
The Impact of Fiscal Policy on the Economy and the Financial Effect on Budget Revenues on the Example of Kosovo

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Abstract:

Purpose: *The paper deals with issues related to the fiscal policy and the impact on the Kosovo economy. The main purpose of the paper is to analyze the impact of the fiscal policy on the economy and the financial effect on the budget in Kosovo.*

Design/methodology/approach: *This article provides a theoretical overview of fiscal policy and its impact on the economy. To finalize the work, the material used includes scientific literature, as well as reports and publications from the Ministry of Finance, the Statistics Agency of Kosovo. To achieve the main objective of the article are different sources of data such as analysis method, comparative method, econometric analysis which has been analyzed and analyzed correlatively.*

Findings: *In the framework of the work we have done regarding the analysis of fiscal policy and the impact on the economy in Kosovo, the results showed that: Fiscal policy affects economic processes and economic activities as well as effects on the budget in Kosovo.*

Practical implications: *Through the study, we consider the results and recommendations to be taken into account by the interested parties and certain sectors in Kosovo.*

Keywords: *Fiscal policy, tax system, tax reform, Value Added Tax, budget revenues.*

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1. Introduction

After the war, Kosovo began to build public institutions with the support of international institutions and at the same time the fiscal system for financing public needs. The creation and construction of the fiscal policy in Kosovo was done under very specific conditions. The economy of Kosovo continues to face many problems after the war, such as: high unemployment, low rate of economic growth, negative trade balance.

Undoubtedly, fiscal policy is considered an important instrument of economic policy, through which economic performance can be influenced. Despite the highlighted economic problems, the fiscal policy in Kosovo has been characterized by a one-dimensional feature with a main focus on the collection of budget revenues, leaving aside the creation of favorable operating conditions for the private sector.

The paper deals with the fiscal reform and the impact on the economy, including the tourism sector, and on the budget with a focus on the Republic of Kosovo. The purpose of the study is fiscal reform and the impact on economic activity and the tourism sector as well as budget revenues. Within the study, the main objective is to analyze the fiscal reforms, including the impact on the economy and the budget.

Research questions of the paper:

- The impact of fiscal reforms on economic activity?
- The financial effect of fiscal reforms on budget revenues?

The study is structured as follows. Section 1 presents the introduction, including the main purpose of the paper and the research questions. In section 2, the literature review is presented. Section 3 demonstrates the methodology and methods. Section 4 of the paper gives the result and discussion. Section 5 includes the conclusion of the study.

2. Literature Review

The basic instrument of public expenditure financing in almost all the contemporary states is the budget. All revenues collected through various financial instruments (taxes, duties, customs, public loans, etc.) are used to finance public expenditures. The budget is very important for both the individual and the government, because it is a general indicator of how much revenue the government has collected and, more importantly, how it has spent this revenue.

The legal and accounting document that contains the sums of state revenues and expenditures, as a rule, for an annual period is called the state budget (Hilmia, Sabah, Angjeli, Anastas, "Public Finances", 1994). The government budget is an annual statement of projected expenditures and revenues during the coming year

along with the laws and regulations that will support the expenditures and revenues (Parkin, Powell, Matthews, "Economics", 2009). Government budgets vary in size and detail, but all have the same components. The three main budget components are (Berisha, "Public Finance", 2022).

- 1) Income;
- 2) Expenses;
- 3) Budget balance.

In modern countries, the main part of public revenues consists of taxes. Taxation is the basic financial instrument for securing the income of the state budget (Bundo, Sherif, Cane, Gentiana, "Finance", 2003). The state provides the necessary financial means to cover public expenses through the collection of public revenues, where in this context, in contemporary states, taxes are considered the main source of budget revenues.

Kosovo has managed to create a budget stability and taxes are considered the main source of budget revenues, especially since the post-war period, it is characterized by the dependence of budget revenues on border revenues in relation to internal revenues. Government budgeting has three main purposes (Parkin, Powell, Matthews, "Economics", 2009).

