reform of privatization, financial reform and so on.... During this time almost all SME are privatized and the rest is on the way of privatization in accordance with the government strategy of privatization. We mention here the privatization in the telecommunication sector, banking, energy etc.... Through this process Albanian

economy has responded fairly well. From 1992, economic growth has been about 7%, inflation rate has been under control between 2-4 %. Albania has good macroeconomic indicators with satisfying growth rate of GDP. These activities made the private sector the major moving economic force of countries development. Private sector makes of 80% of country's GDP.

To further boost economic growth, recently Albania has undertaken several measures toward European integration. Albania has signed the Small Business Act for Europe and is working to fulfill its commitment in accordance with the European standards and practices. In this context its fiscal policy, aimed at lowering tax burden for businesses which till 2006 has been an obstacle to business growth and development. Later on we will talk about this in details.

It's been a difficult road to establish the market infrastructure and institution due to rapid changes in global economy, lack of relevant culture, and the existence of great informal economy. Albanian government has built a strategy to fasten this process and help SME development as a crucial factor in the sustainable economic growth of the country. The mission of this strategy is "to ensure sustained economic growth, high competition and productivity through dynamic development of enterprises, investment incentives, and better use of human, natural and financial resources.

## **2. SME and transition**

Sustainable growth of SME is the cornerstone of Albania's economy. Improvement of government policies in regards to both administrative and fiscal procedures, contributing in both direct and indirect support of SME. The role of NGO as: Chamber of Commerce, government bodies and employment offices must grow. They need to strengthen the SME believe in them, participate (membership), and collaborate.

The fight on corruption and informal economy must intensify, by strengthening and modernizing government institutions. All these steps will guarantee the SME development trend and will bring the end of the economic transition area closer. SME development trend play an important role in both market oriented economies and transitional economies growth. As in other countries which passed from centralized economy to market oriented, Albania's economic policy makers ignored the importance of SME development, focusing more on privatization of states assets. Albania's weak institutions slowed down the SME development and so the economic development during transition.

Albania is one of the transition countries, still struggling with the transition process despite its major improvements done recently. The outcome is barriers to SME development and less contribution of them in speeding up the transition process. In our work we will try to explain SME development in Albania and the role of government agents and other NGO, but we are aware of the difficulties especially in measuring the exact level of SME and its effect on the economic development in Albania. According to OECD it's practically impossible to measure SME and entrepreneur development and its effect to economy since there are no generally agreed indicators. Transition process is described as passing from centrally planned towards market oriented system. This transformation consists on institutional change, change of state and private sector role, change from bureaucratic coordination into open economy. But, only developing a private sector is not enough to implement this transformation. In the beginning of 1990 the idea that government should leave the economy and the market alone, was dominative. By doing so private sector would soon raise and take over and the market would adjust by itself (Smith's invisible hand). This proved not to be successful in Albania. Later on, and precisely after 2000 it was understood that in order to have a successful transformation and a strong, sustained SME development, macroeconomic reforms, stability, and strengthened institutions were needed.

There exists barriers on SME development in market oriented economies, but in the transitional economies this barriers are way higher and stiffer, making it very difficult for new businesses to enter and grow within the market. If there are not taken proper actions, these barriers would result in economic slowdown or worst up to stagnate the transition process.

External Barriers to SME and entrepreneurship development in Albania's transition economy consist in many factors such as policy instability, unsteady tax legislation, inadequate accounting standards, and nontransparent implementation of laws and so on.... Lack of state support in forms of business infrastructure, supporting services characterizes transition economy. Difficulties in financing have been and still are a major concern due to undeveloped financial market system in Albania.

Inefficient banking system, high interest rates, strict collateral requirements make it difficult for SME development in Albania. Despite the lowering figures, Corruption is a very important negative aspect that deters SME and entrepreneurship development. These are derivatives of imperfect legal framework and less effective law application.

Internal barriers are mostly related to lack of managerial skills and entrepreneurship values. This is though normal to a country that comes from a centralized economy where the SME and entrepreneurship did not exist. Listed in a table view, are the internal and external barriers of SME.

