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СЪДЪРЖАНИЕ
CONTENTS

ASSESSMENT OF THE EFFECTIVENESS OF INTERNAL CONTROL SYSTEMS IN THE CONTEXT OF ARTIFICIAL INTELLIGENCE AND PROCESS AUTOMATION ... 13
Kiril Dimitrov ... 13
ОЦЕНКА НА ЕФЕКТИВНОСТТА НА СИСТЕМИТЕ ЗА ВЪТРЕШЕН КОНТРОЛ В УСЛОВИЯТА НА ИЗКУСТВЕН ИНТЕЛЕКТ И АВТОМАТИЗАЦИЯ НА ПРОЦЕСИТЕ ... 13
Кирил Димитров ... 13

MICROBIOLOGICAL INDICATION OF SURFACE WATERS OF THE DANUBE BASIN WITHIN THE CHERNIVTSI REGION (UKRAINE) ... 30
Yurij Masikevych, Andrii Masikevych, Ivan Burdeniuk ... 30

FROM CONFLICT TO COMMERCE: ANALYZING EU MODELS FOR UKRAINIAN TOURISM RESTORATION ... 38
Natalia Dobrianska, Margaryta Liganenko ... 38

DETERMINANTS OF RURAL TOURISM DEVELOPMENT IN UKRAINE: EXPERT'S OPINION ... 43
Sergii Iaromenko ... 43

DIGITAL AND INSTITUTIONAL INSTRUMENTS FOR POVERTY REDUCTION ... 48
Mihail Ciobanu ... 48

EVALUATION OF PUBLIC POLICIES IN THE AGRICULTURAL SECTOR: IS THE VAT SCHEME FOR AGRICULTURAL PRODUCTS OPTIMAL? ... 56
Bajame Vosela, Rezear Kolaj, Denisa Cani ... 56

ANTI–COMPETITIVENESS AND SMART SPECIALIZATION: LEADERSHIP UNDER END–GAME–BEHAVIOR AND POLICY COSTS ... 62
Dorjana Kolaj, Vera Lazri, Rezear Kolaj ... 62

COMPARATIVE ANALYSIS OF DIGITAL QUALITY OF LIFE IN THE REPUBLIC OF BULGARIA AND THE REPUBLIC OF MOLDOVA ... 66
Tatiana Colesnicova, Plamen Lakov ... 66

FACTORS INFLUENCING INVESTMENTS ACTIVITY IN BULGARIAN FORESTRY ... 75
Konstantin Kolev, Nevena Shuleva, Maya Tsoklinova, Valentina Marinova ... 75
ФАКТОРИ, ВЪЗДЕЙСТВАЩИ ВЪРХУ ИНВЕСТИЦИОННАТА АКТИВНОСТ В ГОРСКОТО СТОПАНСТВО НА БЪЛГАРИЯ ... 75
Константин Колев, Невена Шулева, Мая Цоклинова, Валентина Маринова ... 75

INTEGRATED TERRITORIAL INVESTMENTS AND THE ILLUSION OF BALANCED REGIONAL DEVELOPMENT IN BULGARIA ... 83
Yuliyan Mollov ... 83
ИНТЕГРИРАНИ ТЕРИТОРИАЛНИ ИНВЕСТИЦИИ И ИЛЮЗИЯТА ЗА БАЛАНСИРАНО РЕГИОНАЛНО РАЗВИТИЕ В БЪЛГАРИЯ ... 83
Юлиян Моллов ... 83

REGIONAL DIFFERENCES IN THE UNIVERSITY NETWORK IN BULGARIA ACCORDING TO THE INDICATOR OF "INSTITUTIONAL INTENSITY" ... 102
Desislava Simeonova, Dimitar Simeonov ... 102

РЕГИОНАЛНИ РАЗЛИЧИЯ НА УНИВЕРСИТЕТСКАТА МРЕЖА В БЪЛГАРИЯ СПОРЕД ПОКАЗАТЕЛЯ „УНИВЕРСИТЕТСКА ПЛЪТНОСТ" 102
Десислава Симеонова, Димитър Симеонов 102

ASSESSING THE REGIONAL CONSERVATION STATUS OF PLANT DIVERSITY: RESULTS FROM DIGIVALPGR PROJECT 115
Nikolaya Velcheva, Simona Cheperigova, Valko Neshev 115

