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FISCAL POLICIES AND ECONOMIC GROWTH OF KOSOVO

Bedri HAMZA*, Petraq MILO

Faculty of Economics, University of Tirana, Tirana, Albania

**Corresponding author's e-mail: bedrihamza63@gmail.com*

Abstract. Fiscal policy is of great importance for Kosovo's economic development. This study aims at analysing the tax system in Kosovo in the theoretical and analytical terms. The data used are secondary taken from state budget and include tax revenues as well as budget expenditures between 2006 and 2018. Observance of tax laws is an essential civic responsibility. In a modern country, which Kosovo aims to be, citizens are required to pay taxes and other obligations which fund government programs, the provision of public services and high standards of education, welfare, health, social support, protection, law enforcement and general infrastructure. All of these can be secured and made possible only in the proper collection of taxes. The study concludes that tax policy plays a very important role in the collection of taxes and duties as well as in the fair distribution of the budget.

Keywords: *Budget, economic development, fiscal policy, Kosovo*

JEL Classification: E60, E62

INTRODUCTION

The negative implications of the economic crisis should be strongly emphasised at the beginning of the new millennium that developing countries had, which in particular made some difficult challenges for these countries. Building objectives and instruments to achieve the desired macroeconomic goals within its macroeconomic policy, the Republic of Kosovo faces limiting factors inevitably imposed by a degree of uncertainty.

The main goal of the macroeconomic policy of the Republic of Kosovo is to increase economic growth. In terms of competitive and integrated economy, it creates equal opportunities for maintaining macroeconomic stability and a gradual increase of economic growth, while the government aims at implementing capital investments in industry and construction, as well as developing projects of road and railway infrastructure, which is connecting Kosovo with its largest trading partners.

In terms of macroeconomic stability, fiscal policy is implemented by automatic stabilizers but also through discretionary measures, where automatic stabilizers are public revenues and public expenditures. The main points of automatic stabilizers, which have the largest space, are as follows: profit taxation and various forms of compensation (compensation in case of unemployment, welfare, etc.).

On the other hand, we have discretionary fiscal policy which is the right of government modern economies to implement programs and policy changes depending on the stage of the economic cycle, which arises as a result of insufficiency of automatic stabilizers in achieving macroeconomic goals.

There are two types of fiscal policy. The first and most widely used one is expansionist policy. It stimulates economic growth. It is important in the economic downturn phase of the business cycle. This happens when the country is at the recession phase. The second is restrictive policy, which is not commonly used. It takes place in developed countries when the state decides to spend less and at the same time increases taxes. In contrast to expansionary policies, it does not stimulate economic growth.

The tax administration is responsible for collecting the following taxes (TAK, 2015):

- Personal income tax;
- Corporate income tax;
- Value added tax.

A successful state is based on the developments it has, especially in the field of economics, and the latest developments of the economy during a certain period of time. Retrospectively, Kosovo has been much less economically developed for various reasons and is now more developed than it was in the early 2000s (TAK, 2015).

Economic development, especially in Kosovo, is something that goes through different stages and develops step by step.

When we talk about the factors of economic development, the key factor includes the young, educated, aware and qualified population. The method of tax collection has been applied since ancient times, initially with a much simpler structure, while over the years tax collection has been created in a much more complex structure that is of great importance in terms of economic development (TAK, 2015).

Observance of tax laws is an essential civic responsibility (Crespy & Szabo, 2018). In a modern country, which Kosovo aims to be, citizens are required to pay taxes and other obligations which finance government programs, the provision of public services and high standards of education, welfare, health, social support, protection, law enforcement and general infrastructure. All of these can be secured and made possible only in the proper collection of taxes.

The research can contribute to the design of macroeconomic policies because it addresses issues that have not been covered in previous studies, and the research findings will contribute to the existing literature.

1. LITERATURE REVIEW

Economic activity in the modern world is a very complex issue as it consists of several subsystems where each subsystem is a system. However, there are a number of different combinations between these complex changes that make the clear picture of the domestic economy rather complicated.

