

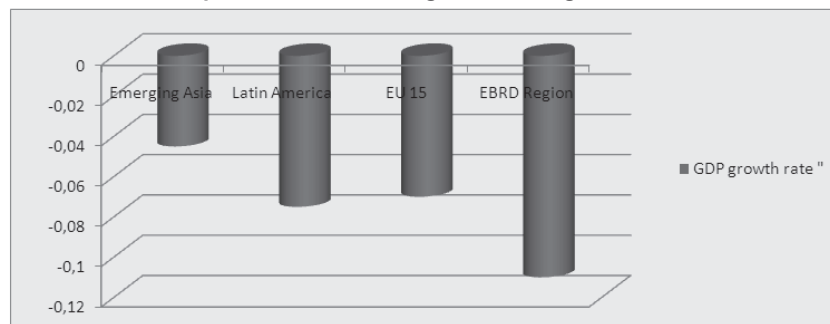
ECONOMICS OF WELFARE – A MISSED DISCUSSION DURING OUR TRANSITION PATH

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Despite the fact that inequality has been continuously growing around the world these last 3 decades, political awareness has come later, at the same time with the economic global crisis. Although it seemed that Albania economy was not affected from the first wave of global financial shock, from 2009 the impact of crisis on the real economy and particularly on the poor pocket of Albanian

people came on. As the chart below shows, despite of all efforts to manipulate the ways in which the recent financial crisis could get through our economy, even from the also – named contagion effect, the crises in different countries was different, according to a study by the European Bank for Reconstruction and Development (EBRD 2010).

Graphic 1: Crisis effecting world during 2007-2009



Source: Life in transition, EBRD, 2010

Until this moment, the depth of inequality was holed up by remittance flows and even by easy credit and its low cost. Nowadays, at the peak of economic crisis, inequality gets tougher which means that the lower and middle classes remain beside in the distribution of income in relative and absolute terms. The debate in developed countries is focused on income taxation of the rich, while in another group of countries including Albania, the focus should be on ensuring access and providing equal opportunities to all classes if it aims on stable socio-economic development. Based on the complexity of the situation and on the fact that Albanians began the transition with low level of welfare, it was proved that Albanian economic reality has an inequality of welfare and income distribution. Policy intervention has become essential in global level.

This paper, focused on inequality of income distribution will affect some other economic indicators which are directly or indirectly increasing the inequality of income specifically on our economy. Corruption, informality or tax evasion effect the distribution of incomes. On the other hand the economical inequality has come from recent financial-economic crises, the decrease of remittances of Albanian families or from flat tax system.

GINI is the most used indicator for measuring inequality by different institutions. This indicator measures the degree of deviation of real income distribution against the perfect level. When the indicator takes the 0 value, it means perfect equality, when all citizens' benefits are equal. When it takes the 1 value, it means perfect inequality, when one citizen receives everything. In countries with polarized economy, violence increases. For example the case of Zimbabwe where the coefficient of unequal income per capita

distribution is higher than the determined world average. It is 0.6% from 0.25% that should be. This conclusion comes from Lloyd Brown-John analysis based on a study of Economic Policy Institute Washington D.C that was made for the report of the median incomes of rich and poor Americans. This analysis includes a period from 1980 to 2006. The conclusion was that 1% of population had 10 times more incomes than the other part in 1980. In the same way this result was increased 20 times in 2006. According to this study, the inequality can be increased with a dramatic step.

Most of people in the planet live in countries where income inequality is higher than one generation before. In states like America, United Kingdom, Canada, China, India and Sweden, the national income has increased by 1% of population with the high level of income. In the case of United state GINI index increased up to 0.39, while in Sweden it was at a level of 0.24 and in China 0.42. The only exception of this tendency is Brazil where the index has decreased over the last 10 years.

According to Lloyd Brown-John the violence level is higher in societies with high poverty and unequal income distribution. Therefore it is possible that the extent of income disproportionally can be linked to the political instability of democracies. In Albania where the middle class is difficult to be distinguished, the democracy is not stable and the transition is getting deeper.