LOCAL TAXES AND FEES AS A FINANCIAL AND LEGAL INSTRUMENT FOR THE IMPLEMENTATION OF REGIONAL DEVELOPMENT STRATEGIES 122
Atanas Kostadinov 122
МЕСТНИТЕ ДАНЪЦИ И ТАКСИ КАТО ФИНАНСОВОПРАВЕН ИНСТРУМЕНТ ЗА РЕАЛИЗАЦИЯ НА СТРАТЕГИИТЕ ЗА РЕГИОНАЛНО РАЗВИТИЕ 123
Атанас Костадинов 123

APPLICATION OF MULTIFACTOR STATISTICAL STUDIES 133
IN ECONOMICS 133
Raycho Minchev, Nadka Damyanova 133
ПРИЛАГАНЕ НА МНОГОФАКТОРНИ СТАТИСТИЧЕСКИ ИЗСЛЕДВАНИЯ В ИКОНОМИКАТА 133
Райчо Минчев, Надка Дамянова 133

THE ROLE OF STATISTICAL ANALYSIS IN THE ASSESSMENT OF HARMFUL EMISSIONS IN A GASOLINE ENGINE WITH A FAULTY AND REPLACED OXYGEN SENSOR 144
Raycho Minchev 144
РОЛЯТА НА СТАТИСТИЧЕСКИЯ АНАЛИЗ В ОЦЕНКАТА НА ВРЕДНИТЕ ЕМИСИИ ПРИ БЕНЗИНОВ ДВИГАТЕЛ С ДЕФЕКТИРАЛ И ПОДМЕНЕН КИСЛОРОДЕН СЕНЗОР 144
Райчо Минчев 144

ON THE NEW REGIONAL DIVISION OF BULGARIA AND THE NEED FOR A COMPREHENSIVE REFORM OF THE ADMINISTRATIVE-TERRITORIAL ORGANIZATION OF THE COUNTRY 149
Krasimir Levkov, Plamen Lakov, Barish Ali 149
ЗА НОВОТО РЕГИОНАЛНО ДЕЛЕНИЕ НА БЪЛГАРИЯ И НЕОБХОДИМОСТТА ОТ ЦЯЛОСТНА РЕФОРМА НА АДМИНИСТРАТИВНО-ТЕРИТОРИАЛНОТО УСТРОЙСТВО НА СТРАНАТА 149
Красимир Левков, Пламен Лаков, Баръш Али 149

STRATEGIC PLAN FOR THE DEVELOPMENT OF AGRICULTURE AND RURAL AREAS FOR THE PERIOD 2023-2027: NEW OPPORTUNITIES FOR MUNICIPALITIES, BUSINESSES AND NON-GOVERNMENTAL ORGANIZATIONS /NGOS/ 157
Valentina Marinova 157
СТРАТЕГИЧЕСКИ ПЛАН ЗА РАЗВИТИЕ НА ЗЕМЕДЕЛИЕТО И СЕЛСКИТЕ РАЙОНИ ЗА ПЕРИОДА 2023-2027 Г.: НОВИ ВЪЗМОЖНОСТИ ЗА ОБЩИНИ, БИЗНЕС И НЕПРАВИТЕЛСТВЕНИ ОРГАНИЗАЦИИ /НПО/ 157
Валентина Маринова 157

RISKS IN FINANCING INNOVATIVE ACTIVITIES IN THE AGRICULTURAL INDUSTRY 165
Natalia Stoyanova 165
РИСКОВЕ ПРИ ФИНАНСИРАНЕ НА ИНОВАЦИОННА ДЕЙНОСТ В АГРАРНИЯ ОТРАСЪЛ 165
Наталия Стоянова 165

THE DIALECTICS OF GLOBAL INTEGRATION: THREATS, OPPORTUNITIES, AND AI-DRIVEN TRANSITIONS IN THE REGIONAL DEVELOPMENT OF BULGARIA AND CEE 173
Stefani Georgieva, Antoni Georgiev, Georgi Ivanov, Tomislav Kaloferov 173

ECONOMIC DIMENSIONS OF THE ENERGY AND CLIMATE TRANSITION IN BULGARIA: REGIONAL CHALLENGES AND OPPORTUNITIES FOR SUSTAINABLE DEVELOPMENT 178
Vesela Angelova 178

FORMATION OF INNOVATIVE DIRECTIONS, MECHANISMS, AND STRATEGIES FOR THE DEVELOPMENT OF NEW FORMATS OF DOMESTIC TOURISM 189
Natalia Dobrianska, Vira Lebedieva, Dmytro Tkachenko, Lada Salenko 189