- 1) To declare the rate and allocation of government expenditures and plans to finance its activities;
- 2) To stabilize the economy;
- 3) To encourage long-term economic growth and balanced regional development.

In this context, it is worth mentioning that Kosovo has managed to create a budgetary sustainability, but it is more oriented towards the first goal, and much less about the other two goals.

From 1999 until the declaration of Kosovo's independence on February 17, 2008, UNMIK was the bearer of the tax system and policy. Tax reforms are aimed at improving the economic environment and usually include steps to build a simple tax system favoring the private sector, at the same time as eliminating numerous taxes that give low yields as well as eliminating the unproductive complexity of various remaining taxes. Fiscal policy is government policy regarding spending and taxation (William Boyes, Michael Melvin, "Macroeconomics", 2011).

Fiscal policy represents the totality of methods and actions used by the government and its bodies, to find, collect and efficiently use the resources needed to complete its programs during a certain period of time. Fiscal policy is about the use of government spending and tax policy to achieve certain economic and social goals (Mançellari, Ahmet, Haderi, Sulo, Kule, Dhori, Qiriçi, Stefan, 2007).

Fiscal policy consists of changes in government spending and/or taxes to achieve specific economic goals, such as low unemployment, price stability, and economic growth (Roger A. Arnold, "Macroeconomics", 2008).

Kosovo has laid solid foundations and continues to build a simple tax system with the application of low tax rates. In other words, the fiscal policy applied so far in our country has given effects of a one-dimensional character, mainly fiscal as progressive results have been achieved over the years in terms of budget revenues, while on the other hand, the results and orientation towards the promotion of economic activity and the economic development of the country have been insufficient.

The fiscal system and policy can be viewed in two periods:

- 1) Fiscal system and policy based on UNMIK regulations, from 1999 to 2007, and
- 2) Fiscal system and policy after the declaration of Kosovo's Independence, based on the tax legislation approved by the Assembly of the Republic of Kosovo.

Undoubtedly, the construction of new institutions with adequate legislation took time, especially the construction of the fiscal system and policy, which includes two aspects:

- 1) Creation of budget revenues and
- 2) Promotion of economic development.

Kosovo, with a low level of development, initially and continuously oriented the fiscal policy instruments to fill the state budget for financing public needs, thus preserving the fiscal character of the fiscal policy. From the economic point of view, the tax system has been mainly characterized by the fiscal character on the one hand, while on the other hand, the unfavorable structure of tax collection continues to remain.

In Kosovo, since the post-war period, budget revenues have been dominated by revenues collected from indirect (border) taxes, such as revenues from VAT, excise duties, customs taxes versus revenues collected within the country by the Tax Administration of Kosovo-ATK from personal income tax, corporate income tax and VAT. Politicians and the Government of Kosovo should pay attention by focusing on the transfer of taxes and the filling of budget revenues in the country and the removal of independence in the collection of funds at the border.

Undoubtedly, in order to achieve these goals, for taxes to be collected within the economy, in addition to taking time, it is required to raise institutional and economic capacities.

3. Research Methodology

In this work, to achieve the purpose of the study, study methods were used, mainly through the analysis method, the issues related to the fiscal reform and the impact on the economy as well as the financial effect on the budget revenues in the Republic of Kosovo were examined. Until the finalization of the paper, the presented material has the following support:

- a) Studies and literature by local and foreign authors, as well as reports and publications from the Ministry of Finance, where the issues of fiscal reform and the financial effect on budget revenues in the Republic of Kosovo are addressed.
- b) The local statistical source, analysis and synthesis method, tabular, graphic and comparative method were used.

4. Results of the Study

The fiscal reforms applied initially consisted in the movement of tax rates which in essence were not oriented towards the creation of a facilitating space for business operations. In other words, the fiscal reform has been accompanied by the reduction of fiscal rates, not including fiscal stimulus measures (facilities and exemptions from taxes) towards businesses. The tax reform of 2009 consists of changing the tax rates as follows (Berisha, Morina, Burim, "The fiscal system and the state budget", Pristina, 2018):

- Tax rates in Personal Income Tax were reduced from 0% - 20% as it was before to 0% - 10%;
- The Corporate Income Tax rate was reduced from 20% to 10%;
- The VAT rate has been raised from 15% to 16%.

