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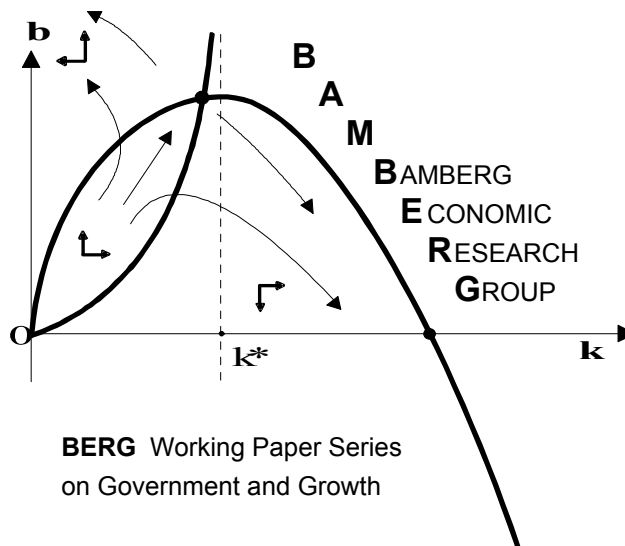
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# **Public Expenditure Planning in Albania**

by

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## **Public Expenditure Planning in Albania**

### **Abstract**

This paper looks at public expenditure planning in Albania, presenting and analysing the first two post-communist era Medium-Term Expenditure Plans (METPs) that have been introduced by the Albanian government for the periods 2000-2001 and 2002-2004, respectively. Albania's medium-term macroeconomic perspectives and elements of fiscal decentralisation, as incorporated by the Local Government Law of Albania, are presented, too. It is found that, taking into account the first years of post-communist governance, both METPs provide an improved framework for the budget drafting, i.e. for a realistic macroeconomic and fiscal planning of public expenditure and a clearer linkage of government policies with public expenditure plans, thus showing better the priorities in public expenditure.

**Keywords:** Public expenditure planning, Medium-Term Expenditure Plans, fiscal decentralisation

**JEL Classification:** H5, H61, H72

## **I. Introduction**

In the year 2000 the Albanian government introduced a medium-term expenditure plan (MTEP), which covered the two years 2000 and 2001. This plan was an attempt to provide a better framework for the budget drafting of the year 2002 and for the next MTEP 2002-2004. With this plan, the government presented its policies in a medium-term perspective, providing a comprehensive analysis of public expenditure (investment expenditure and current expenditure) and the sources for financing them. What the MTEP introduction in Albania tends to achieve is to:

- promote fiscal discipline making possible a realistic macroeconomic and fiscal planning of public expenditure;
- fix public expenditure priorities, linking more clearly government policies with public expenditure plans;
- encourage greater technical efficiency in budgetary resources allocation;
- give an additional planning instrument in the process of budget drafting, giving the ministries the opportunity to plan their expenditures for a two year period.

The MTEP document contains the main report and the annex of summary fiscal tables. The main report comprises four sections:

- macroeconomic outlook for the years 2002-2004 and its impact on budget resources and public expenditure;
- main categories of public resources;
- main categories of public expenditure, by functions and divided in public investment expenditure and current expenditure;
- expenditure analysis and resource allocation for the main sectors of the Albanian economy, which will have priority during the 2002-2004 period.

## **II. A macroeconomic outlook**

During the last four years (1998-2001), after the macroeconomic and structural reform in Albania, a period of sustained economic growth and improving macroeconomic performance initiated. Real

GDP growth in this period was 7-8% per year, inflation decreased arriving at 3%, and the part of the budget deficit, which was domestically financed, has been reduced from 10.5% to 4.6% of GDP. The highest growth rates in the Albanian economy have been in construction, transport and service sectors (Ministry of Finance).

The Albanian government's macroeconomic policy main aim for the period 2002-2004 will be to maintain the strong performance achieved in the last two years. Real GDP is foreseen to grow approximately at a rate of 7% annually, and inflation to remain at around 3% per year (Ministry of Finance). Economic growth is foreseen to be facilitated by:

- an accelerated structural reform in key sectors: transport, social security, communal services, health, education and agriculture;
- a stronger attempt by the state to improve the environment for private sector investment;
- a continuous high level in public infrastructure investment.