SUSTAINABLE MARKETING AND GREENWASHING CHALLENGES 197
Nino Mamuladze 197

GREEN JOBS: TAX POLICY IN BULGARIA AND SPAIN 202
Isabel Dekiouk Cuesta 202

GREEN MARKETING - FACTS AND MYTHS 205
Emanuela Esmerova 205

SOME ASPECTS OF DIRECT AND ONLINE MARKETING 211
Emanuela Esmerova 211

FINANCING LOW-CARBON TRANSITION IN THE EUROPEAN UNION: TRENDS AND PROSPECTS .. 219
Anatolii Kucher, Adam Czajka 219

FROM CARBON COLONIALISM TO CARBON JUSTICE: SOCIAL SCIENCES FOR LOW-CARBON REGIONAL DEVELOPMENT 226
Stefani Georgieva, Antoni Georgiev 226

ANALYSIS OF THE COMMUNICATION POLICY OF LIDL BULGARIA 231
Maxim Popov 231
АНАЛИЗ НА КОМУНИКАЦИОННАТА ПОЛИТИКА НА LIDL БЪЛГАРИЯ 231
Максим Попов 231

DETERMINATION OF THE TARGET MARKET SEGMENT AND POSITIONING OF LIDL BULGARIA . 241
Maxim Popov 241
ОПРЕДЕЛЯНЕ НА ЦЕЛЕВИЯ ПАЗАРЕН СЕГМЕНТ И ПОЗИЦИОНИРАНЕТО НА LID L БЪЛГАРИЯ 241
Максим Попов 241

SUSTAINABLE SUCCESSION IN FAMILY ENTERPRISES: A THEORETICAL INTEGRATION OF STAKEHOLDER CAPITALISM, ESG GOVERNANCE AND SUSTAINABLE FINANCE 248
Velizar Petrov 248

STARTUP ECOSYSTEMS AND GROWTH POTENTIAL 253
Petar Dzhandarmov 253
СТАРТЪП ЕКОСИСТЕМИ И ПОТЕНЦИАЛ ЗА РАСТЕЖ 253
Петър Джандармов 253

REGIONAL "LIVING" LABS - SCIENTIFIC RESEARCH AND INNOVATION IN A "QUADRUPLE HELIX" 258
Ekaterina Arabska 258
РЕГИОНАЛНИТЕ „ЖИВИ“ ЛАБОРАТОРИИ – НАУЧНИ ИЗСЛЕДВАНИЯ И ИНОВАЦИИ В „ЧЕТВОРНА СПИРАЛА“ 258
Екатерина Арабска 258

INNOVATIVE TOURISM PRODUCTS AS A FACTOR FOR SUSTAINABLE REGIONAL DEVELOPMENT IN BULGARIA 265
Nevena Lyaskova-Velikova 265
ИНОВАЦИОННИ ТУРИСТИЧЕСКИ ПРОДУКТИ КАТО ФАКТОР ЗА УСТОЙЧИВО РЕГИОНАЛНО РАЗВИТИЕ В БЪЛГАРИЯ 265
Невена Ляскова-Великова 265

THEORETICAL ANALYSIS OF SUSTAINABILITY REPORTING 281
Diyan Velikov 281
ТЕОРЕТИЧЕН АНАЛИЗ НА ОТЧИТАНЕТО НА УСТОЙЧИВОСТТА 281
Диян Великов 281

PERMANENT MAGNETIC FIELD AND ITS EFFECT ON PLANTS 290
Teodora Ilieva-Pencheva, Dimitar Yakimov 290
ПОСТОЯННО МАГНИТНО ПОЛЕ И НЕГОВОТО ВЪЗДЕЙСТВИЕ ВЪРХУ РАСТЕНИЯТА 290
Теодора Илиева-Пенчева, Димитър Якимов 290

QUALITY SCHEMES IN EU AGRICULTURE: DEVELOPMENT AND POTENTIAL FOR BULGARIA 297
Anna Karova 297

BIOLOGICAL MONITORING AS AN INTEGRAL TOOL FOR ASSESSING ECOSYSTEM HEALTH IN BULGARIA 307
Alex Petkov, Teodora Ilieva-Pencheva 307
БИОЛОГИЧЕН МОНИТОРИНГ КАТО ИНТЕГРАЛЕН ИНСТРУМЕНТ ЗА ОЦЕНКА НА ЕКОСИСТЕМНОТО ЗДРАВЕ В БЪЛГАРИЯ 307
Алекс Петков, Теодора Илиева-Пенчева 307

PERSONS WITH DISABILITIES AND EMPLOYMENT IN EUROPE: IMPLEMENTATION OF INTERNATIONAL PRINCIPLES AND COMPARATIVE PERSPECTIVES 315
Svetlana Rusu 315