<b>Types of Barriers</b>	<b>Types of Policies</b>
External Barriers Financial Framework	Incentive programs through different programs in addition UNDP and Millennium Challenge Fund
Legal Framework	Improvement of Legislation Tax reduction Reducing number of licenses and the time frame of acquiring them
State Support	NRC, ease of registering a business Increased transparency of actions Fighting corruption
Internal Barriers Entrepreneurs knowledge and managerial skills	Consulting, support services of NGOs,

Strong and deep reforms undertaken during 2005-2010 generated unprecedented economic growth, ranking Albania amongst the top list of developed countries. Reforms were mostly directed towards strengthening public finances, improving business environment, and upgrading infrastructures.

Government of Albania took drastic measures to introduce and implement simplifying tax and customs code, tax administration and enforcement, reducing the registration of a business from 38 days in 2007 in just 1 day, eliminating the frustrating process and corruption.

According to the report of 2008 Corruption Perceptions Index (CPI), among 180 worldwide nations surveyed, Albania 85th, 2009 ranked 105th, and 2010 ranked 87th.

### **3. The fiscal changes in Albania and the SMEs (Small and Medium-Sized Enterprises)**

The SMEs in Albania are regulated by special law, which has occasionally been subject of review and necessary changes to improve the environment in which SMEs operate and creation of necessary facilities.

According to the law no. 8957, of 17.10.2002 “For Small and Medium-Sized Enterprises”, amended, there is given the definition of what is called small enterprise and medium enterprise. Small Enterprises are called those enterprises which employ fewer than 50 employees and have a business figure or annual total balance sheet less than 50 millions lek. Medium Enterprises are called those enterprises which employ from 50 to 250 employees, have a business figure or annual total balance sheet by 50 millions to 250 millions lek.

According to the above definitions in the group of SMEs enters a large number of businesses, which are regulated under the category they belong. According to INSTAT (Institute of Statistics) data at the end of 2010 were 100,687 enterprises registered and active (Table 1). Only during 2010 were created 16,290 new enterprises, so despite the economic-financial crisis that is happening, the number of businesses categorized in groups of SMEs has been growing by 19% compared to 2009. If we calculate the average enterprises created during 2006-2010 (12.040) and compare it with the average of the period 2001-2005 (7.334) we have an 80% increase of the growth rate per year. This is a clear indicator of the success of fiscal reforms taken after 2006, despite the economic crises that have accompanied the world economy and its bad impact on our economy. About 91 % of enterprises have 1-4 employees. The SMEs sector in Albania provides about 64% of GDP (Gross Domestic Product), and the employment of about 66% of employees in the private sector, creating stability for the country's economy.

**Table 1:** *Active enterprises by year of creation and size, 2010*

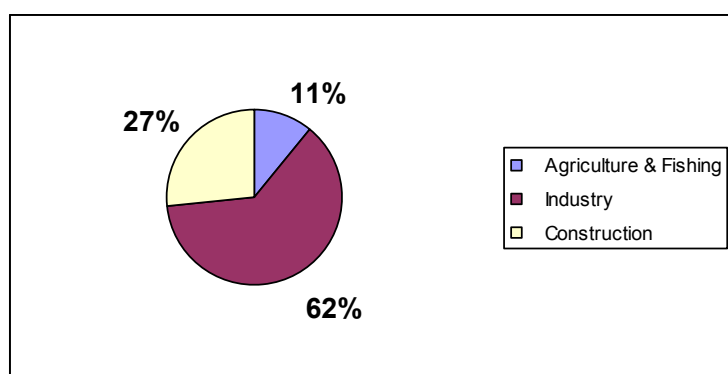
Year of creation	Total	By number of employees			
		1-4	5-9	10- 49	50+
<b>Total</b>	<b>100,687</b>	<b>91,566</b>	<b>4,778</b>	<b>3,500</b>	<b>843</b>
2010	16,290	15,498	621	159	12
2009	12,158	11,501	416	190	51
2008	13,988	13,216	519	220	33
2007	8,636	7,795	412	385	44
2006	9,137	8,527	334	232	44
÷2005	40,478	35,029	2,476	2,314	659