This policy is expected to provide the proper framework for the implementation of the Economic Growth and Poverty Reduction Strategy and the orientation of public expenditure towards the objectives of this strategy.

### **III. Public expenditure finance planning**

The amount of resources available to finance public expenditure depends on the amount of revenue the government plans to collect, i.e. total revenue, and the budget deficit amount.

Total revenue is expected to increase from 22.4% of GDP in 2000 to 24.3%, i.e. 1.9%, in 2004 (Table 1). This growth will be achieved by a better central government tax collection, an increase of local government tax revenue, which is expected to be achieved by the introduction of the agricultural land tax, and a more efficient collection of social insurance contributions. Only revenue from custom duties is expected to be reduced by around 0.7% of GDP up to 2004, because of the application in Albania, from the year 2002, of the world Trade Organization (WTO) arrangement.

**Table 1: Changes in revenue items effecting total revenue, period 2000-2004**

|                                 | Increase                | Decrease      |
|---------------------------------|-------------------------|---------------|
| Taxes of central government     | + 1.9%                  |               |
| Custom duties                   |                         | - 0.7%        |
| Local government tax            | + 0.4%                  |               |
| <b>Total tax revenue</b>        | <b>+ 2.3%</b>           | <b>- 0.7%</b> |
| Social and health contributions | + 0.7%                  |               |
| Non-tax revenue                 |                         | -0.4%         |
| <b>Total revenue</b>            | <b>+ 3%</b>             | <b>- 1.1%</b> |
| <b>Total revenue increase</b>   | <b>+3% -1.1% = 1.9%</b> |               |

Selective reductions in higher tax and contribution rates will be introduced, when an increase of respective revenue from these reductions will be expected, caused by a better compliance in collection, i.e. more payments of new lower taxes and contributions.

The estimations made for the period 2000-2004 are based on the analysis of the revenue performance of the previous Medium-Term Expenditure Plan, which shows that the total revenue for the year 2000, despite being planned in high levels, was completely achieved. Total revenue was increased by 12% during 2000 compared to 1999. This growth came from tax revenue, which in 2000 represented 69.7% of the total revenue. The satisfactory achievements in tax collection (Table 2) were based upon the improvements undertaken in the tax administration and thanks to the new legislation on tax procedures, which created the legal framework for the proper relations between taxpayers and tax authorities. There were increases in collected value added tax, in customs and excise revenue, in revenue from direct taxation with significant increases in profit tax, small business tax and personal income tax.

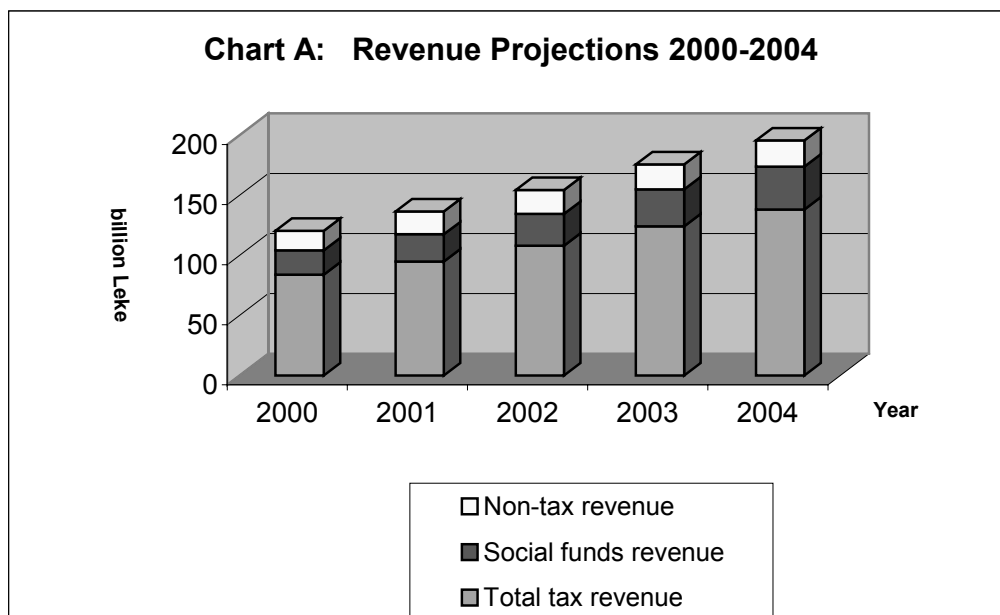
Revenue collected by local governments has increased by around 50% in nominal terms in comparison with 1999. Revenue from social security contributions performed better during the year 2000 and brought about a substantial increase in the number of registered contributors. Collections exceeded the estimation by around 4%. Health insurance contributions were stable at the level 0.3% of GDP (Ministry of Finance).