THE GEOPOLITICS OF RELIGION, MIGRATION, AND SUSTAINABILITY AT EU EXTERNAL BORDERS: ONTOLOGICAL SECURITY, BORDERING PRACTICES, AND GOVERNANCE CAPACITY 321
Bülent Şenay 321

GENDER DIFFERENCES AMONG NEET YOUTH IN THE REPUBLIC OF MOLDOVA: ECONOMIC AND SOCIAL CONSEQUENCES 326
Iulia Bejenaru 326

REGIONAL CULTURAL POLICY IN MODERN TOURISM 335
Tamriko Meskhia 335

DEVELOPMENT OF CREATIVE TOURISM FOR COMMUNITY SOCIAL ENGAGEMENT 340
Natalia Dobrianska, Svitlana Shekera 340

AGRITOURISM IN EASTERN EUROPE AND CENTRAL ASIA: EXAMPLES OF GOOD PRACTICES AND DEVELOPMENT DIRECTIONS 347
Svetlana Ceban 347

IMPLEMENTATION OF ITSM AS MODERN MANAGEMENT IN THE MEDICAL INDUSTRY 356
Vlada Colesnicova 356

EUROPEAN UNIVERSITY ALLIANCES: PRESENT AND FUTURE 362
Ekaterina Arabska 362
ЕВРОПЕЙСКИТЕ УНИВЕРСИТЕТСКИ АЛИАНСИ: НАСТОЯЩЕ И БЪДЕЩЕ 362
Екатерина Арабска 362

ARTIFICIAL INTELLIGENCE IN EDUCATION AS A FACTOR FOR SUSTAINABLE REGIONAL DEVELOPMENT AND ECONOMIC GROWTH 368
Krastina Kuzeva 368
ИЗКУСТВЕН ИНТЕЛЕКТ В ОБРАЗОВАНИЕТО КАТО ФАКТОР ЗА УСТОЙЧИВО РЕГИОНАЛНО РАЗВИТИЕ И ИКОНОМИЧЕСКИ РАСТЕЖ 370
Кръстина Кузева 370

INNOVATIVE PEDAGOGICAL MODELS FOR DEVELOPING ENTREPRENEURIAL COMPETENCES IN SECONDARY EDUCATION 373
Stefan Georgiev Stefanov 373
ИНОВАЦИОННИ ПЕДАГОГИЧЕСКИ МОДЕЛИ ЗА РАЗВИТИЕ НА ПРЕДПРИЕМАЧЕСКИ КОМПЕТЕНТНОСТИ В СРЕДНОТО ОБРАЗОВАНИЕ 374
Стефан Георгиев Стефанов 374

HOW CAN TEACHER-EXPERT COLLABORATION BE IMPROVED IN SECONDARY SCHOOL EDUCATION TO INCREASE STUDENT ENGAGEMENT AND SUBJECT CONTENT UNDERSTANDING? 381
Alex Zhelyazkov 381

STRUCTURED EXERCISES ON SUSTAINABLE DEVELOPMENT FOR STUDENTS 390
Stela Stoyanova 390
СТРУКТУРНИ УПРАЖНЕНИЯ ПО УСТОЙЧИВО РАЗВИТИЕ ЗА СТУДЕНТИ 390
Стела Стоянова 390

OPPORTUNITIES FOR DEVELOPMENT OF CAMPING TOURISM IN NORTH MACEDONIA 394
Dejan Metodijeski, Oliver Filiposki, Yasmina Andreeva, Emilija Todorovic 394

BETWEEN INNOVATION AND FORMALISM: E-LEARNING AND DISTANCE EDUCATION IN BULGARIAN HIGHER EDUCATION 405
Delyan Plachkov 405

HUMAN CAPITAL DEVELOPMENT 410
Emilia Milanova 410
РАЗВИТИЕ НА ЧОВЕШКИЯ КАПИТАЛ 410
Емилия Миланова 410

OPPORTUNITIES FOR THE DEVELOPMENT OF WINTER TOURISM IN THE TERRITORY OF THE SHUMEN PLATEAU NATURE PARK 415
Emanuil Georgiev, Ivalena Valcheva 415
ВЪЗМОЖНОСТИ ЗА РАЗВИТИЕ НА ЗИМЕН ТУРИЗЪМ НА ТЕРИТОРИЯТА НА ПП „ШУМЕНСКО ПЛАТО“ 415
Емануил Георгиев, Ивалена Вълчева 415

NATURE OF INFORMATION SYSTEM 423
Konstantin Tsvetkov 423
СЪЩНОСТ НА ИНФОРМАЦИОННИТЕ СИСТЕМИ 423
Константин Цветков 423