Due to the circular circulation of goods and money, disturbances that may occur in each of these areas will quickly reflect on another area and thus destabilize the area where they originate, so that for each of these areas there is an appropriate economic policy. Under their leadership, the government undertakes a series of measures to create and maintain macroeconomic balance, where economic policy has its field of activity, its measures and the problems it must solve and for which it is responsible (Darvas & Leandro, 2015).

High and stable economic growth and positive external balance have always been a policy priority of any country, regardless of whether we are talking about developed or developing ones by giving sensitivity to fluctuations in macroeconomic variables in the economy. Achieving these goals is certainly not automatic, but requires political leadership, which de facto represents the objective of economic policy.

Monetary and fiscal policy instruments are the main instruments for achieving objectives such as macroeconomic ones, as well as monetary and fiscal policies, which are intended to play tricks on the prospects of economic development. Economic and political science represents fiscal policy as the use of government spending and taxation on economic impact (Sullivan $ Sheffrin, 2003).

The importance of the right economic tools and the existence of a consensus in the economic literature as "an appropriate and macro effective policy is essential for any successful development process aimed at achieving high employment, sustainable economic growth, price stability, realization of the balance of payments and external equilibrium" (Fatás & Mihov, 2004) It therefore suggests that the importance of stabilization policy (fiscal and monetary policy) cannot be emphasised in any growth-oriented economy. In addition, with the use of the endogenous model, government spending has a positive impact on economic growth in the long run, while a negative effect in the short term. On the other hand, agricultural spending has no effect on economic growth (Gregorous & Ghosh, 2007).

In the economic literature, there are three basic objectives of fiscal policy, where the first and most important objective is the provision of public goods and services. The second fundamental objective concerns the redistribution of public revenues and the reduction and mitigation of inequality, which can be generated by the "invisible hand of Smith" or market mechanisms that can lead to inefficiencies (Bexheti, 2007). The third objective is to use the budget to neutralize the temporary fluctuations of the economics cycles of the economy.

Today economists think that government intervention through fiscal policy is essential in overcoming the recession or inflation and promoting and accelerating economic growth, as monetary policy cannot sustain this. There is no doubt that government fiscal and budgetary policy needs to be sounded, keeping in mind the needs and requirements of a developing economy. In short, we can say that this is part of government policy, which is about increasing revenues through taxes and other means and setting the level and model of spending.

One of the most serious challenges to the legitimacy of state and public policies of our time is the continued reduction of corporate taxation resulting from high international mobility and competition for capital. Reduced capital tax has the potential to greatly increase inequality and damage the social contract on which our societies are based. According to Stiglitz (2014), like any other system, the tax system has its own characteristics. The characteristics of the tax system according to the author in question are: economic effectiveness, administrative simplicity, flexibility, political accountability and tax justice.

Historically, the importance of fiscal policy as a policy tool has grown and waned. Prior to 1930, a limited government approach, or laissez-faire, prevailed. With the stock market falling and the Great Depression, policymakers encouraged governments to play a more proactive role in the economy (Laffan & Schlosser, 2016). Recently, countries had reduced the size and function of government – with markets taking on an increasing role in the delivery of goods and services – but as the global financial crisis threatened the global recession, many countries turned to more active fiscal policy (Albo et al., 2010).

The desired tax mix will vary from one state to another, both due to changes in policy preferences and due to changes in states in the characteristics of individual taxes and the way they interact with the state economy (Gentry & Ladd, 1994).

Public finances are essential for the development of a state as they deal with the taxation and expenditures of various civil society organisations. Public finances play a vital role in obtaining the financial resources needed for an economy to achieve its social well-being. There are many ways in which public finances are capable of influencing a nation's economy. Some of them are revenues, expenditures, public sector deficit, etc. Moreover, contributing to the sustainability of a country, public finances help determine factors such as inflation rate, current account deficit, national debt growth, etc. (Peacook, 1979).

Public revenue is generated to fund public spending. There are two main sources of public revenue: taxation and fees. However, these standard sources of revenue may be insufficient to generate the revenue needed to match the large investments in infrastructure development (Akerlof, 1970).