Non-tax revenue, as foreseen in the 2000 budget, decreased to 3.1% of GDP during the year 2000 compared to 4.7% in 1999. The reason was the reduction of the profit transfers from the Bank of Albania, due to practicing lower interest rates by the bank and decreasing of the bank financing for the budget deficit.

**Table 2: Taxes revenue composition, in % of GDP (2000)**

|                          |              |
|--------------------------|--------------|
| Value added tax          | 7.1%         |
| Custom duties            | 2.5%         |
| Excise                   | 1.7%         |
| Direct taxes             | 2.7%         |
| -profit tax              | 1.5%         |
| -personal income tax     | 0.9%         |
| small business tax       | 0.3%         |
| National taxes           | 1.4%         |
| Local government tax     | <u>0.2%</u>  |
| <b>Total tax revenue</b> | <b>15.6%</b> |

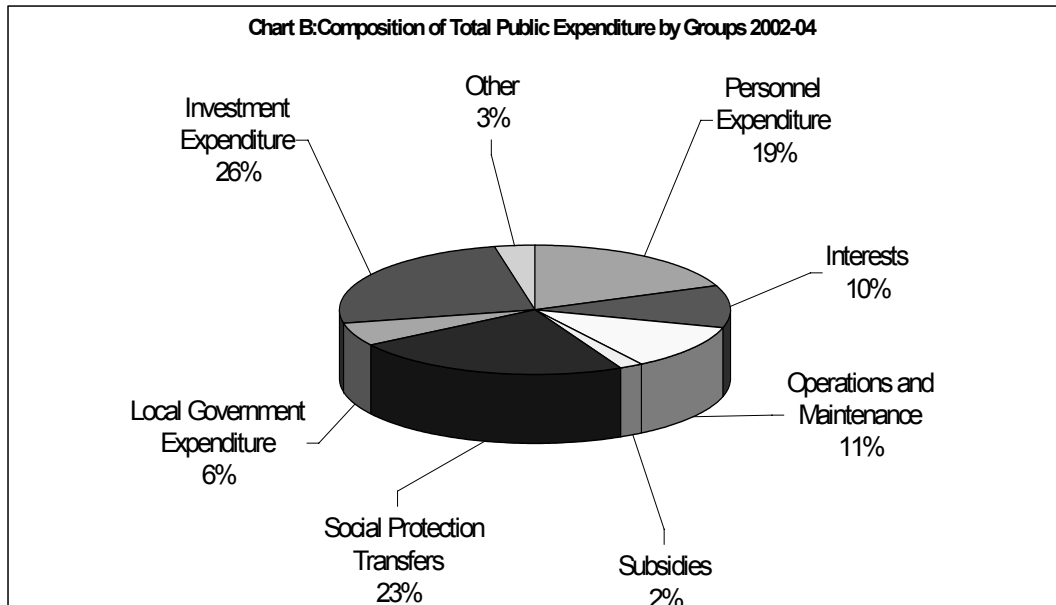


Budget deficit is foreseen to be further reduced, from 8.6% of GDP in 2001 to 7.9% in 2004, i.e. by 0.7 percentage points, and the domestic financing of the budget deficit will be reduced, too, from 5.1% to 3.1%, i.e. 2.0 percentage points of GDP over the same period. By contrast, external financing of the budget deficit will increase from 3.5% of GDP in 2001 to 4.8% in 2004, i.e. by 1.3 percentage points. The main instrument used for domestic financing of the budget deficit in Albania is domestic borrowing (the issuing of treasury bills, to be matured in three, six and twelve months). Domestic borrowing is foreseen to decrease from 2.9% of GDP in 2001 to 2.6% of GDP in 2004. This factor, together with lower bill interest rates, will lead to a substantial reduction in debt servicing payments of the State. Revenue from privatisation has become an important source for financing the budget deficit, increasing in 2001 to 2.1% of GDP, due to the privatisation of strategic enterprises. Revenue from privatisation is foreseen to decrease to 0.6% of GDP in 2004, i.e. by 1.5 percentage points by the end of the privatisation of the Savings Bank, Albanian Telecom and INSIG during the 2002-2003 period. This macroeconomic policy of the Albanian government concerning the budget deficit financing aims at a better use of domestic financing resources, tending to create more opportunities for the domestic businesses to set in motion their cash in productive activities, which will contribute to GDP growth and to the financing of the budget deficit.

