Fiscal Policy of Kosovo, Taxation and Reforms

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Abstract: In Kosovo and in the new consolidating countries the fiscal policy plays the primary role in the functioning of the state, its institutions and economic growth in general. In the lack of monetary policy instruments, fiscal policy remains the only means available to the Kosovo Government for promoting investments in the private sector. Therefore, sound and prudent fiscal policies is key to maintaining macroeconomic stability, particularly when considering that fiscal policy is the main instrument of economic policy in Kosovo. Special emphases is given fiscal policies applied in Kosovo, its reforms, actions to be taken on the occasion of the policy-making reforms and finally are given appropriate recommendations.

Keywords: fiscal policy; economic policy; welfare and economic stability.

1. INTRODUCTION

The state and its institutions will not be able to exist and function without payment of tax obligations by citizens as well as enterprises, so the tax is part and parcel of the existence of the state and the payment of taxes is mandatory (M. Dubrowski & T. Magdalena, 2001, 6). Fiscal policy is the use of government expenditures and taxation which affect economic activity (M. Dubrowski & T. Magdalena, 2001). Fiscal policy can be expansive or restrictive (P. Jurkovic, 1991, 32-40)[12]. An expansionary fiscal policy means reduction of direct and indirect taxes and increase of government expenditures. These policies will reduce the level of aggregate demand and help reduce inflation. Choosing between the two types of fiscal policy is not an easy decision, as with regard to the current state of the economy, as well as political decisions. Choosing a given fiscal policy is one of the oldest issues concerning the government in the social and economic life of a country, not only by economists, but from a wider range of people (OECD, 2013)[11]. Republic of Kosovo has built and continues to build a simple, tax system the application of low tax rates and with a free mode of trade (barriers and customs restrictions), is among the liberal countries in the region, which enables connection to the fast integrations. This policy would need to impose more rapid preparation of businesses to access free competition with other economies be more competitive and also to increase the productivity of labor. To be an effective fiscal policy it must have adequate fiscal system. The fiscal system to us is relatively new, a system that is based on direct and indirect taxes. The capacity building has started since 1999 with the Regulation on customs, then in 2001 begin to apply and other taxes as tax untried (May 2000), VAT (May 2001), income tax (1 April 2002), property tax (June 2003), corporation tax (December 2004) on the road tax (March 2005) in royalties taxes and steadily and the application of other non-tax revenues. Since January 2005, tax policies begun with the initial tax amendments and with the application of new taxes such as Corporate Income Tax (CIT) as well as Personal Income Tax (PIT) and this continued until end of 2008 or beginning of 2009 (Ministry of Finance of Kosovo, the annual reports 2002 - 2010). In January 2009 a new law started to apply, with deduction in tax rates in Kosovo, also the tax rates on dividends, interest, rent, gambling, capital gains, sale of intangible property, etc., were reduced from 20% to 10%. However, the VAT went through a slight increase from 15% to 16%, which in reality caused a small increase of prices in the country. By mid-2012 there has been an increase rate of 5% to 9% of each quarter, but not less than 37.5 euros for three months and this was made possible for businesses that do not pay tax on real basis, those that deal with service activities, such as services, professional activities, vocational, entertainment and similar, while trading activities remain the same 3% rate. Reforming the tax system is one of the most important segments of the countries in a socio-economic transition, led by the aspiration to join the European Union. In the recent years, there has been a continuous reform in the tax policy in Kosovo, after equipping taxpayers with fiscal numbers, coming into effect of the legislative package, equipping businesses with fiscal cash registers and projects which are showing very good results, such as E-statement, One Stop Shop, call center and service center for Taxpayers, etc. Currently, the tax system in Kosovo is considered to be quite simple and harmonized. However, much remains to be done regarding the treatment of some issues of strategic importance, such as further development of its IT system, the harmonization of
payment procedures for the revenues used by banks and tax authorities, and the development and utilization of efficient taxpayer registration system and a risk management system.