Many regions of the world face the problem of aging infrastructure and declining revenues to maintain and repair infrastructure. Financing urban public infrastructure is becoming increasingly problematic in a world with high real interest rates and strict fiscal constraints (Frideman & Frideman, 1980).

Kosovo's tax system is developed based on the best experiences and policies of the EU. This development of this system is valid for customs policies and taxes that include direct and indirect taxes (Excise, Customs, Corporate Income Tax, Personal Income Tax, Value Added Tax, etc. (Tax Administration of Kosovo, 2000).

The tax system in Kosovo consists of a package of tax laws and administrative instructions. This paper contains information about:

- Legislation on Tax Administration and Procedures;
- Value Added Tax (VAT);
- Personal Income Tax (PIT);
- Corporate Income Tax (CIT);
- Pension contributions (KP);
- Gambling legislation.

2. RESEARCH METHODOLOGY AND DATA

The research methodology used in the paper begins with a review of the literature on the recognition of concepts and then continues with the bibliographic research of various authors about taxes and their importance in the state budget in general and the role of the Tax Administration of Kosovo in state budget in particular. The research is of descriptive and comparative nature where the quantitative method is followed by the presentation of tabular and graphic data using secondary data. Secondary data are second-hand data collected by various institutions and statistical agencies.

The data used in this study are exactly secondary data collected by the Tax Administration of Kosovo, the Ministry of Finance, specifically the draft budget laws, the Kosovo Agency of Statistics, etc.

3. FINDINGS AND DISCUSSION

The section discusses the research results.

Table 2. Tax Rates by Public Revenue

Monthly income	Yearly income	Tax rate
0–80	0–960	0 %
80–250	960–3000	4 %
250–450	3000–5400	8 %
Over 450	Over 5400	10 %

Source: Tax Administration of Kosovo (2020)

Taxpayers with a gross annual income of € 50 000 or less are taxed at 3 % (for activities such as trade, transport, agriculture and similar commercial activities) or 9 % (for service, professional, craft, entertainment and similar) (TAK, 2015). Taxpayers with gross annual income over € 50 000 and those who have voluntarily selected to be taxed on real income, are taxed according to the following rates: – For taxable income nine hundred and sixty euros (€ 960) or less, zero percent (0 %); – For taxable income over nine hundred and sixty euros (€ 960) up to three thousand euros (€ 3000), including the amount of three thousand euros (€ 3000), four percent (4 %) of the amount over nine hundred and sixty euros (€ 960); – For taxable income over three thousand euros (€ 3000), up to five thousand four hundred (€ 5400), including the amount of five thousand four hundred (€ 5400), eighty-one point six euros (€ 81.6) plus eight percent (8 %) of the amount over three thousand euros (€ 3000); – For taxable income over five thousand four hundred (€ 5400), two hundred and seventy three point six euros (€ 273.6) plus ten percent (10 %) of the amount over five thousand four hundred (€ 5400) (ATK, 2015).

Revenue performance was up until 2012; however, overall revenue growth started to stagnate in the country in 2013, with border revenue declining by 10 %, but in 2015 revenue started to rise again. Total revenue increased by 48 % between 2006 and 2012, with an increase in tax revenue to 27 %, where two-thirds of revenue came from indirect taxes, which are: internal VAT, border VAT, customs duties, excises and other indirect taxes. In 2016, indirect taxes were about 70 % of Kosovo’s tax revenue. Due to the continuous economic growth, the income performance in Kosovo was good even during the crises and marked a record growth of 18 % in 2011.

