
Fiscal Policy and Foreign Trade in Kosovo: Drivers of Economic Development

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Abstract:

Purpose: *The paper addresses issues related to Kosovo's foreign trade, including the analysis of the effect of fiscal policy on economic development in Kosovo. The main purpose of this paper is to analyze Kosovo's foreign trade, including the analysis of the effect of fiscal policy on economic processes in the Republic of Kosovo.*

Design/methodology/approach: *This article provides a theoretical overview of foreign trade and the impact of fiscal policy on the economy. To finalize the work, the material used includes scientific literature, as well as reports and publications from the Kosovo Agency of Statistics, the Central Bank of Kosovo, etc. In order to achieve the main objective of the article, various data sources were used such as analysis methods, comparative methods, etc.*

Findings: *Within the framework of the work we have done regarding the analysis of foreign trade and the effect of fiscal policy on the economy, the results have shown that, fiscal policy has an impact on economic processes and economic activities.*

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

Originality/value: *To the best of our knowledge this is a unique study regarding Kosovo's economic development through fiscal policy and foreign trade.*

Keywords: *Foreign trade, fiscal policy, export, import.*

JEL codes: *E62, F13, F43, H20, O52.*

Paper type: *Research article.*

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1. Introduction

Since the post conflict period, Kosovo is very public spirited for trade liberalization. Institutions of Kosovo were part of the processes and initiatives for liberalization of trade in the region.

Kosovo at the beginning signed the free trade agreement with Albania and then with North Macedonia, Bosnia and Herzegovina and Croatia. The whole process of negotiations was completed by extension of the CEFTA Agreement with South East Europe countries in 2006, in this way changing the bilateral agreements in one single free trade agreement (FTA). In international trade exchange a crucial role plays taxation. Therefore the taxation is considered one of the instruments of the fiscal policy of great importance which affects the process of international exchange.

The research questions are:

- Does fiscal policy have an impact on foreign trade and on exports and imports?
- Do the countries of the region have trade exchanges with each other?

For the finalization of this paper, the submitted material has the following support:

- Local and foreign literature, as well as reports and publications from the Ministry of Finance and the Kosovo Agency of Statistics, related to fiscal policy and foreign trade in the Republic of Kosovo.
- The local statistical source was used, the method of analysis and synthesis, tabular and graphic separately, comparative method, etc.

2. Theoretical Background

The negative trade balance is just one of the economic problems that Kosovo is facing. Kosovo institutions are aware that changing this reality requires a comprehensive economic and political approach and reforms in order to change the operating environment in Kosovo, with the aim of improving Kosovo's competitive position in the global market.

Kosovo with an open economy in international trade is dominated by import and low level of export, resulting in this way with high commercial deficit. Aside from other macro-economic indicators also the international exchange formulates the level of the economic development of respective country expressed through the structure and value of imported and exported goods.

International trade greatly enhances living standards for all parties involved because (Baumol and Blinde, 2010, p. 725):

- Every country lacks some vital resources that it can get only by trading with others.
- Each country's climate, labor force, and other endowments make it a relatively efficient Producer of some goods and a relatively inefficient producer of others.
- Specialization permits larger outputs via the advantages of large-scale production.

3. The impact of Fiscal Policy on Foreign Trade

In international trade exchange a crucial role plays taxation. Therefore the taxation is considered one of the instruments of the fiscal policy of great importance which affects the process of international exchange. The influence of the taxation in international exchange depends from the status and objective national economy.

Indirect taxes shall mean taxes which have effect in the price of goods and services and in this way they also have effect in international exchange of goods and services through export and import. In this course the taxation has an impact in export and import of the national economy.

Taxation impacts in export and import of goods and services stimulating or de-stimulating them through the measures of taxation policy.

Taxation calculated in the price of the goods and services impacts in their increase or decrease in the market. Taxation stimulates export through low taxation rates or realising the exporters from taxation.

By application of such measures of taxation policy the national export shall be stimulated. Application of measures of taxation policy as are low tax rate or clearing from taxes stimulates the national production, with a view to cut down prices of the goods and services and such prices be more competitive in the international markets.

The taxation has its effect in import of the goods and services having effect as well holding up or delaying the import of goods and services. The government to protect national producers or a certain branch of the economy from the competition undertakes strict measures of fiscal policy respectively increases customs taxes, VAT rate in imports with a view to increase the prices of imported products and services protecting in this way national producers.