While from 01. September. 2015, the tax changes separately in VAT, in addition to the standard VAT rate, the reduced VAT rate is also applied. The tax changes in VAT that began to be applied in Kosovo since September 2015, include the change in VAT rates as follows (Law, No. 05/L-037, on Value Added Tax, Pristina, 2015):

- VAT is charged at the standard rate of eighteen percent (18%).
- The reduced VAT rate is calculated and paid at eight percent (8%) for the supply of goods and services, as well as their import.

In this context, the tax changes related to VAT include the reduction of the VAT rate on basic products and services from 16% to 8%, the increase of the VAT rate on other products and services from 16% to 18%, as well as the reduction of the VAT threshold for businesses from 50,000 euros to 30,000 euros.

Immediately after the war and continuing until 2009, the fiscal policy implemented in Kosovo can be said to have produced one-sided results, mainly of a fiscal nature.

The fiscal instruments applied in the first years of the construction of the fiscal system in Kosovo have been of a one-dimensional character, continuously maintaining the orientation in the provision of budget revenues, while partially in function of stimulating economic activity. The fiscal reform of 2009 represents the institutional initiative to create a favorable environment for businesses and investments.

However, in the name of the fiscal reform of 2009 and 2015, changes are made in the level of tax rates and other fiscal facilities, which do not show any significant improvements in business activity and investments.

Even in spite of the results achieved in the sphere of fiscal policy, there is still room for action in the framework of fiscal measures which should be in function of creating a favorable environment for business.

In the framework of our study, we surveyed 50 businesses with the prepared questionnaire regarding the fiscal policy and taxes applied in Kosovo. Through the fiscal policy, Kosovo has undertaken fiscal reforms oriented to the economy, including the sectors of the economy and businesses that deal with accommodation.

Table 1. *Willingness to pay taxes and customs*

No.	Title	%
1.	High readiness	22.0
2.	Medium readiness	42.0
3.	Low readiness	22.0
4.	No answer	14.0
5.	Total	100.0

Source: Author calculation.

The willingness to pay the tax is considered at an undesirable level, as 22.0% of the respondents have a high willingness, 22.0% a low willingness, 42.0% an average willingness. Let it be understood that the willingness to pay taxes remains unsatisfactory and clearly indicates the presence of the informal economy and fiscal evasion.

Table 2. *Where are the main obstacles to tax payment.*

No.	Title	%
1.	High taxes	12.0 %
2.	Lack of payment habits	28.0 %
3.	Lack of proper control	22.0 %
4.	Because others don't pay	24.0 %
5.	No answer	14.0 %
6.	Total	100 %

Source: Author calculation.

Among the main obstacles in the payment of taxes are considered, the lack of payment habits, because others do not pay, the lack of proper control, while the tax burden is considered a small obstacle.

Table 3. Taxes and customs in Kosovo

No	Title	Acceptable	High	Unacceptable	P.p	%
1.	Customs tax	29.2	62.5	8.3	---	100 %
2.	Excise duty	---	61.9	35.7	2.4	100 %
3.	VAT	40.4	53.2	6.4	---	100 %
4.	Personal income tax	86.4	11.4	2.3	---	100 %
5.	Corporate income tax	71.4	23.8	4.8	---	100 %
6.	Property tax	71.1	26.7	2.2	---	100 %
7.	Other taxes	58.3	14.6	---	27.1	100 %

Source: Author calculation.

Perceptions of businesses regarding taxes and customs in Kosovo. How much are acceptable, high, unacceptable, it turns out that indirect taxes are considered high and unfavorable for economic activity, especially the productive one, while personal income taxes, corporate income tax and property tax are considered acceptable.

Table 4. Should fiscal incentives apply

No	Answer	%
1.	Yes	98.00 %
2.	No	0.00 %
3.	No answer	2.00 %
4.	Total	100 %

Source: Author calculation.

