

# SMES DEVELOPMENT IN ALBANIA- THE IMPACT OF TAX POLICIES ON SUSTAINABLE SECTOR GROWTH

Almarin Frakulli<sup>1</sup>

## ABSTRACT

Currently Albania is facing enormous financial problems due to extremely low rates of employment, high levels of undeclared work, low financial discipline and a lack of equity and efficiency in tax matters. It is a fact that in Albania referred to the structure of active enterprises in 2012 it was concluded that SMEs mostly dominated by micro-enterprises with 1 to 9 employees, who make up about 95.3% of the total number of active enterprises. On the other hand if we do an analysis of economic growth in the last decade we will see a decline in growth rate of GDP. Recently the government has taken a series of tax policies that tend to increase the safety and competitiveness of businesses but these efforts have not been sufficient. Based on the data from the National Business Center regarding the business situation will notice that the number of new businesses has decreased in recent years and meanwhile there is an increasing number of businesses that are closed or have suspended their activity. Since the major share of active enterprises occupied precisely SMEs consequently the greatest numbers of enterprises that have closed or suspended their activity are SMEs.

Referred to above in the current economic development of Albania in the short run up to the stage of consolidation of big business and corporate, strengthening SMEs is the proper way for a sustainable economic and social development.

**Keywords:** *Fiscal system, tax policy, micro-enterprises, economic growth, SME, taxes*

**JEL classification:** *E62, F43, P42*

## 1. Introduction

Starting a business in today's environment brings opportunities and challenges. New lifestyles demand greater choice of products and services. New technologies and greater access to global markets have provided increased business opportunities. At the same time increased competition, insistence on quality and unremitting pressure for lower costs, just to mention some issues, represent major challenges for business. As a result of cyclical economic changes, the transition countries and their enterprises face major challenges for strengthening their human and institutional capacities to take advantage of trade and investment opportunities. For Small and Medium-sized Enterprises (SMEs) the challenge is greater. They lack scale, resources and the capacity to handle complex business management. While governments make policies in trade and investment areas, it is enterprises that trade and invest. Therefore, supply-side obstacles in the trade and investment areas and how governments, development partners and the private sector itself address these constraints have direct implications on the economic growth potential of transition countries. In almost all countries, SMEs play a key role. Private investment by Small

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<sup>1</sup>E-mail: [marin\\_ruse@yahoo.it](mailto:marin_ruse@yahoo.it)

and Medium-sized Enterprises (SMEs) is a key generator of economic growth and social change for a certain country economy. These enterprises typically account for more than 90% of all firms outside the agricultural sector, constitute a major source of employment and generate significant domestic and export earnings. It is now widely accepted that the contribution of SMEs to new jobs, exports, innovation and regional development is vital to national development. As such, SMEs development emerges as a key instrument in poverty reduction efforts. SMEs, due to their size, are particularly constrained by non-competitive real exchange rates, limited access to finance, cumbersome bureaucratic procedures in setting up, operating and growing a business, poor state of infrastructure and lack of effective institutional structures. The removal of these constraints is a daunting task calling for holistic SME support, i.e. an enabling environment for SME development consisting of functioning macro, meso and micro level institutions. The main aim of the study is to discuss the importance of SMEs sector for developing and sustaining business competitive advantages the economic activity of Albania. The taxation of SMEs is an important issue given their importance to the economies of countries. Careful design of government program for SMEs, including special tax rules, can address market failures and the disproportionately high compliance burdens faced by SMEs. Consideration of the heterogeneity of the SME sector and the different challenges faced by SMEs and their owners need to be considered in the design of the taxation rules as governments endeavor to promote the creation, innovation and growth of SMEs.

The statistical definition of an SME usually varies from one country to another. However the choice to classify a company as SMEs is always based on the number of employees, value of assets or the value of sales. SMEs in Albania are classified according to the number of their employees and turnover and/or balance sheet in compliance with the law nr. 1042 (22/12/2008) on small and medium-sized enterprises,

For statistical purposes enterprises will be classified into:

1. Micro: 1 to 4 persons;
2. Small Enterprises: 5 to 9 ;
3. Medium enterprise: 10 to 49 ;
4. Large enterprise: 50 +

**Table 1 - Active SME 2005-2012**

Year	2005	2006	2007	2008	2009	2010	2011	2012
1-4 employed	55,976	66,368	71,049	85,380	84,474	91,566	96,429	94,025
5-9 employed	2,406	2,861	3,694	3,655	4,357	4,778	4,952	5,396
10-49 employed	1,722	2,093	2,797	2,762	3,165	3,500	4,164	3,898
50+ employed	547	701	757	725	781	843	958	956
<b>Total</b>	<b>60,651</b>	<b>72,023</b>	<b>78,297</b>	<b>92,522</b>	<b>92,777</b>	<b>100,687</b>	<b>106,503</b>	<b>104,275</b>