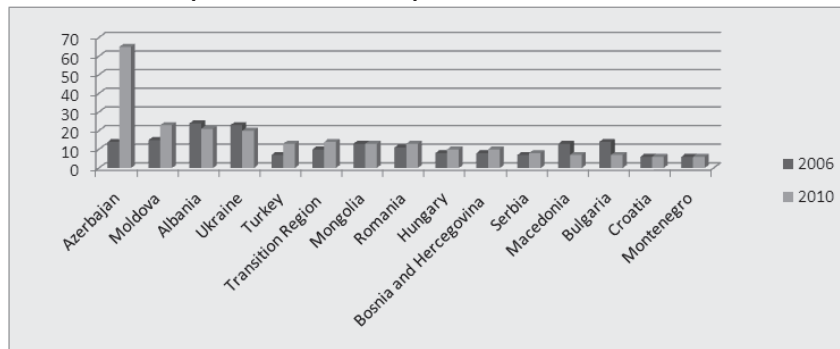
But what can be said for Albania? Unfortunately the measurements of welfare in Albania have been studied only on 2002, 2005, 2008. However these measurements showed the tendencies of increased inequality in income distribution. In 2002, GINI index was 0.282, in 2005 it was

0.33 and in 2008 it had a level of 0.345. Based on these data, 20% of Albanians with the highest income level in 2008 have benefited 43% of total incomes, while in 2002 this benefit was 37.4% of total income. In contrast, 20% of Albanians with the lowest income level have benefited 8.1% and 9.1% of total incomes in respective years.

Are these data worrying? Which is the effect of this inequality? To what extent should be addressed this problem and which is the priority order of government policy?

How will this situation be affected if the latest information of Global Financial Integrity would be a bit true giving the fact that 1.3mld dollars went abroad through corruption, illegal activity and tax evasion? When the source of 1.3mld dollars are 60% from tax evasion, 35% from informality and 5% from corruption, the rich will become richer and the poor will become poorer. So the welfare inequality tends to be deeper and to polarize the society.

Graphic 2: Level of corruption for different countries

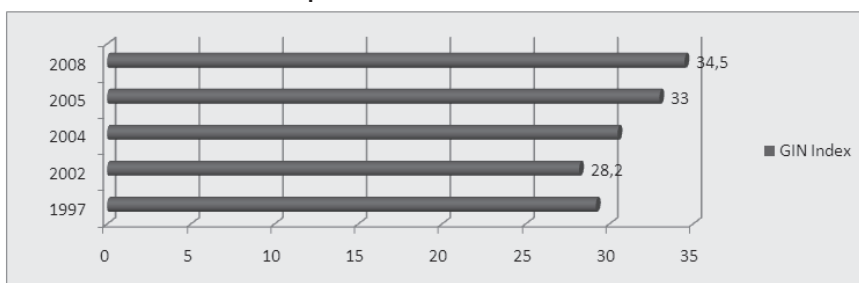


Source: Life in transition, EBRD, 2010

The level of corruption in Albania has always been very high. In a classification of 176 countries Albania is listed the 113th, which means that the level of corruption is high. As

the above chart shows Albania is ranked below 3 countries of Soviet Union; the corruption level remains 10 times higher than the average of Western Europe and higher than all transitional economies in our region

Graphic 3: Gin Index for Albania

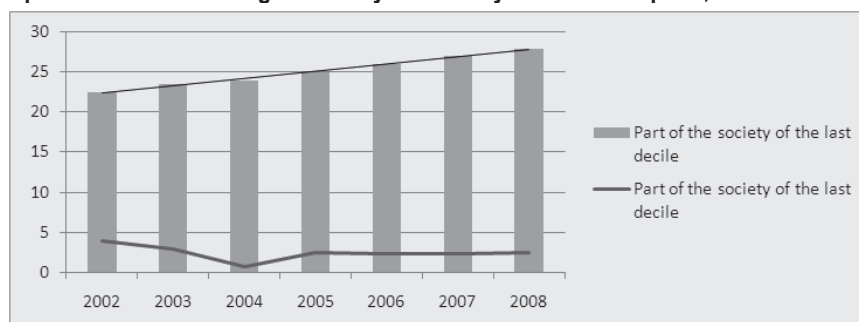


Source: WB, World Economic Developments

The chart above shows the increasing trend of GINI index especially after 2002. After this year the income inequality has been continuously increasing except in 1997, when GINI index had a decreasing trend. The only group of society that have had an increasing trend is the 20% of