#### **IV. Public Expenditure Planning**

Public expenditure is grouped in two different ways: by chief groups (into two main economic categories of expenditure: current expenditure or current costs, and investment expenditure) and by functions or sectors.

*Public expenditure by groups*



Total public expenditure is foreseen to increase from 31.3% of GDP in 2000 to 32.3% in 2004. From this total, total current expenditure will decrease from 24.8% of GDP in 2000 to 24% of GDP in 2004 (0.8% of GDP decrease), while total investment expenditure will increase from 6.5% of GDP in 2000 to 8.3% of GDP in 2004 (1.8% of GDP increase). The macroeconomic policy of increasing the part of investment expenditure in the total public expenditure for the period 2002-2004 is a really foreseeing policy, the effects of which will be evident in the coming years (Ministry of Finance).

**Public investment expenditure** is projected to increase from 6.5% of GDP in 2000 to 8.3% in 2004. Investment in energy, transport and local infrastructure is expected to account for two thirds of all public investment. In order to improve the budgeting of public investment expenditures, the government will undertake some measures, asking that:

- the ministries that control these sectors give to the government additional details on projected expenditures and expenditures up to date;
- the ministries will be under a continuous control, aiming at a more adequate provision for local costs and VAT coverage on externally financed projects;

- the allocations for infrastructure maintenance (current expenditure) will be increased without decreasing the allocations for investment expenditure;

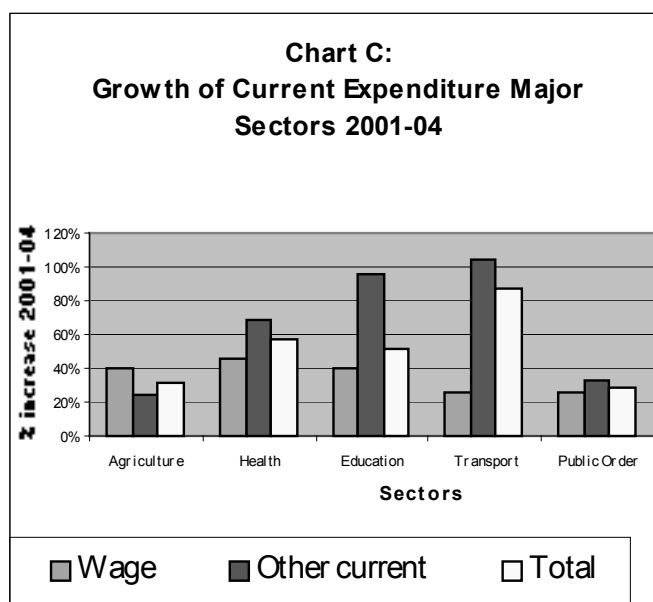
**Public current expenditure** – wages and salaries expenditure constituted 5.6% of GDP in 2001. For this item a total annual increase of 10% of GDP is predicted. In health and education sectors, where average salaries are lower, expenditure is foreseen to increase by 12% annually, and for the other sectors by 8% of GDP. This policy tends to motivate better the personnel that works in health and education sectors, aiming to have better results in these two crucial sectors in the future.

Subsidies expenditure, which at 2001 has been at the high level of 1.3% of GDP, will decrease to 0.5% of GDP in 2004. From 2002 onwards, the greatest part of subsidies is spent on imported electricity. This part, for the period 2002-2004, is projected to fall by 25% per year thanks to an improvement of the management of the state corporation of electricity (KESH), thanks to increasing electricity tariffs and an improved cash collection from the consumers. These measures are almost processing in Albania and the Albanian government will continue to step rapidly in this way, to meet the objective of eliminating subsidies that are not considered appropriate or efficient.