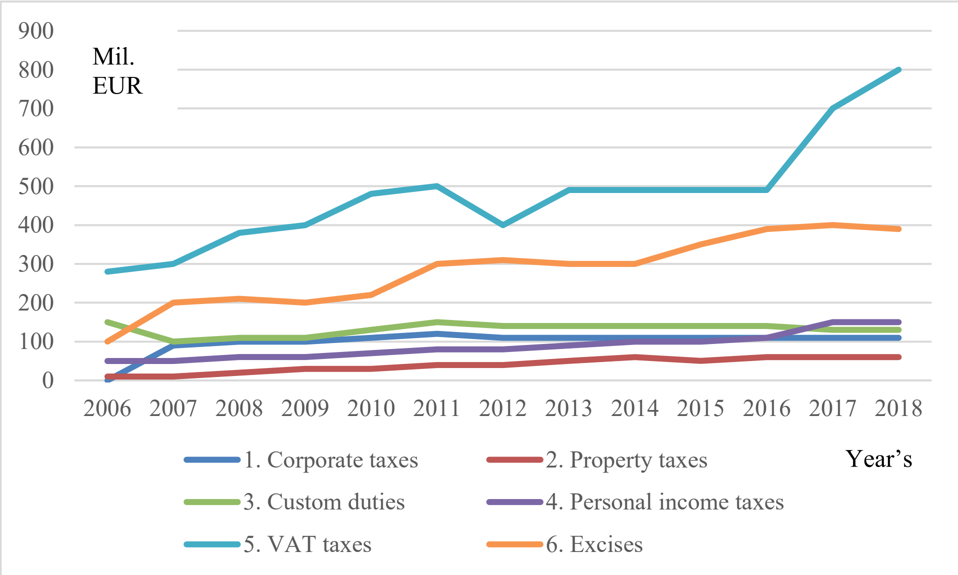

Fig. 1. Categories of public revenues in the Republic of Kosovo in 2006–2018, million euros (Budget of the Republic of Kosovo, Ministry of Finance (MoF), Annual Financial Report of 2006–2018).

Receipts during 2015, not including the designated donor grants, were 1 456 819 522 euros and represented about 89.3 % of total planned annual revenue. We had an annual revenue increase of 8.5 % compared to the previous year.

Revenue from direct taxes include revenue collected from personal income taxes, which are the main contributors to the group of direct taxes, respectively, revenue from corporate tax, withholding tax and property tax.

The highest contribution to the increase of direct income in recent years has been given by the revenue collected from personal income tax around 2.5 % of GDP, partly due to the larger base as a result of the increase in wages by 25 % that has happened in recent years. The system suffers from a large tax gap, which is defined as the difference between the revenue that TAK would have to collect and the actual revenue.

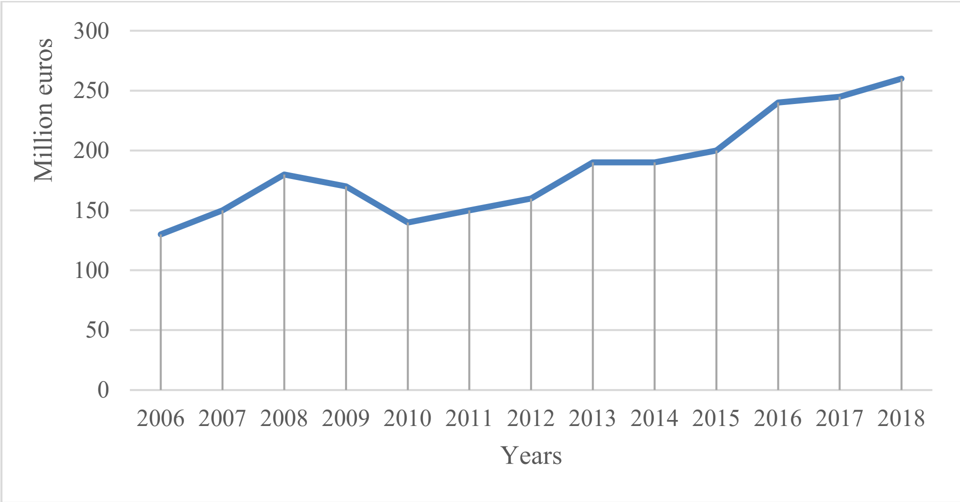

Fig. 2. Direct taxes (Budget of the Republic of Kosovo, Ministry of Finance in million euros (MoF). Annual Financial Report of 2006–2018).

Based on the World Bank report, the informal sector or informal economy is estimated to be between 26.7–34.4 % of GDP that has contributed to the low values of direct taxes that Kosovo has (National Strategy of the Republic of Kosovo for Preventing and Combating the Informal Economy, Money Laundering, Financing of Terrorism and Financial Crimes 2014–2018). The Government of Kosovo is committed to increase economic activities in the country and measures aimed at narrowing the tax gap for the types of taxes that belong to this category.