population with the highest level of incomes, that means that this part of society have gained more incomes compared to the rest, which is represented from the middle and low classes.

Graphic 4: Trend of owning income by the society divided in 10 parts, each one of 10%

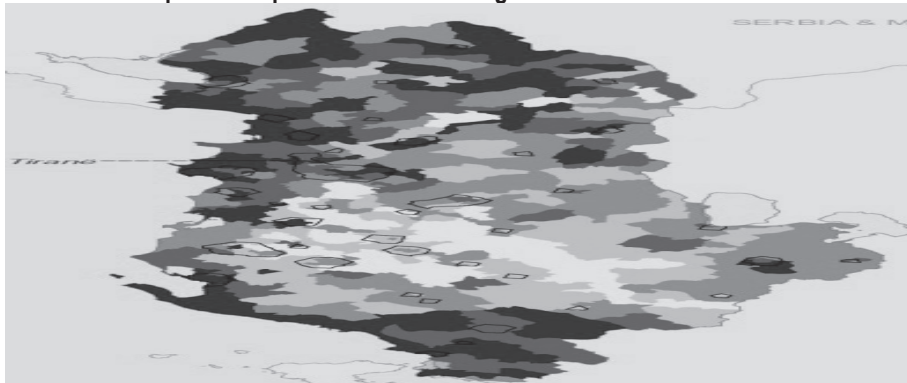


Source: WB, World Economic Developments

Also the inequality is increasing among the population as it is showed in the above chart, where the 10% of society

with the highest income has raised its ownership of income.

Graphic 5: Map of Albania according to the values of GINI index



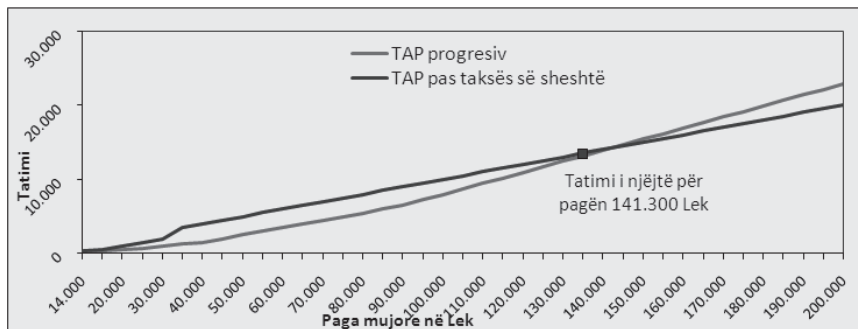
Source: CIESIN, Columbia University

The above map represents the GINI index expanded in the Albanian cities. With the darkest color there are shown the cities with high coefficient of GINI, corresponding to cities with a high level of production factors. This map shows even the cities where welfare level is higher. It is not random the relation between inequality of incomes and production factors.

This is the most meaningful indicator of the failure of the Albanian society to create schemes and institutions

necessary to facilitate in building social cohesion. While in poor areas exists equality in poverty, in potentially economic areas it exists inequality in distribution, that does not generate welfare, nor tends to substitute poverty on the other hand, but it simply goes to the pockets of rich people. One of the main policies that affect the distribution of incomes is fiscal policy in form of taxation, subsidies or economic aid transfers. Albania since 1 January 2008 uses the flat tax system.