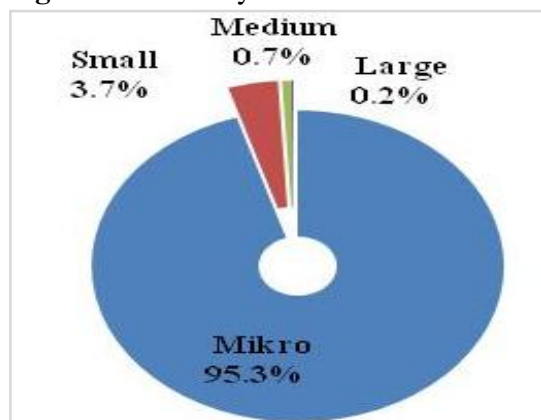
Source: INSTAT

The small business sector is well represented in Albania and has a similar structure with the European Union. Small businesses in Albania provide the majority of jobs. The size of the average Albanian firm is smaller than in the EU, with 3.7 employees compared with an average of 4.3 for the EU. The most important sector (55% of all enterprises, 45% of employment) is the

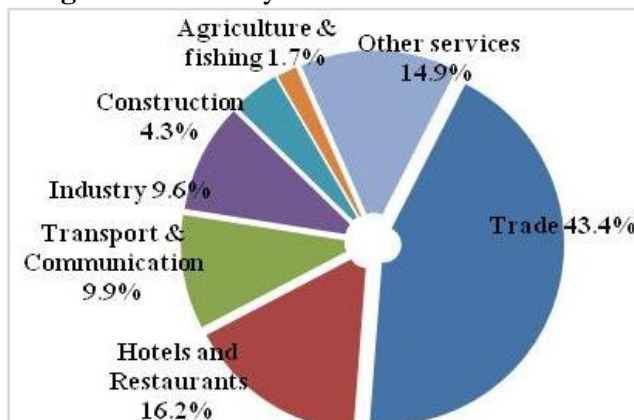
wholesale and retail trade. Estimated data for 2009-2011 show positive trends, so a growing number of enterprises and jobs offered by them.

According to the structure of active enterprises in 2012 it is noticed that SMEs mostly dominated by micro-enterprises with 1 to 9 employees, who constitute about 95.3% of the total number of active enterprises. Distribution of active enterprises by economic sectors for 2012: 43.4% trade, hotels & restaurants 16.2%, transport & communications 9.9%, industry 9.6%, construction 4.3%, agriculture and fishing 1.7% while other services occupied 14.9%.

**Figure 2-** SMEs by size



**Figure 3-** SMEs by sector



**Source:** Register of Enterprises INSTAT 2012

## 2. The impact of tax policies in SMEs developing

In our country recently have become aware that small and medium-sized enterprises (SMEs) are not only necessary and good partner for large corporations, but the real backbone of any economy. Development and their welfare is often indicative of the level of economic development of a country and the investment climate. In most countries of the region with the necessary legal tools have encouraged the creation and development of SMEs through appropriate tax regimes; promote investment and innovation and the creation of new jobs. Albania is also making efforts in this direction, which unfortunately are insufficient. In recent years, in Albania are undertaken many legislative and institutional reforms in support of SME development. Some of the reforms that have improved the business climate and the development of SMEs: business registration, permits and licenses, regulatory impact assessment / RIA, e-government, support for ICT, provision of financial instruments, training, growth of electronic communications, the free trade agreement, CEFTA, etc., all these reforms brought tangible results in improving the business climate. Albania embraced all principles of the Small Business Act (SBA). Implementation of principles of this act is one of the most important agreements of the European Commission's agenda for the development of SMEs, not only for the EU Member States, but also for the Western Balkan countries.

The Albanian government has a fundamental role to play in providing a favorable framework and environment for private sector development. The economic conditions in Albania, where private investment levels lag behind those of developed countries, the necessity to create an enabling environment for SMEs and private investment is more urgent. Reform of the business

and investment environment leading to the creation of a dynamic entrepreneurial culture is crucial to drive the process of change in industrial structures and the transition to market economy structures.

As a country which has the support of different international organizations, Albania has undertaken a series of Enterprise Policy Performance Assessments in order to monitor the development of policies and infrastructures to support the SME sector. Substantial emphasis has been placed in eliciting the views of private SMEs on their past experience and perception of the key barriers to business and new investment, and their assessment of progress in implementing policies to encourage the development of SMEs. Generally are identified six broad dimensions of the framework and environment supporting SME growth and development, which are particularly important for governments to get right:

- Institutional framework for SME policy;
- Rule of law and the regulatory environment;
- Tax policy for small businesses;
- Financial instruments for fostering small businesses;
- Advisory services supplied to new and small businesses;
- Implementation of business incubators;

The sufficient tax revenues are necessary to guarantee democracy, public order and the legal system. Modern taxation should be more than just a source of income for the operation of the state; the tax must also ensure that public authorities contribute actively to pursue the objectives of economic, social and environmental policies.