Fiscal policy is considered an important instrument of economic policy that affects economic processes. From the statistical analysis derived from the business survey, it results that 98% of the respondents state that fiscal facilities should be applied in certain activities.

Table 5. Should fiscal facilities be applied in certain activities

No.	Title	%
1.	No specification	34.00 %
2.	Export	2.00 %
3.	Construction	2.00 %
4.	Manufacture	30.00 %
5.	Wine and spirits	6.00 %
6.	Services	16.00 %
7.	Commerce	6.00 %
8.	Small activities	2.00 %
9.	No answer	2.00 %

10.	Total	100.0 %
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Source: Author calculation.

The application of fiscal facilities, specified according to the activity, results that fiscal facilities should be applied mainly in the manufacturing sector 30% and services 16% (including the accommodation sector and related services) compared to other sectors.

Table 6. Which fiscal facilities should be applied.

No.	Title	%
1.	Tax exemption of new investments	16.00 %
2.	Exemption from corporate income tax for new businesses for the first years and generating employment	32.00 %
3.	Exemption from customs duty for raw materials	30.00 %
4.	Exemption from VAT for equipment	20.00 %
5.	No specification	2.00 %
6.	Total	100 %

Source: Author calculation.

The application of the fiscal package (fiscal exemptions and facilities) by the respondents mainly results in: exemption from corporate profit tax for new businesses for the first years and that generate employment, exemption from customs tax for raw materials, exemption from VAT for equipment and exemption from taxes on new investments.

From the economic point of view, this line of orientation of the fiscal policy so far by the decision makers in Kosovo, represents the finding of "safe haven of the collection of budget revenues at the border" that included two inverse dimensions among themselves (Berisha, "Public Finance", 2022).

- First, it is easier to collect budget revenues;
- Second, it hinders the growth of economic activity, in the absence of alleviating fiscal measures.

5. Financial Effect on Budget Revenues

In modern countries, the main part of public revenues consists of taxes. Taxation is the basic financial instrument for ensuring the income of the state budget (Bundo and Gentiana, "Finance", 2003). The state provides the necessary financial means to cover public expenses through the collection of public revenues, where in this context, in contemporary states, taxes are considered the main source of budget revenues.

Kosovo has managed to build a budget stability and taxes are considered the main source of budget revenues, especially since the post-war period, it is characterized

by the dependence of budget revenues on border revenues in relation to internal revenues. Taxes, even indirect taxes, have a central place in the system of state revenues in developing countries (Bozhidar, "Science on finance and financial law", 1985). One of the reasons that indirect taxes in developing countries are the main form of budget revenue remains that the procedure for determining, paying and controlling the payment of these taxes is simpler.

Transitional countries with a low level of development in the structure of budget revenues mainly depend on border revenues. Such a situation has followed Kosovo since the post-war period, where the largest participation of border revenues in filling the state budget, compared to internal revenues, can be observed (Berisha, "Public Finance", 2022).

Taxes remain the main source of budget revenues of contemporary states. In each country, the tax authority operates and applies all taxes within the framework of the relevant legislation. Taxes, even indirect taxes, have a central place in the state revenue system in developing countries. One of the reasons that indirect taxes in developing countries are the main form of budget revenue remains that the procedure for determining, paying and controlling the payment of these taxes is simpler.

Countries with a low level of development in the structure of budget revenues mainly depend on border revenues. Such a situation has followed Kosovo since the post-war period, where the largest participation of border revenues in filling the state budget, compared to internal revenues, can be observed. The progress of border revenues in the budget is reflected below.