Graphic 6: Fiscal Income before and after Flat Tax System

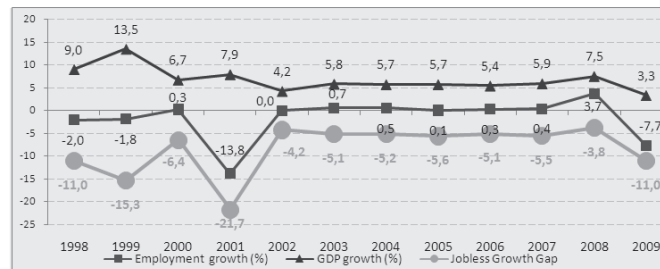


Source: AGENDA Institute (2007)

In this graph it is clear showed that in the flat tax system, the share of income tax after a certain level of salary is lower than the progressive tax system. While it was expected that flat tax system would make easier the

process of collection and would reduce the fiscal evasion, in fact it reduces the fiscal burden of business and for the part of society with high incomes, and increases it for the population with low and middle incomes.

Graphic 7: Trends of GDP and Employment and their correlation

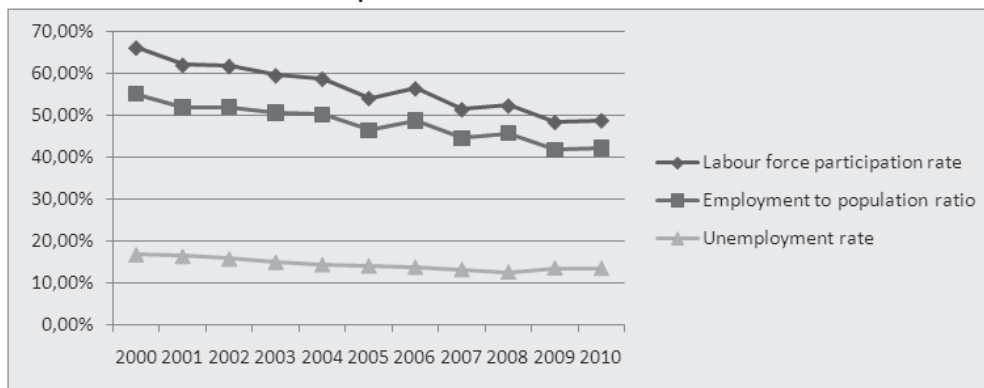


Source: Agenda Institute based on Instat data

Which is the effect of this tax system to the employment? Some other countries that applied flat tax before Albania have seen positive effects in employment. It will be also positive for Albania this result if fiscal burden on wages would produce on a higher rate of employment. In fact the graphic shows the opposite. The flat tax failed to produce equilibrium of inequality. After this reform was applied, the number of Albanian employees decreased.

The graphic also shows that it was made no effort to increase the employment, but neither the economic growth produced it. Giving the fact that this economic growth does not create additional income, inequality of income distribution is higher.

Graphic 8: Trends in Labor Market

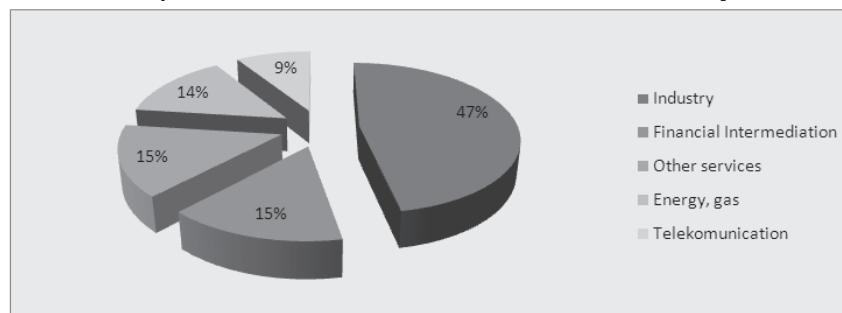


Source: Agenda Institute based on Instat data

Despite the fact that Albania is a country with a young average age, since 2000 the workforce has a decreasing trend. A main reason is the disappointment of society related with the employment opportunities; so this promotes poverty and the difference in welfare income. An important source of capital for the host countries are foreign direct investment (FDI), which support the

development of the host economy and of course generate prosperity by opening new jobs. In most cases FDI accompany with technology transfer which encourage economic growth. According to a study Neuhas (2005), FDI is estimated as a promoter of growth and development of Eastern European countries, contributing 2.3% to a total of 3.5% of their average annual growth.