2. FISCAL POLICY-OBJECTIVES, INSTRUMENTS AND EFFECTS

The objective of the fiscal policy is to provide needed revenues by application of the fiscal instruments which can be covered public expenditures (P. Jurkovic, 1991, 32-40)[12]. Fiscal policy is related to actions undertaken by the government in changing the composition of revenue and public expenditure, aggregate demand management to maintain sustainable economic growth with relatively high employment without generating inflation and without increasing public debt and satisfactory balance of payments. The basic goal of fiscal policy is related to its economic goals of the state. They are: high employment rate, stable and low inflation, consistent position of the balance of payments and high growth and stable economy. Fiscal policy can have other goals as well: such as reducing economic inequality, reducing regional disparities, environmental progress and so on. These goals are realized through adequate instruments which are implemented and reflected in public revenues, public expenditure, fiscal deficit and public debt. Economic policy measures and fiscal policy aims to achieve the optimal rate of economic growth measured which will make use of production factors and other factors affecting the general social interests. To achieve this optimal rate of growth should have adequate fiscal policy and to exist an optimal taxation, which must adapt to economic trends. In the process of fiscal policy making, policy-makers set objectives which they aim to achieve as well as the instruments with which these become feasible objectives, while necessarily adhering to the principles of fiscal management such as: transparency regarding the objectives, implementation of fiscal policy and publication of public accounts: a). stability of fiscal policy making process; b). efficiency of the impact of fiscal policy on the economy; c). responsibility in the management of public finances; d). efficiency in modeling and implementation of fiscal policy; e). justice (fairness) including between generations. The objectives of a fiscal policy are related with the increase of an overall social welfare as a primary aim of a modern society. This welfare is provided only in an environment where economic, political and social stability prevail. Therefore, when we discuss the fiscal policy objectives, we bear in mind: a) realization of full employment; b) increasing the added economic rate; c) preserving price stability; d) the stability of the balance of payments; e) improvement of working conditions including improvement of qualification structure of the workforce and technological progress; f) savings incentives; g) investment incentives; h) enhancing the competitiveness of local products and services; i) enhancing the quality of education and health services. The realization of these objectives depends on: the ability of government to coordinate their fiscal instruments to influence the composition and level of aggregate demand; the accuracy of the analysis associated with the main trends of economic and financial indicators; regulation and institutional arrangements for coordination of macroeconomic policies.

2.1 Instruments and effects of fiscal policy

Through fiscal policy, the state can directly affect the economy. When a state decides about tax collection, transfers, goods and services it buys, deficit financing, in fact it engages in fiscal policy (Bronchi, C. and A. Burns, 2000)[3]. Any change in the level of these instruments has a direct effect on the general economic course. Through instruments of fiscal policy many things can be affected, such as employment and price level, a better redistribution of income and wealth, economic growth, savings increase, level of investments, issues of education, culture and health.

2.2 Fiscal policy acting on the economic increase

Fiscal policy measures could face and try to improve the short-term difficulties driven by the damaging trends in economy. They could eliminate the causes of those trends and establish stability with measures of stabilization policy. In addition to short-term flows, fiscal policy can be oriented in the long-term growth of GDP, respectively per capita income. In this case we are talking about the rate of economic growth (M. Gallagher & A. Babič, 2004, 20-24). Economic growth is measured primarily by the growth in GDP within a specified period. This growth also means increased public expenditures and revenues, improved living conditions and raising living standards. Measures of economic and fiscal policy aim to achieve an optimal, not a maximal rate of economic growth (Public Expenditure and Financial Accountability (PEFA), 2008). The maximal rate can be achieved with a full employment of all factors of production. But in practice, that would be impossible. When drafting a fiscal policy, other factors should be taken into consideration, such as environmental protection. Therefore, there can be no discussion of full employment of all factors of production under ideal conditions. Optimal rate of growth means the use of factors of production while taking into account other factors affecting the general interests of society.

2.3 Some international experience in tax reforms, global trends

Tax reforms are constant processes, taking place from state to state and all over the world. In general, governments undertake tax reform for two reasons: a) to improve the revenues and b) to improve and to promote the most sustainable economic environment. Tax reforms in general includes: replacement of functional tax policy, modernization of tax administration and increase tax
audits and the recognition of new taxes, especially the VAT. Also, they are oriented at improving economic environment and usually include steps that simplify the tax system, at the same time eliminating the numerous taxes of which give low performance and in the elimination of unproductive taxes (M. Gallagher & A. Babić, 2004, 20-24). In the world tax reforms are to focus on: a) to increase the confidence in VAT as a tax on consumption; b) by increasing foreign investments through tax 'support'; c) reduction of tax rates in the personal income tax; d) reducing tax rates for tax on profit on corporate. From the lessons learned from successful reforms in tax systems and operating practices taken around the world, it can be concluded that: a) the tax base should be much more extensive that it is possible; b) tax rates should be lower as much as possible; c) in the most of the cases tax stimulations do not provide their efficacy, and when they function normally do not provide the expected results; d) tax appeals should be as simple and mostly free; and f) the administration of taxes and strengthening the administration usually require modernization.