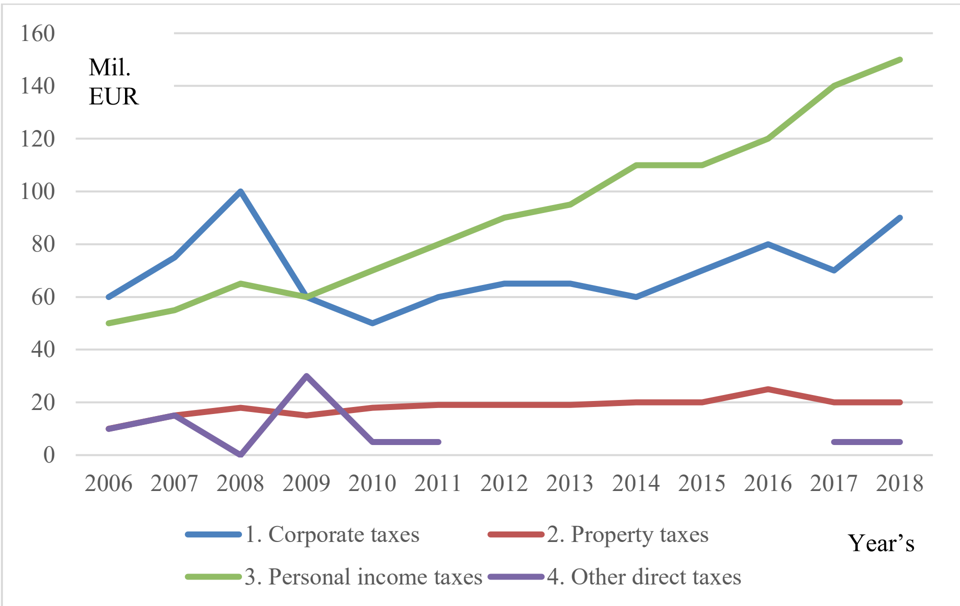

Fig. 3. Structure of direct taxes in the Republic of Kosovo in 2006–2018, million euros (Budget of the Republic of Kosovo, Ministry of Finance (MoF). Annual Financial Report of 2006–2018).

The current situation of direct taxes proves the low economic growth in Kosovo; the countries that have lower internal tax revenue than the border ones are countries that have high unemployment rates and have a low level of domestic production and are influenced by imported products.

Indirect revenue significantly follows the import trend. Indirect taxes consist of customs taxes, VAT and excises, are among the main indicators of movements of economic activities of the country and give the main contribution to tax revenues, reaching about 70 % of the total level in 2016. Indirect taxes encountered VAT and VAT at the border and excise were the biggest contributors. Indirect taxes contribute to about 19 % of GDP.

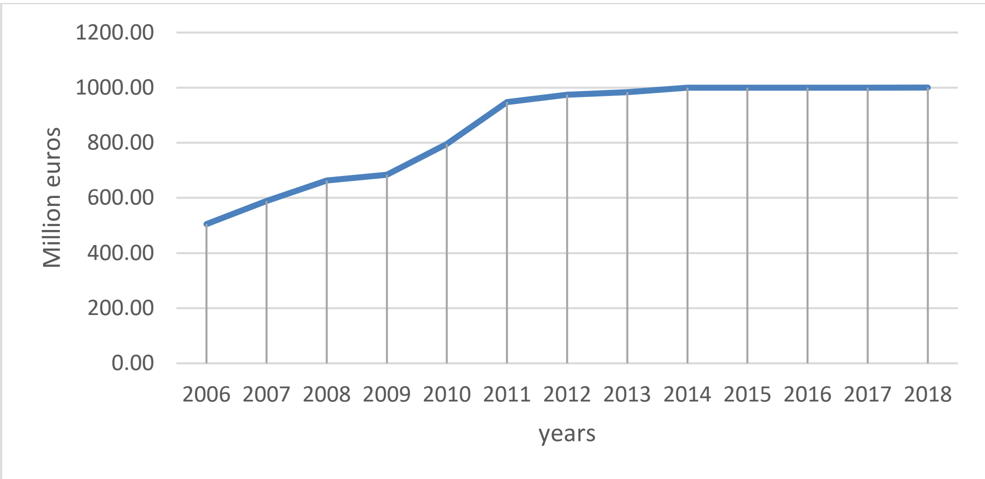

Fig. 4. Performance of indirect taxes in the Republic of Kosovo in 2006–2018 (Budget of the Republic of Kosovo, Ministry of Finance (MoF). Annual Financial Report of 2006–2018).