GLOBAL NETWORKS AND THE DARK WEB AS A PLATFORM FOR THE DISSEMINATION OF BIOTERRORIST CAPACITY: FROM CYBERCRIME TO BIORISK AND NATIONAL SECURITY 428
Stefan Bankov, Radoslav Rangelov 428
ГЛОБАЛНИТЕ МРЕЖИ И DARK WEB КАТО ПЛАТФОРМА ЗА РАЗПРОСТРАНЕНИЕ НА БИОТЕРОРИСТИЧЕН КАПАЦИТЕТ: ОТ КИБЕРПРЕСТЪПНОСТ КЪМ БИОРИСК И НАЦИОНАЛНА СИГУРНОСТ 429
Стефан Банков, Радослав Рангелов 429

FROM TRANSHUMANISM TO "LONGEVITY HYPE": ORGANELLIC KNOTS (MITOCHONDRIA AND GOLGI APPARATUS) IN THE EVOLUTION OF THE HUMAN LIFE EXTENSION PROJECT — A QUALITATIVE THEMATIC META-SYNTHESIS 434
Radoslav Rangelov, Stefan Bankov 434
ОТ ТРАНСХУМАНИЗЪМ КЪМ „LONGEVITY HYPE": ОРГАНЕЛНИ ВЪЗЛИ (МИТОХОНДРИИ И АПАРАТ НА ГОЛДЖИ) В ЕВОЛЮЦИЯТА НА ЧОВЕШКИЯ ПРОЕКТ ЗА УДЪЛЖАВАНЕ НА ЖИВОТА — КАЧЕСТВЕН THEMATIC META-SYNTHESIS 435
Радослав Рангелов, Стефан Банков 435

KINESIOTHERAPEUTIC APPROACH TO ACHILLES TENDON RUPTURE - PRESENTATION OF A CLINICAL CASE 443
Maria Vakrilova-Becheva 443
КИНЕЗИТЕРАПЕВТИЧЕН ПОДХОД ПРИ РУПТУРА НА АХИЛЕСОВОТО СУХОЖИЛИЕ - ПРЕДСТАВЯНЕ НА КЛИНИЧЕН СЛУЧАЙ 444
Мария Вакрилова-Бечева 444

EDUCATION AND THE TOURISM BUSINESS – MODELS OF STRATEGIC INTERACTION IN THE CONTEXT OF DIGITAL AND GREEN TRANSFORMATION 451
Zlatka Grigorova 451
ОБРАЗОВАНИЕ И ТУРИСТИЧЕСКИ БИЗНЕС – МОДЕЛИ НА СТРАТЕГИЧЕСКО ВЗАИМОДЕЙСТВИЕ В УСЛОВИЯ НА ДИГИТАЛНА И ЗЕЛЕНА ТРАНСФОРМАЦИЯ 451
Златка Григорова 451

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EVALUATION OF PUBLIC POLICIES IN THE AGRICULTURAL SECTOR: IS THE VAT SCHEME FOR AGRICULTURAL PRODUCTS OPTIMAL?

Bajame Vosela[1], Rezear Kolaj[2], Denisa Cani[1]

[1]*Qiriazi University College, Tirana, Albania*

[2]*Agricultural University of Tirana, Albania*

Abstract: The discussion on the evaluation of the Value Added Tax (VAT) compensation scheme for agricultural products involves the interaction between fiscal and agricultural policy. There is an ongoing debate regarding the performance and achievements of the agricultural sector. Evidence shows that farmers are not VAT-registered but bear the VAT burden on agricultural inputs. The compensation scheme aims to alleviate this burden by applying a fixed compensation rate at the point of sale of agricultural products. This study adopts an analytical and descriptive approach, drawing on the practices applied in European Union member states, while also examining the legal framework and the implications of the scheme through an illustrative example of a small-scale farmer in Albania. The paper analyzes the alignment between the level of compensation and the actual fiscal burden borne by farmers and assesses its effects along the agri-food value chain. The findings indicate that the scheme does not ensure full fiscal neutrality and may result in under- or overcompensation. These effects vary by regional conditions and the specific characteristics of agricultural producers.

Keywords: VAT compensation, agriculture, fiscal policy, Albania.

Introduction

Agriculture is a strategic sector of the Albanian economy in several respects, playing a key role in value-added creation, employment, food security, and exports. According to official data from INSTAT and the World Bank, the agricultural sector contributes approximately 18.5% of Gross Domestic Product (GDP), representing one of the highest shares in Europe, and employs about 37% of the labor force, primarily through small-scale farms and family-based agricultural holdings. This fragmented sector presents challenges, including inadequate irrigation systems and a high degree of informality.