Table 7. Progress of revenues from taxes and VAT in budget revenues 2020-2022
- in thousands of euros

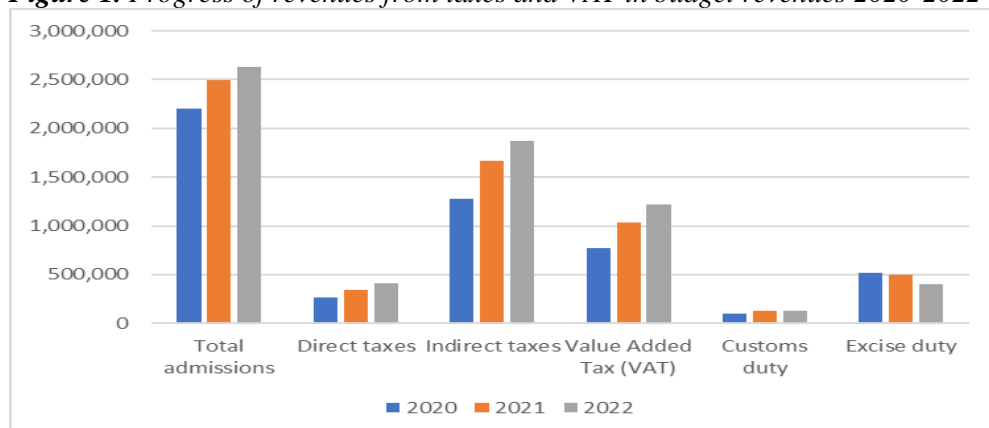
Description	2020	2021	2022
Total admissions	2,206,647	2,490,973	2,628,552
Direct taxes	267,247	342,165	413,829
Indirect taxes	1,272,735	1,664,685	1,870,248
Value Added Tax (VAT)	770,145	1,038,218	1,220,007
Customs duty	101,618	124,606	132,663
Excise duty	517,264	501,295	398,072
Other indirect taxes	313	565	2,900

Source: Ministry of Finance and Transfers, Annual Financial Report 2022, Prishtina, 2023, pg. 6.

From Table 7 and Figure 1, it can be seen that tax revenues have had an upward trend during the period 2020-2022. Direct taxes increased from 267 million euros in 2020, reaching 413 million euros in 2022. Indirect taxes increased from 1.2 billion

euros in 2020 to 1.8 billion euros in 2022. In this context, VAT remains the main contributor to budget revenues and having growth in the respective years 2020-2022, increasing VAT revenues from 770 million euros in 2020, reaching 1.2 billion euros in 2022.

Figure 1. Progress of revenues from taxes and VAT in budget revenues 2020-2022



Source: Author calculation.

6. Discussion

We can say that the application of VAT in Kosovo since 2001 has had effects on the budget, on the activity of businesses and on the price level. VAT is considered the largest contributor of revenues to the budget. In addition to the positive effects on the increase of revenues in the budget, through the fiscal reforms applied within the fiscal system and in particular the VAT, it can be said that the VAT in Kosovo already has effects on the stimulation of businesses.

Value added tax with a rate of 0% in exports has positive effects on the stimulation of local producers. Likewise, the escalation of VAT, the exemption from VAT of raw materials, machinery, information technology, etc., is a positive step towards stimulating businesses and encouraging economic development.

7. Conclusions

- 1) The fiscal reforms applied so far have proven to be relatively efficient. This is due to the fact that they did not have as a priority the support of the business sector in Kosovo, but only their fiscal aspect. The fiscal reforms undertaken since the post-war period, only in the movement of tax rates, have mainly preserved the fiscal character and budgetary sustainability, but in essence, the lack of application of full fiscal measures (tax exemptions and facilities) in the creation of a facilitating space for business action is observed.

- 2) Dependence of budget revenues on revenues collected at the border in relation to internal revenues. The low level of development in the country has oriented the Kosovar economy in the post-war period to dependence on imports, which is also reflected in budget revenues, namely in the dominant level of border revenues in relation to internal revenues.

8. Recommendations

- 1) The necessity of applying full fiscal reforms, among others, including fiscal measures - fiscal facilities for new businesses for a certain period of time and those that generate employment to alleviate some of the difficulties and economic problems in the country.
- 2) The structure of the collection of budget funds, being unfavorable, makes it necessary to improve it. The dependence of budget revenues on the funds collected at the border is the result of dependence on imports and the low level of development in the country. It is necessary to move on to the collection of revenues within the economy.

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