Kosovo applies a favorable fiscal policy in the context of trade policy. Kosovo is applying a very competitive tax rate comparing to countries in the region. Besides this the taxation system is favorable for export activities.² In other words, through fiscal policy it is attempted to stimulate national production and exports.

²*Ministry of Trade and Industry, Kosovo's Trade Policy, Pristina 2009, page 19.*

While for the imports are applicable VAT, Customs tariffs and excise, excluding some of the categories of the goods which are free from the fiscal policy with the view to stimulate national production.

4. Characteristics of International Trade Kosovo's Trade Partners

The Kosovo's economy has had a relatively low development since 1999. Even that, during this period have been undertaken important macroeconomic steps for regeneration of Kosovo's economy, still there are many challenges. One of the indicators is a high negative and constant commercial balance since 1999.

Since the post conflict period the low level of economical development of Kosovo that in economical relations to dominate the import of goods and services which evidently is higher than export and impacts in a high deficit of payment balance. Kosovo in a post conflict period has commercial relations with different countries in a region and worldwide. Regarding to the commercial relations with other countries, Kosovo since the post conflict period is very devoted for trade liberalization.

However, economical exchange with other countries for Kosovo's economy since the post conflict period is reflected as unhandy. This is for the fact that the low level of Kosovo's economical development is reflected that in economical relations dominate import of goods and services which evidently is higher than export and in this way impacts in a higher deficit of commercial balance.

This can be concluded through the reflection of international exchange of Kosovo with other countries as it is shown in the table below. The table below represents Kosovo's economical relations with other countries in a period of time from: 2001–2024.

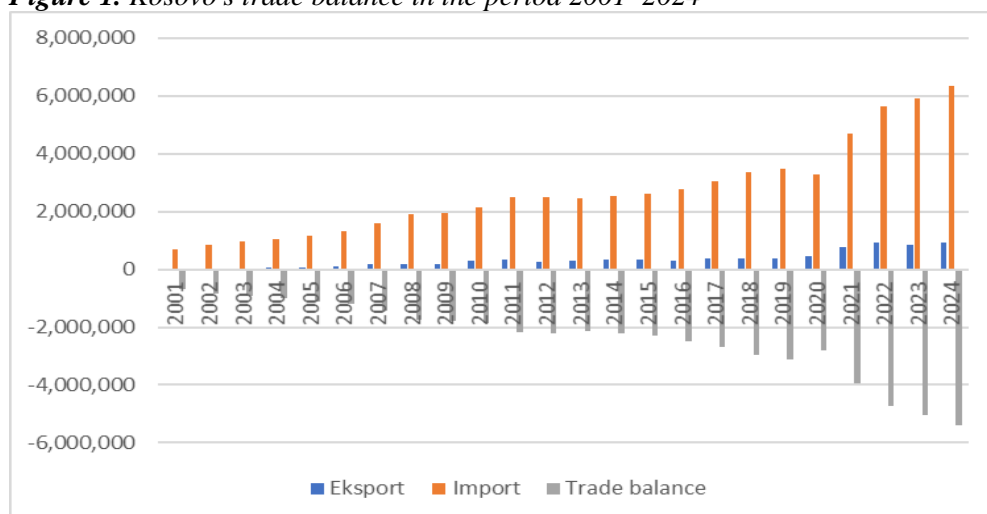
Table 1. Kosovo's trade balance in the period 2001–2024 - in 000 euros.

Years	Eksport	Import	Trade balance	Import and export coverage (%)
2001	10.559	684.500	-673.941	1.5
2002	27.599	854.758	-827.159	3.2
2003	35.621	973.265	-937.644	3.7
2004	56.567	1.063.347	-1.006.780	5.3
2005	56.283	1.157.492	-1.101.209	4.9
2006	110.774	1.305.879	-1.195.105	8.5
2007	165.112	1.576.186	-1.411.074	10.5
2008	198.463	1.928.236	-1.729.773	10.3
2009	165.328	1.935.541	-1.770.213	8.5
2010	295.957	2.157.725	-1.861.769	13.7
2011	319.165	2.492.348	-2.173.184	12.8