Graphic 9: Level of FDI in different sectors of the economy

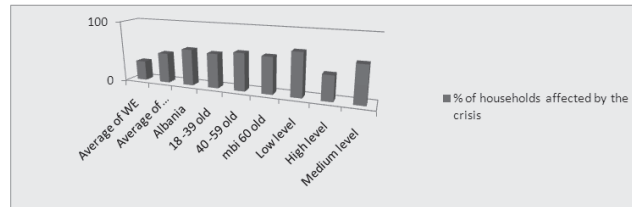


Source: UNCTAD (2011)

In the case of Albania, the absorption of these investments is done without clear objectives related to balancing the inequality, for example we can remind the fact that we are focused on energy sector and forgetting the other sectors (free zones, industrial parks) which can improve more

employment. According to EBRD, Albanian families have been affected from the recent crises on the level of 60%, which is higher than Macedonia and the average of our region.

Graphic 10: Affection of Albanian householders by the last crisis



Source: Life in transition, EBRD, 2010

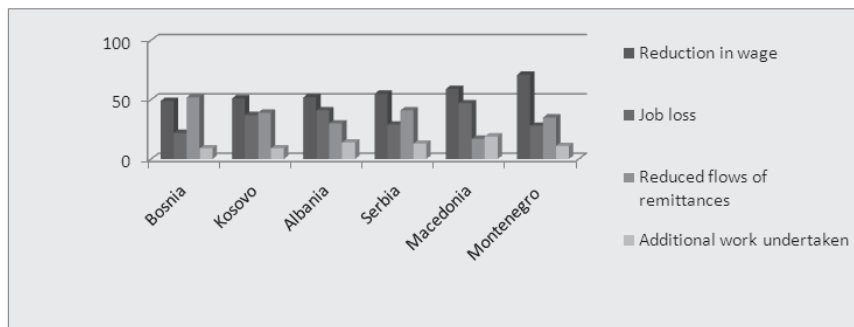
The chart above shows more specifically the level that Albanian households have been affected by the crisis. That means that Albanian economy has been affected by the economic crises on a level of 59%. Meanwhile the average of the transition region is 49%, higher of the affect on

Western European average. In Albania the impact of crises was bigger in middle and low income classes (the last three columns on the graph).

According to EBRD the main phenomena of crises are:

1. The loss of jobs
2. The reduction of wages

Graphic 11: Main channels of crisis transmission

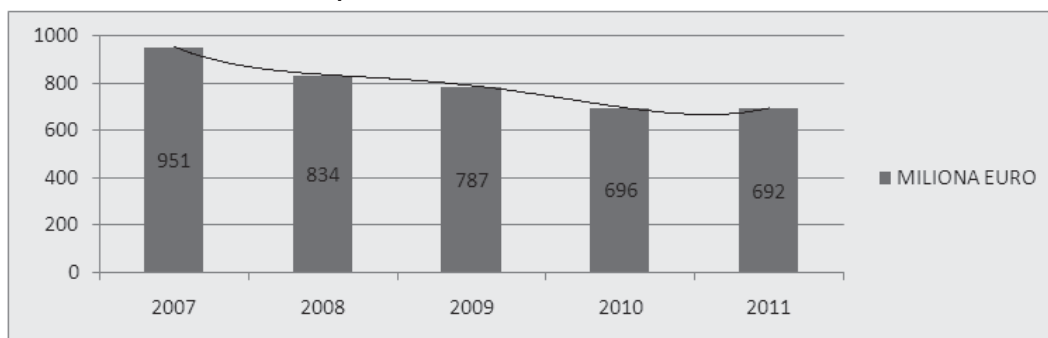


Source: Life in transition, EBRD, 2010

Many studies have analyzed the impact of the crisis on the countries that have a high proportion of remittances in GDP. While was continuously thought that banking system had been largely protected, this was the main channel of transmission of the crisis, as it was expected. According to the Bank of Albania 2009 approximately 65% of the

remittances are dispatched in rural areas. And as a result of World Bank 2011, 35% of the population without those remittances would live on a total poverty. Also the World Bank estimate that in 2011 remittances were about 692 mln Euro, value that shows a decreasing of 27% compared to 2007.