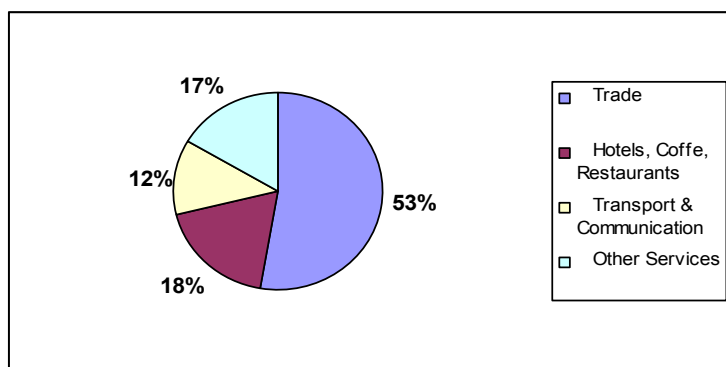
The structural separation of SMEs presented by the following table, separating businesses in (1) the group goods' producers and (2) services' producers (**Table 2**). In the first group about 62 % of the enterprises operating in the industry, about 27% operate in the field of construction and about 11% operate in the field of agriculture and fisheries (**Graph 1**).

While in the second group about 53% of enterprises operating in the area of trade, 18% operate in the area of hotels & restaurants, 12% operate in the area of transport & communication and 17% operate in other areas of services (**Graph 2**).

**Table 2:** *Active enterprises by economic activity and size, 2010*

Economic Activity	Total	By number of employees			
		1-4	5-9	10-49	50+
<b>Altogether</b>	<b>100,687</b>	<b>91,566</b>	<b>4,778</b>	<b>3,500</b>	<b>843</b>
<b>Producers of goods</b>	<b>15,911</b>	<b>12,087</b>	<b>1,786</b>	<b>1,637</b>	<b>401</b>
Agriculture & Fishing	1,702	1,591	57	43	11
Industry	9,964	8,051	878	752	283
Construction	4,245	2,445	851	842	107
<b>Producers of services</b>	<b>84,776</b>	<b>79,479</b>	<b>2,992</b>	<b>1,863</b>	<b>442</b>
Trade	44,709	42,699	1,307	629	74
Hotels, Coffee, Restaurants	15,674	14,829	698	131	16
Transport & Communication	10,361	9,931	222	166	42
Other Services	14,032	12,020	765	937	310

**Graph 1.** *Producers of goods*

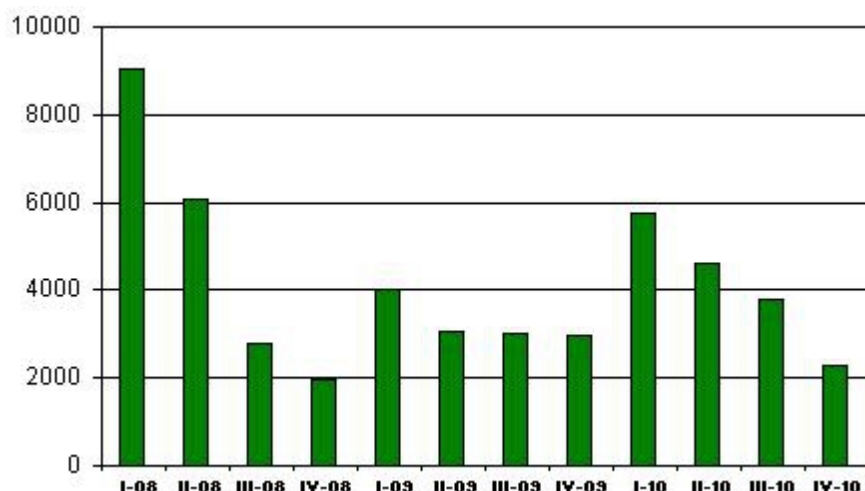


**Graph 2.***Producers of services*

The following chart shows the trend of creating new enterprises from 2008 to 2010, divided in 3-month periods. The number of enterprises that take part in the group of the SMEs has increased from year to year, as for the first time, it has been facilitated the establishment of a business. Pursuant to Law no.9723, of 3.5.2007 “On the National Registration Center (NRC)” business does not have to wait for a long period of time to be recorded in the fiscal authorities and obtain a VAT number and many other bureaucracies, but for a period of 1 day a business is recorded and can start its normal activity. Also, in the offices of NRC can be performed actions regarding capital increase or reduction, withdrawal of a partner, adding new partners, closure of business and many other actions. This service has created a great business respiration, primarily because it reduces much time and the multiple bureaucracies, and secondly reduces corruption significantly, especially with the tax authorities.