2012	276.100	2.505.609	-2.231.509	11.0
2013	293.842	2.449.064	-2.155.221	12.0
2014	324.543	2.538.337	-2.213.794	12.8
2015	325.294	2.634.693	-2.309.399	12.3
2016	309.627	2.789.491	-2.479.864	11.1
2017	378.010	3.047.207	-2.669.196	12.4
2018	367.500	3.347.007	-2.979.507	11.0
2019	383.504	3.497.131	-3.113.627	11.0
2020	474.960	3.296.918	-2.821.958	14.4
2021	755.726	4.684.198	-3.928.472	16.1
2022	920.405	5.639.393	-4.718.989	16.3
2023	863,141	5,917,027	-5,053,886	14.6
2024	941,250	6,332,896	-5,391,646	14.9

Source: Kosovo Agency of Statistics, *Kosovo International Trade Statistics*, Pristina, December 2022, p. 4. Kosovo Agency of Statistics, *Foreign Trade in Goods*, February 2025, p. 4.

Figure 1. Kosovo's trade balance in the period 2001–2024



Source: Own study.

Looking at foreign trade, the performance of exports and imports show that Kosovo has a low level of economic development. Imports make up the bulk of Kosovo's trade exchange. Foreign trade in Kosovo since the post-war period has had increasing trends in exports and imports. Despite the increase in exports, the low export base has a relatively low impact on reducing Kosovo's trade deficit.

From the table and graph, there is a trend over the years in the expansion of trade activity, but despite the increase in exports, the significant increase in the dominance of imports continues. The export performance from the period 2001-2024, increased

from 10.5 million euros as it was in 2001, to 941.2 million euros in 2024, while the import from the period 2001-2024, increased from 684.5 million euros as it was in 2001, in 6.3 billion euros in 2024.

The performance of exports and imports in post-war Kosovo is an indicator that reflects the level of development in the country, and the dominance of imports over exports results in a high trade deficit. The trade deficit in 2001 was -673.9 million euros, reaching -5.3 billion euros in 2024. Total exports in 2023 were 863.1 million euros, while imports 5.9 billion euros.

Table 2. *Export and import with the countries of the Western Balkans for the period December 2021-2023 - in 000 euros.*

Exports			
	2021	2022	2023
Albania	8,784	9,681	11,933
North Macedonia	8,650	11,984	8,178
Montenegro	1,283	3,354	3,205
Serbia	3,490	3,868	3,775
Bosnia and Herzegovina	644	782	830
Imports			
	2021	2022	2023
Albania	19,983	28,604	29,141
Northern Macedonia	23,869	25,695	24,075
Montenegro	1,910	3,241	2,221
Serbia	29,505	30,430	9,853
Bosnia and Herzegovina	4,138	4,704	3,501

Source: Kosovo Agency of Statistics, *Foreign Trade of Goods, Pristina, December, 2022*, pg. 7-8. Kosovo Agency of Statistics, *Foreign Trade of Goods, Pristina, December, 2023*, pg. 8-9.

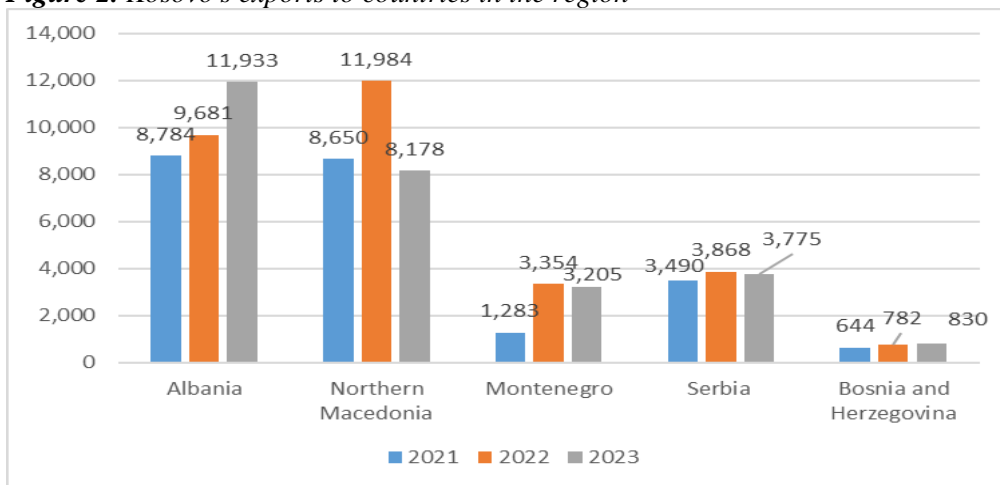
The year 2023 turned out to be with a degree of coverage of imports with exports of 14.6 percentage points, while in 2024, exports were 941.2 million euros, imports 6.3 billion euros.