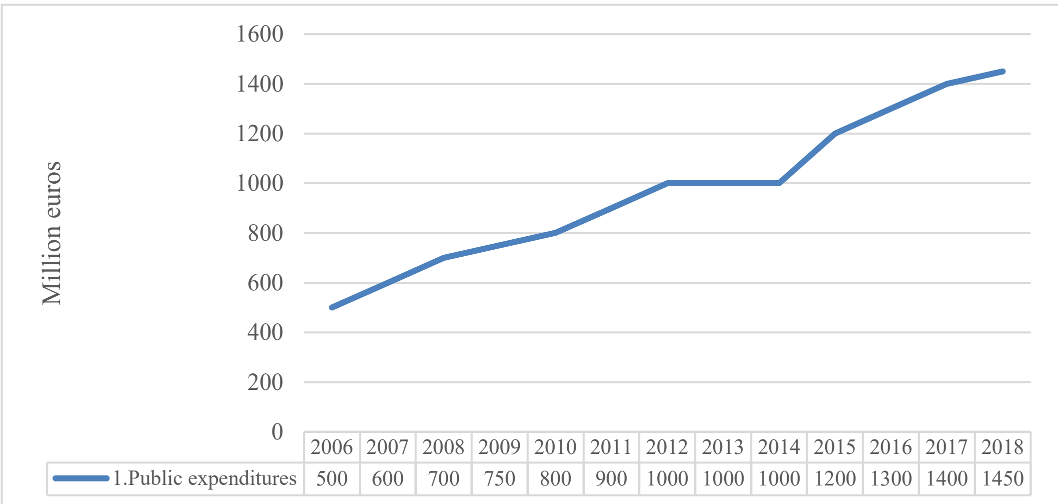

Fig. 5. Performance of public expenditures in the Republic of Kosovo in 2006–2018, million euros (Budget of the Republic of Kosovo, Ministry of Finance (MoF). Annual Financial Report of 2006–2018).

*Current expenses***.** As a result, the ratio of total public expenditure to GDP has again shown a slight increase, from 27 % in 2015 to about 27.7 % in 2016. The ratio of current expenditure to GDP increased, reaching 18.9 % in 2014, 20.0 % in 2015 and 20.1 % in 2016, *accounting for more than 75 % of total expenditures*. During this period, expenditures on wages and salaries amounted to about 9.6 %, subsidies and transfers to about 7.5 % and goods and services to 3.8 %; this type of expenditures represented the largest percentage of total current expenditures. Although fiscal policies in recent years have focused on reducing unproductive spending, deciding that wage increases are in direct proportion to economic growth, yet the increase in the number of public servants and the increase in salaries, as a result of the change of government, have been affected by the increase in unproductive public spending.

Capital expenditures remained at an average of 7.9 % of GDP in the period of 2008–2016, although they were subject to continuous fluctuations due to the advantages in infrastructure investments. In general, the distribution of capital expenditures has been oriented to maintain a relatively high level of expenditures in areas such as infrastructure and most recently planned in railway infrastructure, electricity, but not as in the countries of the region where they are invested and in the fields of health and education. These expenditures are mainly financed through external and internal borrowing.

Subsidies and transfers. As the second highest participant in the category of current expenditures, expenditures for subsidies and transfers are planned to have a moderate increase during the reporting period, as a result of accommodating new spending initiatives in this category. This category of expenditures reflects the implementation of the Law on War Veterans as well as the natural increase of beneficiaries in other schemes. Furthermore, this category of expenditures also includes subsidies for the agricultural sector and reflects the cost of the change in the pension law. It is worth mentioning that capital expenditures were the highest in 2008–2013 as a result of investments that occurred in the field of infrastructure, while in 2014 and 2015 capital investments followed decrease. The expenditures on wages and salaries were the highest.