The agricultural sector utilizes approximately 50% of the country's arable land, out of a total area of around 695,000 hectares. Despite these constraints, agricultural production in Albania has recorded growth in several subsectors. In 2024, cereal production reached 649,919 tons, while vegetable production reached 1,424,404 tons (INSTAT, 2024). The production of fresh vegetables amounted to 941,344 tons, dried vegetables to 136,247 tons, and fruit to 295,532 tons.

These indicators highlight the economic importance of the agricultural sector and underscore the need for continuous improvements, particularly through assessing the effectiveness of fiscal and agricultural policies in supporting its long-term sustainability.

In this context, the Value Added Tax (VAT) system is a core element of fiscal policy that directly affects the agricultural sector. The legal framework governing VAT in Albania is Law No. 92/2014 "On Value Added Tax in the Republic of Albania," which establishes the fundamental rules for the application of VAT across the entire economy, including the agricultural sector. Before 2014, agricultural products were subject to a reduced VAT rate of 6%, within an environment characterized by high levels of informality and the absence of effective monitoring of prices and transactions. This situation generated uncertainty regarding the actual VAT burden and its distribution between farmers and commercial intermediaries.

The introduction of the standard VAT rate of 20% in the agricultural sector after 2014 aimed to promote formalization and improve the functioning of the agri-food supply chain. Within this framework, a specific VAT compensation scheme for farmers was introduced, operating differently from the traditional VAT mechanism applied to registered businesses. The current scheme provides 10% compensation for non-VAT-registered farmers on sales of agricultural products to VAT-registered entities, such as collectors, processors, and certified agritourism businesses. This compensation does not constitute VAT in the classical sense, but rather a financial transfer intended to alleviate the fiscal burden borne by farmers.

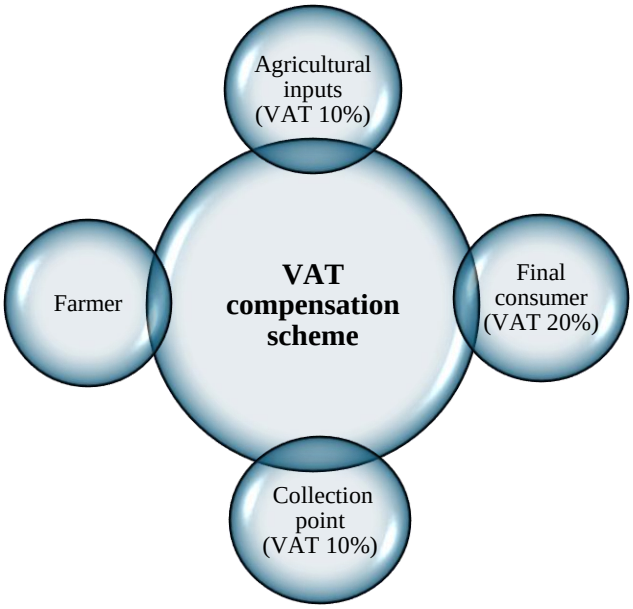

Fig. 1. VAT compensation scheme in Albania
Source: Authors' processing

The scheme applies to farmers who hold a tax identification number (NIPT) but are not VAT-registered. Collectors and processors are required to be VAT-registered entities and to issue the relevant documentation for all transactions carried out. The invoicing process is conducted through self-invoicing by the buyers, and farmers apply for compensation during two annual periods. The tax administration reimburses the compensation amount directly to the farmer's bank account within the statutory period.

However, despite its stated objectives, the actual effectiveness remains subject to debate. Key questions concern the extent to which the compensation mechanism succeeds in neutralizing the VAT burden on agricultural inputs, its impact on the functioning of the farmer–collector–consumer supply chain, and the role of the scheme in promoting formalization and increasing farmers' incomes. These dilemmas are not unique to Albania. As early as the 1960s, European Union countries encountered initial difficulties in integrating small-scale farmers into the standard VAT system, leading to the adoption of alternative mechanisms such as the flat-rate scheme, which aims to indirectly compensate VAT on inputs without requiring farmers to register for VAT (Cnossen, 2017).

As of January 1, 2026, a revision of the VAT compensation scheme in agriculture will enter into force, providing for the application of a compensation rate of 10%. Given the potential of digital tools and the growing demand for enhanced coherence and efficiency among public policies in a complex sector such as agriculture, an important question arises as to whether this scheme succeeds in fulfilling its primary objective: the effective compensation of the VAT burden borne by farmers on agricultural inputs.