As seen from the graph 3, in the first 3-month period of the year 2008 the graph totals the highest point. During 2010 there is an increase of the number of new enterprises comparing it with 2009, which is indicated by the chart below.





**Graph 3.** *New Enterprises according to 3-months periods*

According to the Albanian fiscal legislation, businesses that take part in the group of SMEs are categorized in:

- (1) Businesses subject to local tax on small business and not subject to VAT with a business figure up to 5 millionslek,
- (2) Businesses subject to VAT and local tax on small business with a business figure from 5 millions to 8 millionslek,
- (3) Businesses subject to income tax and VAT with a business figure over 8 millionslek.

So, it turns out that the group of SMEs includes a wide spectrum of business, and their fiscal treatment varies depending on the category they belong to. Albanian governments have had as a priority the development of SMEs and time after time this has been observed also in the reduction of fiscal burdens on SMEs. Occasional fiscal changes have had a descending trend of fiscal burden, facilitating businesses and reducing the informal economy and tax evasion, concretely:

(1) Income Tax during the period 2005-2006 was reduced by 23% to 20% and by 2008 was reduced to 10%. This reduction of profit tax rate resulted in increased figure of business, reduction of the informal economy because businesses were encouraged to declare more due to lower tax burden.

(2) The simplified tax return, which means that businesses are subject to local tax on small businesses, was reduced from 3% to 1.5% during the period 2005 to 2006. The tax rate amounted to realize the economic turnover of small business is considered personal income

and estimated a 10% tax on the difference between revenues and expenses for the training period. This change had a positive effect in the calculation of tax for small businesses, as they were facilitated by high fiscal burden and subjectivity and to these businesses were given the opportunity to identify their costs. Albanian SME needs to put to better use this low tax system, using the increased profits to technological investments and competitive advantages. Fason's sector for example: by lowering tax on profit and employer's social contributions will be more competitive in European and regional markets, being a tough competitor of China, as well.

(3) Social insurance contribution paid by employer decreased from 29% to 20% during the period 2005 to 2006, then to 9 %, and from 2008 onwards was reduced by 5% to 15% level. This significant reduction in the rate of social insurance that pays the employer, created more facilities to the business because it reduced significantly the obligation that has the employer to shed cash in the coffers of social insurance.

All these changes in the fiscal package, in general, had positive effects on SMEs by creating more breathing at this time of crisis that are going through the economies of all countries, including Albania's economy. So, the income tax rate was reduced for the medium enterprises, was reduced the rate of contribution to social insurance, was decreased the excise for domestic production (beer producers), while small enterprises were offered the possibility of recognition of costs to calculate the taxable income, which was not allowed before the tax changes above.

#### **4. Conclusions**

On this work it was concluded that the development of SMEs should be strongly supported by easing fiscal policies. This is because the SMEs have a more active role in the economy of the country and specifically about 64% of GDP provided by SMEs, about 91% of employees are employed by SMEs.

Fiscal burdens such as Income tax, social insurance, Tax on Small businesses have dropped, in order to facilitate the SME businesses. Specifically, profit tax is reduced by 23% in 2005 to 10%, so a reduction of 13%. Social Insurance paid by the employer from 29% in 2005 decreased to 15%, a 14% decrease. The elimination of Simplified Profit Tax, which is subject to small businesses, changed the method of calculation of Tax on Small Business,

which enabled small business to recognize expenses incurred during the fiscal period in calculating the taxable profit, which was not allowed until 2007.

Promoting entrepreneurship culture through managerial improvement and trainings, encouraging creative entrepreneurship, workforce training etc....

Development of the growing business, improvement of business climate, increase of competition through innovation and technological development.

Improvement of SME financing, through increase of access to credit, increase of government guarantee fund and its extension not only to exporting companies, increase of funds of microcredit and the strengthening of micro financing institutions.

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