3. FISCAL POLICY CHANGES AND REFORMS

It is necessary for the fiscal policies in Kosovo to go through changes and reforms, but care should be taken that any change should be done professionally and in accordance with the living standards and the economic development of the country, because otherwise it will reflect negatively on lives of citizens. Based on the definition of fiscal policy, they imply the use of revenues and expenses in accordance with the purposes and objectives of economic policy. By this we understand that proper fiscal policies are a priority for the government in order to carefully plan every tax and fee foreseen by the government’s economic politics. All this so there are sufficient revenues to cover public spending or public expenditures. We believe that Kosovo is faced with three major challenges in terms of fiscal policy making as one of the most important subsystems of state economic policy. These changes are necessary for business representatives, but according to them, every fiscal change will not improve the situation in the economy of Kosovo, without tackling corruption and organised crime. These changes are expected to take place at a time when Kosovo is facing difficulties in economic development. Kosovo authorities claim that with these changes, they aim to relieve from some taxes the domestic producers, who according to them are a source of new jobs. For business representatives such warnings are necessary because, according to them, the economic state of the country is worrying as a result of accumulated problems. As a result of these fiscal policies, Kosovo has lagged behind in the fiscal reforms, and those are quite necessary. The government aims fiscal changes through stimulation of new investments, employment and attracting foreign capital. The government during the first half of the term, foresees VAT escalation. Such action means reducing the VAT rate for basic products such as bread, milk, oil, drinking water. The government foresees reduction of VAT threshold for small and medium enterprises from 50 000 to 20 000 euro, which will enable many businesses to operate and grow easier. Under this program, it would increase the tax base for about 1,500 businesses and create additional revenues. Within the reforms plan, it is expected the Tax Administration and Customs to join in the next three years, while VAT collection to be done inside the country, after the sale of goods. Through customs exemption, the Government intends to exempt from custom duty the import of Information Technology equipment. Abolition of customs charge for these devices will provide a 30% increase in this sector. National institutions’ policies, especially fiscal ones should be at the service of strengthening the private sector, given the importance of the latter for economic development and creation of new jobs. Discussions on lowering the threshold of VAT, increased effort to fight informal economy, further analyzing of the proposal for tax exemptions, other fiscal incentives which will enable equal competitive position among producers of certain industries and imported products. The government should consider expanding the list of products exempt from customs duties, namely raw materials that are not produced in Kosovo.

3.1 Changes in the fiscal system in Kosovo

At the 20th meeting of the Government of Kosovo, dated 24 March 2015, the Government made a number of decisions for fiscal adjustment. Among other things, these decisions are related to the approval of new drafts: a. Value Added Tax (VAT); b. Corporate Income Tax; c. Personal Income Tax.

The biggest changes regarding these draft laws are expected to occur in the draft for VAT. First of all, under Article 6 of the Draft Law on VAT, the threshold of VAT is reduced of 50 000 € as current law is 30 000 €. So any business that performs turnover over 30 000 € per year, will be obliged to register for VAT and pay the portion that exceeds this amount. Budget would benefit from this reduction in the VAT threshold because a greater number of businesses will be obliged to pay VAT. On the other hand, this fiscal policy will burden the new businesses and small businesses, especially those services that have lesser levels of supplies. It is exactly the new businesses that need fiscal incentives and which potentially create new jobs. Set by law no. 05 / L-037 on Value Added Tax-VAT. The rate of reduction from 16% to 8%, and that of the standard from 16% to 18%. h) Persons liable to registration for VAT
A person is obliged to register for VAT when a person independently carries out economic activity in Kosovo, in accordance with Article 4 of the Law and whose turnover (including turnover of supplies exempt of VAT) in its entirety, within the calendar year exceeds 30,000 €. Before this, the turnover was 50,000 €.

b) Changing the rate of VAT
1. VAT is charged with the standard rate of eighteen percent (18%).
2. notwithstanding paragraph 1 of this Article, the reduced VAT rate is calculated and paid eight at percent (8%) for the supply of goods and services, as well as their import.