Key agricultural inputs, such as chemical fertilizers, seeds, and pesticides, are supplied by VAT-registered entities and are taxed at 10% rate. This means that farmers who are not VAT-registered

directly bear the cost of this tax on every input purchase, increasing production costs by approximately 10%. The compensation scheme aims to neutralize this burden through an indirect reimbursement at the point of sale of agricultural products, by applying 10% compensation on the sales value. This paper aims to assess whether the current VAT compensation scheme in agriculture effectively offsets the fiscal burden borne by farmers and improves the functioning of the agricultural supply chain in Albania.

Literature Review

The international literature on Value Added Tax (VAT) in the agricultural sector emphasizes the structural difficulties of integrating small-scale farmers into standard VAT schemes. Since the introduction of VAT in European Union countries in the 1960s, agriculture has been regarded as a complex and challenging sector for fiscal administration due to fragmented production, low levels of formalization, and high compliance costs (Cnossen, 2017).

Studies argue that the exclusion of farmers from the standard VAT system, without compensatory mechanisms, leads to increased costs of agricultural inputs and the transfer of the tax burden along the production and distribution chain, negatively affecting final consumer prices (Ebrill et al., 2001). In this context, VAT on agricultural inputs may have a regressive character, being associated with reductions in farmers' real incomes and creating social and economic distortions, particularly in agri-food markets (Adam, 2011).

In response to these challenging processes, the EU has implemented alternative schemes, such as the flat-rate scheme, which aims to indirectly compensate VAT on agricultural inputs for small-scale farmers without requiring them to register for VAT or maintain complex tax records (Cnossen, 2017). These schemes seek to balance two main objectives: alleviating the administrative burden on farmers and preserving VAT fiscal neutrality (Keen & Lockwood, 2010).

However, empirical evidence on the effectiveness of VAT compensation schemes is mixed. Some studies indicate that compensation schemes can contribute to increased formalization and the stabilization of farmers' incomes, particularly in transition economies (Bird & Gendron, 2007). At the same time, critical literature emphasizes that these schemes often fail to fully offset the actual VAT burden on inputs, as the compensation rate does not always reflect the true structure of agricultural production costs (OECD, 2020).

Another line of literature focuses on the effects of VAT along the agri-food value chain. The shifting of the VAT burden from farmers to collectors, processors, and final consumers is a common phenomenon in specialized agricultural schemes, raising questions about the economic neutrality of these mechanisms (Keen, 2013). Within this context, compensation schemes may create incentives to direct trade toward exports, particularly in countries where agricultural exports are zero-rated for VAT, thereby affecting the availability of products in domestic markets.

In developing and transition economies, studies emphasize that institutional design and administrative capacities play a decisive role in the effectiveness of VAT schemes in agriculture (Bird, 2015). The lack of monitoring, high informality, and limited fiscal knowledge among farmers often constrain the positive impact of compensation schemes, rendering them more a formal instrument than an effective support mechanism (OECD, 2020).

For Albania, the academic literature on VAT in agriculture remains limited and primarily descriptive. Nevertheless, recent studies on fiscal policies and formalization indicate that special VAT schemes have contributed to increased farmer registration and improved transaction documentation, but without clear evidence on the actual compensation of the fiscal burden (Cani et al., 2024). This creates a research gap regarding the assessment of the effectiveness of the current VAT compensation scheme in agriculture, particularly concerning the distribution of the tax burden along the farmer–collector–consumer value chain.

This study contributes to the existing research literature by providing an institutional and conceptual analysis of the VAT compensation scheme in Albania, situating it within the broader international debate on fiscal policy in the agricultural sector.

Methodology and analytical approach

This study adopts an analytical approach aiming to assess the effectiveness of the current VAT compensation scheme in the agricultural sector in Albania. The methodology is based on the analysis of the existing fiscal legal framework, the practical functioning of the compensation scheme, and the distribution of the VAT burden along the farmer–collection point–retail point–consumer value chain.

The analysis relies on descriptive and illustrative evidence, using concrete examples of agricultural input cost structures and the self-invoicing mechanism to evaluate whether the compensation level provided by the scheme accurately reflects the fiscal burden borne by farmers. The approach seeks to provide a conceptual and economic assessment of the scheme's design and its practical implications.

The main limitation of this type of study is the lack of microeconomic data on the actual cost structures, which makes the quantitative assessment of VAT compensation complex and difficult to measure directly.