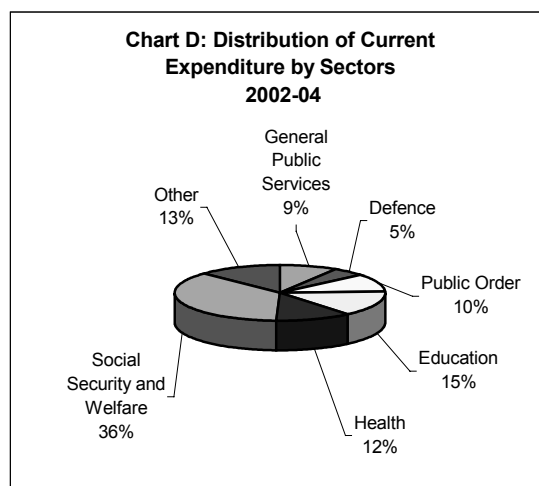
Social insurance and transfers are foreseen to remain at 6.9% of GDP during 2002-2004 (Ministry of Finance). The Albanian government's main strategic issues concerning current expenditure for the period 2002-2004 are: continuing the policy of cutting the general subsidy to the pension scheme, undertaking a series of measures to improve compliance in contributions, raising the retirement age to bring it in line with other European countries, improving the administration and targeting of government funds, subsidising the introduction of the rural pension scheme that will have a broader impact on poverty, looking for more appropriate criteria in determining categories of people who benefit from social insurance and transfers, and improving the State control over the real destination of the subsidies during the period.

#### *Public Expenditure by Functions*

**Chart C** shows the planned growth in **current expenditure in major sectors (functions) during 2001-2004**. Chart C shows a very rapid increase in planned current expenditure on operations and maintenance in health, education, and transport sectors.

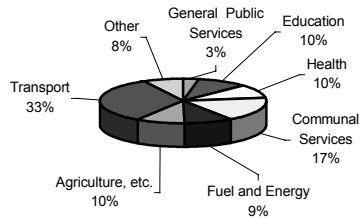


Social security, education, health and public order will account for 73% of total current expenditure over the period 2002-2004. **Chart D** shows the distribution of **current expenditure** among sectors during this period.



**Chart E** shows a very high level of **investment expenditure** in transport (33%), in communal services (17%), in health and education 10% respectively. **Chart F** shows the **distribution of investment expenditure over the 2002-2004 period**.

**Chart E: Distribution of Investment Expenditure by Major Sectors 2002-04**



The distributions in Chart E and Chart F reflect the accelerated structural reform projected for the period 2002-2004 in Albania in the priority sectors of transport, social security, communal services, health, education and agriculture.