The year 2024 turned out to have a degree of coverage of imports with exports of 14.9 percentage points. Such a relationship between imports and exports leads us to the conclusion that, in Kosovo, most of the material goods to meet the needs of the population, are imported from abroad from which we can draw two findings:³

- First, we are dealing with low level of economic development and
- Second, through imports, development policy makers have wanted to more easily fill Kosovo's budget coffers.

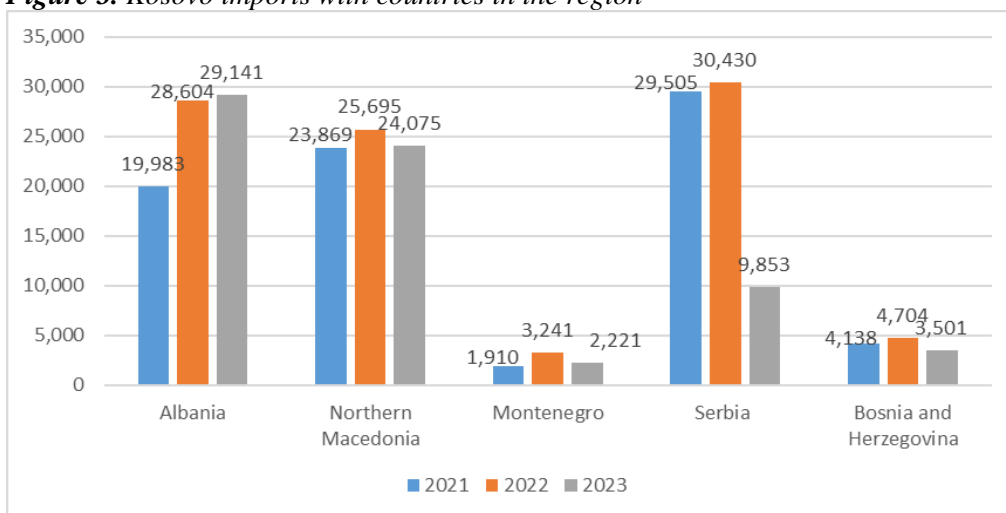
³Berisha. dr, Agim, *Public Finances, Pristina, 2022, page, 115.*

Figure 2. Kosovo's exports to countries in the region



Source: Own study.

Figure 3. Kosovo imports with countries in the region



Source: Own study.

Table 2 shows the performance of Kosovo's exports and imports with the countries of the region in the period 2021-2023 (period December). Kosovo in terms of countries in the region mainly exports more to Albania in the amount of 11.9 million euros in 2023 (period December) and Northern Macedonia in the amount of 8.1 million euros in 2023 (period December).

While in terms of imports mainly imports more from Albania in value of 29.1 million euros in 2023 (period December) and from Northern Macedonia in the amount of 24.0 million euros.

Table 3. Share of export and import in GDP in Western Balkan countries (%)

Exports				
	2020	2021	2022	2023
Albania	6.0	8.3	10.8	9.3
Bosnia and Herzegovina	27.1	32.5	35.4	36.9
Kosovo	7.0	9.5	10.4	8.8
Montenegro	9.8	10.6	12.9	12.0
North Macedonia	44.4	51.3	57.0	56.8
Serbia	34.3	39.4	44.6	43.1
Imports				
	2020	2021	2022	2023
Albania	28.4	33.6	34.6	31.1
Bosnia and Herzegovina	45.2	50.8	57.5	59.0
Kosovo	45.0	54.3	58.4	54.5
Montenegro	49.0	49.3	58.0	56.8
Northern Macedonia	61.0	71.6	83.7	82.3
Serbia	45.5	50.7	60.1	52.8

Source: World Bank Group, *Western Balkans, Regular Economic Report, No.24/Fall 2023*, pg. 65-98.

Table 3 reflects export and import in the countries of the Western Balkans, including the ratio of export and import in GDP.