The total government expenditures budgeted for 2018 in Kosovo are based on the existing fiscal space, making available revenue planning and limited to the required level of budget deficit, according to the fiscal rule and obligations arising from the Stand-By Agreement agreed with the IMF in 2018.

The Government of Kosovo, as a result of its increasingly good performance in revenue collection, as well as improvements in the management of public finances, has made possible the implementation of a number of additional measures to improve social welfare, such as: increase by 25 % of social assistance for families in need, implementation of the law on state-funded pension schemes, implementation of compensation for work experience of public servants, maintaining the level of subsidies for the agricultural sector, providing pensions for veterans and other categories of war, accommodation of expenditures deriving from Kosovo's integration agenda, increase of financial support for the prosecution and judiciary.

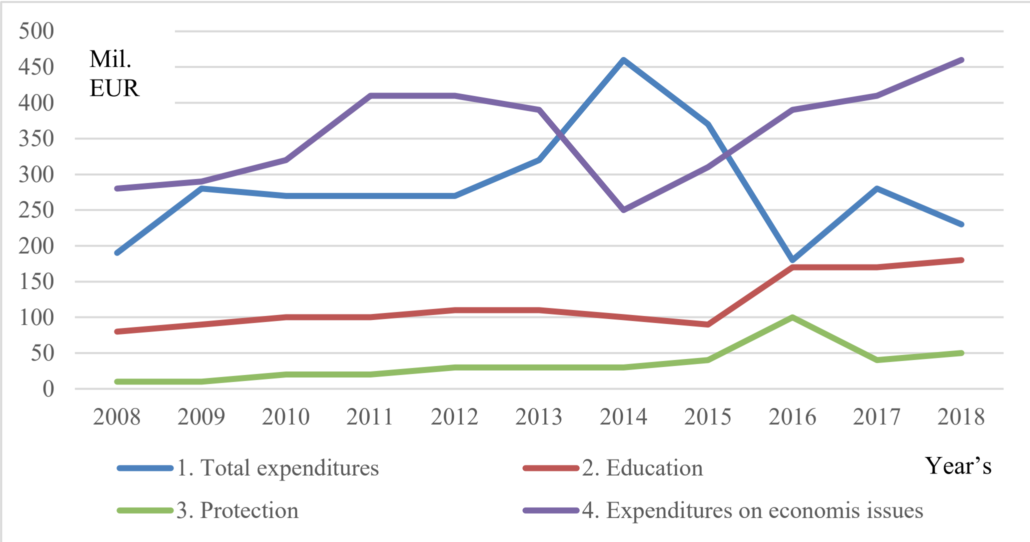

Fig. 6. Sectorial public expenditures in the Republic of Kosovo in 2008–2018 (Statistical Agency of Kosovo).

Based on Fig. 6, low economic growth in Kosovo is also evidenced by the direction of expenditures. We notice that Kosovo has an inappropriate direction of distribution of government expenditures, where expenditures on wages and salaries are still the highest expenditures in the country and the region. Capital expenditures and expenditures on education and health are still low, which proves an unstable or unstable economy.

CONCLUSION

An efficient budget is built, if fiscal policy functions to the benefit of businesses, not to their detriment, because from the revenue of the private sector the budget base is built. Secondly, the budget must balance the expenditures uncontrolled, and in sectoral policies, which in fact suffocate the budget, expenditures must be directed to projects and concrete economic investments. This paper clearly shows why tax information and facilities need to be made in order to increase civic responsibility to meet tax obligations and increase the state budget, as public benefits will always go towards the most perfect investments to improve as much as possible the lives of the citizens of the country.

The tax system should not distort the principle of efficiency which is seen as the basic principle of a tax system. A proper tax system should be transparent, simple, consistent and minimise distortions of taxpayer behaviour. The tax system should be fair, comprehensive and contribute to the distribution objectives, together with the system of social benefits.

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