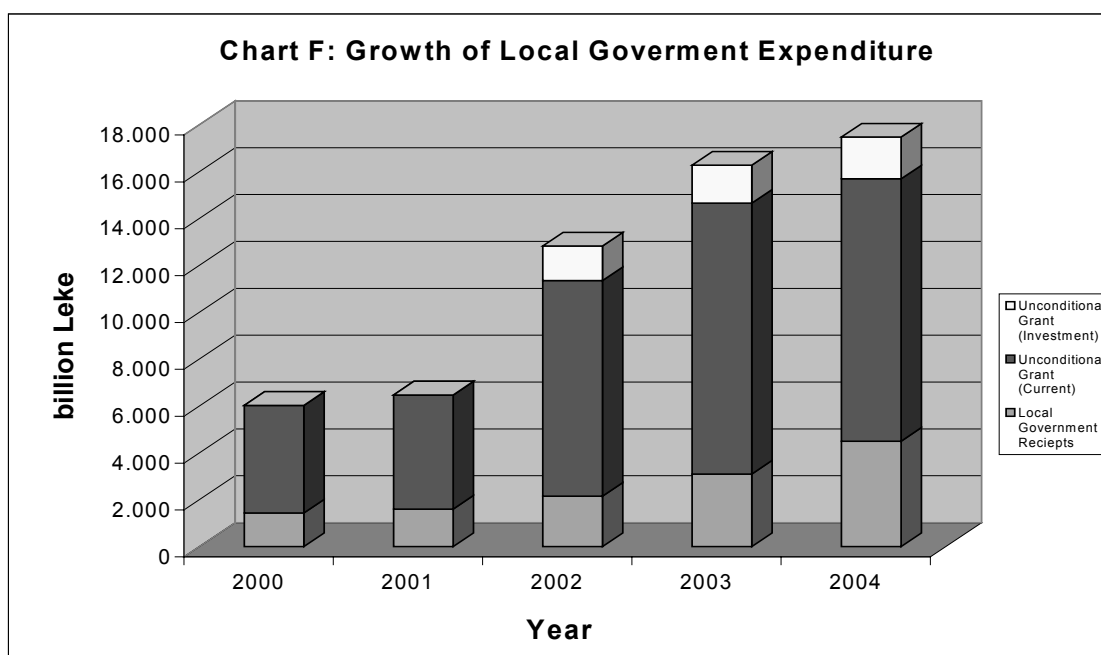
## V. Fiscal Decentralisation

The Local Government Law of Albania distinguishes three types of functions to be performed by the local government tier – exclusive, shared and delegated ones.

Exclusive functions are those over which local governments exercise full administrative, service, investment and regulatory authority. These functions have to be financed primarily from the general budget of local government. Exclusive functions are related mainly to the provision of: a) local infrastructure and services (local roads, street lighting, public services, urban planning, urban transport, water supply); b) social, cultural and sports activities, and c) local economic development services (public markets, information and infrastructure, etc.).

Shared functions are undertaken jointly by the central government tier and the local governments. These functions are financed by conditional transfers from the central government budget. Shared functions include pre-university education, primary health services, social assistance, public order and environmental protection.

Delegated functions are performed by local governments as agents of the central government, i.e. operating a particular service or facility. Delegated functions are wholly financed by transfers from the central government budget.



As Chart F shows, local government revenues have grown significantly during the 2000-2001 period, and are foreseen to grow even more rapidly during the 2000-2004 period. The Local Government Law of Albania specifies several sources for financing local government expenditure. These sources for the 2002-2004 period will be:

- local taxes, such as property tax, small business tax, and tax on agriculture land;
- national taxes;
- unconditional grants from the central government, which will cover exclusive functions of the local government tier;
- conditional grants from the central government, which will cover partly, shared functions of local government.

Actually, local taxes collected by local governments consist in property taxes, whose collection responsibility has been assumed by local governments since 1999, and tax on agriculture land, which has begun to be collected by local governments in 2002. The last is foreseen to bring to local governments revenues equivalent to 0.5% of the GDP. The small business tax, which in 2001 constituted 0.3% of the GDP, is collected by the central government taxes directories and assigned to the local governments through unconditional grants. The MTEP introduces new criteria for the distribution of the unconditional grants, taking into account the place of collection of the small business tax. This is the first step versus the real decentralized administration of this tax, for which it is foreseen that after the 2002-2004 period it will be collected in percentages decided by local governments, and used as a real local source for fulfilling the local needs in accordance with the priorities decided by local governments. The function of the small business tax collection is foreseen to be performed by the tax directories of the central government, acting as agencies of local governments for this service.

Local government revenue is expected to increase rapidly during 2002-2004, caused by measures that tend to improve tax collections and by the introduction of taxes on agricultural land.



## **VI. Summary**

The introduction in Albania in the year 2000 of the first medium-term expenditure plan after the post-communist period was a satisfactory attempt of the Albanian government to present its policies in a medium-term perspective, and to move forward towards Europe. The first MTEP, which covered the two years 2000 and 2001, was accompanied by improved macroeconomic performance and economic growth. The MTEP 2000-2002 has made possible a realistic macroeconomic and fiscal planning of public expenditure, linked more clearly government policies with public expenditure plans, showing the priorities in public expenditure, and has helped a lot the process of budget drafting. The second MTEP 2002-2004 has relied on the analysis of public expenditure and its financing sources, using for this aim the performance data of the first MTEP to achieve a greater technical efficiency in budgetary resources allocation, and exploiting better the planning capacities of the ministries.

The MTEP has foreseen as main directions of increasing the public expenditure financing resources the growth of the total revenue, especially of that coming from central government and local government tax collection, and the continuous reduction of the budget deficit. In the MTEP a great increase in public investment expenditure and a decrease in the total current expenditures are foreseen. Amongst these last, the wages and salaries will increase significantly. The MTEP intermediate fiscal decentralization plans that local governments grow their local financial sources and manage them better to finance their needs. The Local Government Law of Albania specifies several sources of financing local government expenditure and gives local governments more competencies.

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