Graphic 12: Trend of the level of remittances



Source: ACIT (2012)

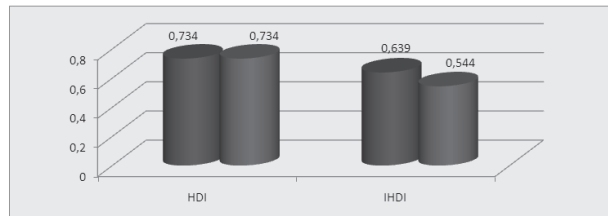
Every year since 1990, the Human Development Report (HDI) has published the Human Development Index, which

was introduced as an alternative conventional measure of national development, such as level of income and

economic growth rate. HDI represent a 3 dimensional definition of welfare: 1. Education, 2. Health, 3. Income. The HDI in Albania is approximately 0.74, being on the 70th position from 187 countries. According to UNDP 2012, Albanian life expectancy at birth is 79.6 years, the average years of education is 10.4 and the value of income per capita is 7803 dollars.

IHDI - means actual level of human development
 HDI - means human potential development index which can be achieved if there is not inequality in income distribution. So generally IHDI=HDI, but falls down HDI when the inequality increases.

Graphic 13: Passing from HDI to IHDI

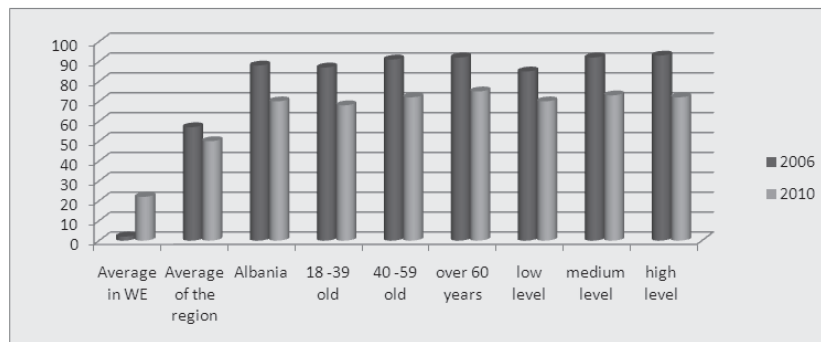


Source: Human Development Report (2011)

The average loss in the HDI due to inequality is 23%, which means that countries with less human development tend to have larger losses in human

development index. As a conclusion it is interesting analyzing the fact that Albanians despite all the negative impacts remains

Graphic 14: Level of optimism before and after the crisis



Source: Life in transition, EBRD, 2010

Conclusions:

1. Inequality in income distribution has become one of the biggest problems for the wider regional economies, but especially for our economy under polarization.
2. The increase in the inequality of income distribution, observed during the analysis of the performance of the GINI index, becomes even more concern when we notice the difference in income access between 10% and 20% with higher income versus 10% or 20 % with lower incomes.
3. High levels of corruption, high levels of informality and tax evasion are some of the conditions that have favored and still are favoring unequal distribution of income.
4. The appliance of flat tax system in the economy since 2008, has contributed to the promotion of inequality.
5. The decrease in the level of remittances as a source of income for most of Albania's poorest families affected to the downward growth of the country, but also in the increase of poverty and consequently inequality in the distribution of welfare.
6. Foreign direct investment, as a contributor to economic growth in developing countries, mainly in the promotion of employment, after a relatively high decline from the last crisis, will have to focus more on sectors that influent to a large and sustainable economic development of the country.

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the most optimistic in the region.