4. QUESTIONS TO BE ANSWERED BEFORE UNDERTAKING OF FISCAL REFORMS

As we mentioned earlier the fiscal reform are ongoing processes, there is no perfect tax system, always are created the conditions and rise new demands linked to the economic policies within the state, region beyond which the system of taxation and fiscal policy should be complemented with these (G. Asllani, 2014, 14-16)[5]. During the change of fiscal policy it is important to be answered in several important questions which are related to each other and complementing each other: a) Is it fiscal policy that prevents economic development, b) If so what to change and in what proportions, c) Which will be the goal that must be achieved, d) What would be the time frame of their realization, e) How much is willing the institutional capacity for such changes, f) what results would be expected in the future in the economy of the country and the region, g) who will be the implementation and control mechanism? Also should be taken into consideration the negative aspects which may have changes in fiscal policy, some of the most important are: a) Frequent changes may cause difficulties in securing budget revenues; b) Such changes could create problems in the functioning of the tax system and its deregulation; c) Frequent changes may affect the loss of importance of the tax system. These mentioned issues or of great importance for decision makers and in any case they should be taken into consideration when they make reforms either full or partial reforms in the tax system. During the drafting of the tax system reform, the fundamental issue is analyze of the economic and financial implications that may have such changes, then analyses of the current situation, it should be seen of trends of the fiscal changes in the neighboring countries and at the end the proposal of adequate measures.

5. FUTURE ORIENTATIONS OF FISCAL POLICY IN KOSOVO

Fiscal policy in our country must be continued in its orientation to the creation of such policies which are in line with EU standards limits and also to take into account the specificity of the economy in which we are. From the analyses of the trend in collection of tax and non-tax incomes we can notice that we have a poor collection of the incomes (Ministry of Finance of Kosovo, the annual reports 2002 - 2014). Mostly dominate border taxes (excise, customs fees, VAT) with tendency to fall down slowly and beside this a symbolic increase of internal taxes. The intention of government policy should be oriented in the collection of the taxes inside the country not to be collected at the border. Certainly to achieve the objective in collection of the incomes within the economy the country, needs time and to build institutional and economic capacities. Also, at the local level should be done more not only in the most incredibly completion in the field of harmonization of legislation but should increase the efficiency even in cases of collection of funds and also should be done the fiscal decentralization. Another important component is the issue of government spending, as those costs burden the budget and where they are oriented (Public Expenditure and Financial Accountability (PEFA), 2008). Another important issue is creation a good climate for new businesses and sustainable economic development. The experience of other developed countries show that countries with open and competitive economy without different restrictions have moved forward in economic development than the countries which have restrictions. This liberalization of the market will obligate Kosovo businesses to be oriented in those activities where we have a comparative advantage and increase the productivity of labor. It is extremely great importance involvement of Kosovo in the EU and in the benefits of its structural funds.

6. CONCLUSION AND RECOMMENDATIONS

Fiscal policy and construction of the tax system in our country has found and continues to find support in scientific approaches and meet modern requirements submitted now-days before the taxation as an application of the low tax rates and broaden the tax base, orientation in those taxes bringing high performance in consumption tax, low cost of administration and simplification of the tax system. Of course there is still need for improvement and advancement both in terms of management and the simplification of legal procedures, in order to reach the optimal tax system. We have entered the phase of fiscal policy reforms and these reforms should be continued with great carefulness. This liberalization of the market will obligate Kosovo businesses to be oriented in those activities where we have a comparative advantage and increase the productivity of labor. It is extremely great importance involvement of Kosovo in the EU and in the benefits of its structural funds. State intervention in economic flow through fiscal policy is justified by the adjustments made towards eliminating the phenomena that become an obstacle to preserving the general welfare of the society. These phenomena are associated with imperfect market action in protecting the poor strata of
society, creating jobs, elimination of monopolies and enhancing fair competition, more equitable redistribution of wealth, and others.

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