This part of the work “Tax policies in SMEs developing” examines the influence of tax systems on a range of challenges faced by SME, including decisions relating to their creation, form and growth. SMEs make up the vast majority of business entities and contribute strongly to employment and economic growth, spanning the full breath of industries and sectors and differing in their propensity to innovate and grow. At the same time SMEs face particular challenges on relation to their access to finance. The tax system plays a dual role at times as a tool to assist in overcoming these challenges and at others as an obstacle. Tax policy and its administrative structures is considered by many entrepreneurs to inhibit, rather than encourage the development and expansion of new enterprises. Despite recent reductions in the tax burden and a recognition that the tax system is improving and becoming more sophisticated, the private sector is very critical of the tax administration system, not least of the poor collection rates and the levels of tax evasion. Entrepreneurs feel that this results in unfair competition and puts a higher burden on compliant taxpayers. Understating the role of the tax system in the decisions of SME owners and managers is therefore critical in providing policy solutions to support their success. This study provides insights into the influence of tax system on SME in Albania.

As a taxation issue, income tax is considered as a good opportunity for the government to give breath to small enterprises. And in fact more than 80 per cent of businesses are small and medium enterprises in our country. The working group of the new fiscal package, recognizes that tax profit will be at two levels, 15 percent of the business that has more than 5 million ALL turnover per year and 7.5 percent for small businesses with a turnover 2-5 million ALL. This sector is expected to be the first positive impact of taxation, but if informality remains at these levels and other taxes will be imposed without discussion carefully, small businesses will not be able to benefit from this kind of taxation.

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. Regarding the most recent tax reforms, the Government approved fiscal package by Law 179/2013, which main objective is to preserve macroeconomic stability and continuation of structural reforms to create the conditions necessary for the economy in the context of potential growth. This fiscal policy is oriented towards the recovery of economic growth in its potential. Tax procedures have been also simplified. The drafting of fiscal policy has consulted closely with the International Monetary Fund (IMF) and World Bank (WB). Every exemptions or tax incentive is granted only by law. The tax incentives comprise different forms applied by law:

- Low tax rates (15%) with no preconditions,
- Reduced tax rates (special scheme for farmers),
- Tax exemptions sectors (research and drilling of hydrocarbons),
- Contributions made by the employer to ensure the health and lives of employees are non taxable,
- Investment tax credits (investments of all kinds),
- Tax loss carry forward,
- Accelerated depreciation rates.

If the tax rate on income taxes can be compared with the neighbor countries with Albania, it can be noticed that the income tax rates are competitive and attractive ones. The tax rate on income and profit is applied on equal basis to all taxpayers regardless of the region, the branch they perform their economic activity from or the type of activity.

Also these reforms of the government have aimed promoting a friendly business climate, and to provide assistance and incentives for SMEs. Strategies for the business development are based on European Union directives, and are some of the priority obligations that Albania has to fulfill towards European integration.

## **Conclusion**

In Albania, over 80 % of all employment is in SMEs, compared to the EU average of around 67 %. Albanian SMEs provide about 68 % of the country's total value added, while the average in the EU is about 58 %. In 2013, value added dropped by 3.6 % compared to 2012. In parallel, employment increased by close to 10 %, and the number of businesses grew by 1.7 %. Real GDP is expected to grow by 3.3 % in 2015 and by 4.2 % in 2016. The growth is almost solely driven by internal demand. Forecasts also point to falling unemployment rates. Due to the fact that the Albanian economy is led by SMEs, it is expected that the projected economic upswing will result in increased SME employment and output growth.

Overall the development of tax policy regarding tax rates can be assessed as positive as far as predictability and in recent years a steady tendency to reduce the tax burden, especially on direct taxes. The introduction of more economic stimulus tax rates, however, should be accompanied by a change in tax philosophy in determining the taxable basis - taxation be subject only real remaining income taxpayers, after deducting the actual operating expenses. This would increase consumption and hence to an increase in turnover and revenues from VAT, which will not only offset the reduction in income from direct taxes, but will result in additional revenue for the budget in the amount of 5-10%.

The Ministry of Finance and the Ministry of Economy, in co-operation with ASME, should work together to ensure that:

- Greater simplicity, stability and clarity are achieved in tax policy.
- The fiscal administration is made much more sensitive to the needs of the SME sector.
- Tax laws and regulations are consistently and fairly enforced.
- The integration of the tax system is continued.
- Consultation with SMEs or their nominated representatives on tax issues is carried out regularly.
- SMEs are able to obtain regular, simple and up-to-date information explaining the tax system.

#### VAT

- Design the VAT refund period to facilitate cash flow, using the international standard of one month.

#### Grey Economy

- Strengthen efforts to collect arrears, regardless of firm size.
- Improve administration and collection rates to widen the tax base.

#### Consultation

- Use regional forums and seminars to ensure that the SME sector is consulted on the implementation details of forthcoming taxation developments, and is well informed / trained in advance of new tax rules coming into effect.

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