5. Results - Relationship between Gross Domestic Product and Imports-Exports

Foreign trade is an important economic parameter. Foreign trade is a key issue in economic discussions and at the same time an extremely intensive area of research. Correlational analyzes are used in this article to measure the strength of the relationship between the independent variable export (X) and the dependent variable GDP (Y).

The result of the correlative study is obtained from the correlation coefficient. The values of the correlation coefficient are between - 1 and + 1. Its value + 1 indicates that the two variables are in a completely linear relationship and in the same direction, which means that all points lie on a straight line with the coefficient positive. While the -1 value of the correlation coefficient indicates that the variables are in a complete linear relationship and in the opposite direction.

For correlation analyses, it has been argued that the correlation coefficient is a summary measure that describes the degree of statistical relationship between two variables; dependent variables and independent variables. Export and GDP Correlation Analysis Indicators are represented by Correlation Coefficient (r), Determination Coefficient (r^2) and Alliance/Contingencies Coefficient (ka).

On the basis of correlational analysis, we analyze the impact of export on GDP. For export and GDP, the correlation analysis covers the period from 2021 to 2023.

Table 4. Data are expressed in EUR millions over the period 2021– 2023

Years	Export X1	GDP Y1	X1-X	(X1-X) ²	Y1- \bar{Y}	(Y- \bar{Y}) ²	(X1-X)*(Y1- \bar{Y})
2021	755.7	7,957.8	-90.7	8,226.49	-886.7	786,236.89	80,423.69
2022	920.4	8,895.7	74.0	5,476.00	51.2	2,621.44	3,788.8
2023	863.1	9,680.0	16.7	278.89	835.5	698,060.25	13,952.85
Total	846.4	8,844.5	0.00	13,981.38	0.00	1,486,918.58	98,165.34

Source: Own study.

$$r = \frac{\sum(X1 - X) * (y1 - \bar{Y})}{\sqrt{\sum(X1 - X)^2 * \sum(Y1 - \bar{Y})}}$$

$$r = \frac{98,165.34}{\sqrt{13,981.38 * 1,486,918.58}} = \frac{98,165.34}{2,078,921.0} = 0.047$$

Covariance: The covariance of choice is defined as follows:

$$S_{xy} = \frac{\sum(x1 - x) * (y1 - \bar{Y})}{n - 1}$$

$$S_{xy} = \frac{\sum(x1-x)*(y1-\bar{Y})}{n-1} = 98,165.34/3 = 32,721.78$$

Correlation coefficient:

The correlation coefficient is $r = 0.047$. From this we see that we have a positive average correlation, and that there is a positive average correlation between export and GDP.

Determination coefficient:

$r^2 = (0.047)^2 = 0.0022$ From here it results that **0.0022%** of the export variation is explained by the variation of GDP.

Alliance coefficient:

$Ka = 1 - r^2 = 1 - 0.0022 = 0.9978$ It results that **99.78%** are other unexplained factors affecting export.

6. Conclusions

Kosovo in the period after the conflict started to build an open market economy. Kosovo is devoted to liberalise the trade where the participation in regional mechanisms and worldwide shall facilitate trade was one of the main objectives of policies of the Kosovo's Institutions. In Kosovo's commercial exchange it is evident the negative commercial balance where the import is dominating comparing to export. Even that during this period have been taken important macro-economic steps for renewal of Kosovo's economy, still there are many challenges.

There are many reasons for such poor performance in the export sector in Kosovo, therefore one of the factors which should be specified and which has had impact in development of enterprises and in particular export sector are: Kosovo after the conflict has inherited companies and industries almost in total collapse as a result of abductions and destructions, delays in the process of privatisation, unsatisfactory level direct foreign investments as a very important factor in many countries in transition for renewal of economy and in particular export sector.

Then informal economy, non-systematic supply with energy and limited road infrastructure remains main factors having impact in economical development of the country. Disproportions in international trade generate macro-economic disproportions with long -term implications in a sustainability and economic growth of Kosovo.

Herewith the reduction of these disproportions should be a long –term priority. Economic policies and in particular fiscal policies must be in focus to exceed this situation and growth production and also to growth of competition capabilities and promotion of export through better and more favourable actions in the future.

Therefore, reform of fiscal policy should be oriented in stimulation of national production. In this way by encouraging of national production can be founded conditions to decrease the level of the dependence from the foreign market, a wide assortment of products be offered in the international market as the result of this there will an improved commercial balance.

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