Results

To illustrate the practical functioning of the VAT compensation scheme and assess whether the compensation level accurately reflects the fiscal burden on farmers, the analysis relies on a descriptive example of the cost structure of agricultural inputs and the self-invoicing mechanism.

The illustrative study experiment involves a small-scale farmer in the Berat region, who engages in continuous agricultural activity and holds a tax identification number (NIPT) but is not VAT-registered. The farmer purchases agricultural inputs (chemical fertilizers, seeds, and pesticides) from VAT-registered entities. In January 2026, he bought 10 quintals (1 ton) of chemical fertilizer at 250 000 Albanian lek (ALL) (2 600 EUR), of which 10%, 25 000 ALL (260 EUR), represents the VAT paid on the input. In this case, the farmer directly bears the VAT burden, increasing production costs by 10%.

In January, the farmer sold his agricultural products to a VAT-registered collection point for a total value of 290 000 ALL (3 016 EUR). Under the current scheme, the farmer does not issue a VAT invoice. Instead, the collection point issued a self-invoice on his behalf, applying 10% compensation on the sales value. The compensation received in January amounted to 29 000 ALL (302 EUR). In this case, the farmer was overcompensated by 4 000 ALL for that month.

Table 1. Illustration of the VAT burden and compensation level for a small farmer in January 2026

Description	**Value (ALL)**	**Value (EUR)**	**Explanation**
Purchase of agricultural inputs (chemical fertilizer – 10 quintals)	250 000	2600	Total value of the purchase invoice
VAT on inputs (10%)	25 000	260	Fiscal burden born directly by the farmer
Total input cost	250 000	2600	Effective production cost increases by 10%
Value of agricultural product sales	290 000	3016	Sales to the collection point
Compensation rate	10%	10%	According to the current compensation scheme
Compensation amount received by the farmer	29 000	302	10% of the sales value
VAT is actually paid on inputs	25 000	260	Actual fiscal burden
Net difference (compensation – VAT paid)	4 000	42	Farmer overcompensation

Source: Authors' processing

The example illustrates that the compensation level is not directly linked to the actual VAT paid on agricultural inputs, but rather to the sales value of the product. In this case, the farmer receives compensation higher than the fiscal burden incurred, resulting in an overcompensation effect.

However, this outcome is neither stable nor guaranteed. If the sales value were lower (e.g., due to low market prices, adverse climatic conditions, or production losses), the compensation received would be proportionally smaller and might not fully cover the VAT input paid. Consequently, the current compensation scheme does not ensure sustainable fiscal neutrality for farmers, producing variable outcomes that depend on external factors unrelated to the structure of production costs.

Discussion and conclusion

The analysis shows that the compensation level is not directly linked to the actual cost structure. Since agricultural production is influenced by multiple determining factors, including climatic conditions, seasonal cycles, and market price fluctuations, it is difficult to ascertain whether the 10% compensation fully covers the VAT paid inputs or whether farmers benefit more or less than the actual burden incurred. In practice, this scheme does not provide a clear measurement mechanism to evaluate whether the compensation is proportional to the actual production costs, which is a critical aspect for assessing its effectiveness.

From the perspective of the agri-food value chain, the compensation received by the farmer is partially transferred to the collection point, which purchases the products through self-invoicing and applies the 10% compensation as VAT on the purchase. If the products are sold on the domestic market, the collection point is subject to a 20% VAT on sales, retaining a net burden of 10%. This burden is further reflected in the final price, ultimately passed on to the consumer, who bears the full 20% VAT.

Thus, the VAT burden is distributed among the farmer, the collection point, and the final consumer, while the state budget benefits from cumulative revenue along the entire value chain. From a fiscal perspective, the scheme is effective in generating revenue, but from an economic and distributive standpoint, it does not ensure full VAT neutrality for farmers.

Another important aspect relates to trade orientation. For collection points, exporting agricultural products is more profitable compared to selling on the domestic market, as exports are zero-rated for VAT, while the VAT paid on purchases is reimbursed by the state. This creates incentives to direct domestic products toward foreign markets, raising questions about the supply of the domestic market and the competitiveness of local products relative to imports.

The analysis suggests that the current VAT compensation scheme in agriculture contributes to the formalization of transactions and provides administrative relief for farmers. However, its effectiveness in genuinely offsetting the fiscal burden remains limited. The applied scheme shifts the VAT burden along the value chain rather than fully neutralizing it for farmers. The findings highlight the need for a thorough review of fiscal policy in the agricultural sector, considering alternatives such as revising the VAT rate on agricultural inputs or implementing more direct and measurable compensation mechanisms to support farmers.

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