

Fiscal Policy Reforms in Kosovo

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Abstract- *Fiscal policy represents one of the most important components of economic policy and as such it should be treated in its context. For this there are at least two reasons: First, economic policy defines the goals and criteria of fiscal policy in order to assess its contribution to the implementation of economic policies, and Second, defining the connection between the objectives and instruments, theory of economic policy explains the process of fulfilling the objectives of economic policy, part of which process is fiscal policy itself. Therefore, in the following, in a quite direct manner, we will address the interdependence between economic policy and fiscal policy. The word policy, in everyday life is used to clarify the principles on which various activities run, in order to realize the goals set by the designated authorities by determining the holders of those activities, their size as well as means by which those goals should be realized. In order to achieve prosperity and political stability, national governments aim at achieving economic equilibrium. Kosovo is one of the last countries in Europe to transition to a market economy. The transition process has begun from a very difficult starting point. During the years after the war, a symbolic economic growth occurred, which has been attributed mainly to remittances, investments in infrastructure and privatization. Investments, despite continuous growth, are considered insufficient to boost domestic production. This pattern of growth has not been able to meet the development needs of the state and failed to translate into a better standard of living for citizens, given that neither unemployment nor poverty are reduced. (The Progress Report on Kosovo, European Commission 2011).*

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

1. INTRODUCTION

In other words, economic policy defines the process by which social goals are established, the choice of instruments is done, the Government decisions are issued and necessary measures are taken to implement those goals. Fiscal policy is the use of government expenditures and taxation which affect economic activity.

Determination of a fiscal policy in a given year actually takes into account the past (the current socio-economic situation), as well as the implications for the future (fiscal stability).

Fiscal policy can be expansive or restrictive. 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. This article will discuss some of the issues upon which the debate over fiscal policy remains open.

The paper consists of four issues. The first part will deal with the role fiscal policy plays on economic growth.

Analysis will focus on the theoretical treatment as well as the role played by fiscal policy in our country, and even heading further by giving suggestions for the future. The second part will treat the fiscal policy in a long term, the fiscal sustainability.

Also, the status of the fiscal policy in Albania will be analysed, seen in the context of fiscal sustainability.

The third part will focus on the role fiscal policy has on the social aspect. In a country with a high poverty level and an economy which requires major investments, the choice of budgetary policies is a debatable issue. The role of politics in the choice of fiscal policy will be discussed in the last part. The focus will be on the political will for the development of the country. The paper ends with conclusions.

Kosovo Tax Administration was established on 17 January 2000 under the direction and administration of UNMIK, and since February 2003 the leading competencies were transferred to the Ministry of Economy and Finance, but even then it did not have the opportunity to make any reforms.

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. 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 centre and service centre for Taxpayers, etc.

A financial crisis which may appear in any given country, it is fair to say that it affects every segment of the economy, as well as the tax system of Kosovo. Other financial institutions could not avoid this neither. This was a signal that from January 2005 tax policy begins with the initial tax changes i.e. application of new taxes such as Corporate Income Tax (CIT) and Personal Income Tax (PIT) and this situation continued until the end of 2008 or early 2009.

The choice of subject was focused on the current issues as well as innovations offered by the developed countries in the field of tax system.

As arguments in making this choice, we took into consideration:

- Difficulties in locating sources of the tax system, because most businesses do not have adequate information about the tax system and legal regulations.
- The experiences of developed countries create the possibility to eliminate the causes which hinder the development since the establishment of the system of taxation, where Kosovo is aiming to have a harmonized system with the tax system and legal framework of the EU, and with European standards.
- The lack of reading material and textbooks by scholars and researchers regarding this subject in our country.

Among the reasons for choosing this topic we can mention that: 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

Costs and state taxes directly affect the overall economic performance since they constitute a large part of the activity in the national economy. Fiscal policy together with monetary policy are the two basic components of state economic policy which are used for macroeconomic purposes: Influencing general domestic product (GDP), the level of employment, income and price level.

Fiscal policy relates to the actions of the government in changing the composition of revenues and public expenditure in order to manage aggregate demand to maintain sustainable economic growth with employment relatively high, without generating inflation, without increasing public debt and with a satisfactory balance of payments.

Depending on the economic situation, fiscal policy can be expansionary and contractionary. A fiscal expansion means reduction of taxes or increase of public spending in order to stimulate consumption growth, ie growth of aggregate demand. This happens when the government notes stagnation or slow economic gain or when unemployment is high. While, contractionary fiscal policy means public spending cuts and increase of taxes. When the government is aiming to reduce aggregate demand in order to slow economic increase or to decrease inflation, then it opts for a contractionary fiscal policy. Through contractionary fiscal policy, money supply is reduced, which further reduces costs and aggregate demand. Similarly, the reduction of money supply also puts pressure on the overall increase of prices in the economy. When a government decides about a fiscal policy, beforehand it takes into account many different factors, including the performance of variables and main economic and financial indicators. All this because of the impact they have on the amount of revenue collected through tax which in return fulfil the need for financing the governments' programmes.

Another issue of importance for the government is the decision regarding the budgetary deficit. Whether the increased government expenses will be covered by loans or by cash issuing (monetary financing of deficit).

Fiscal policy decisions largely depend on political considerations, such as the credibility and the role that government plays in the economy but also from public feedback on the conduct and actions of government. Those decisions may also be influenced by external factors, which implies that the government has to take into consideration global economic trends and other countries' fiscal policies, which might have an effect on the relocation of domestic companies through fiscal benefits.

2.1 Objectives of fiscal policy

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 modelling 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:

Meeting public needs through a sound public finance system

- 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.

2.2 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. 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.

2.3 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.

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. 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.

2.4 Other effects of the application of fiscal policy instruments

Fiscal policy instruments can be applied for other purposes like in the field of education policy, schooling, demographic, cultural, constructional, health and commercial purposes. The state is presented as the employer in public enterprises, the public administration, organs of law enforcement and security. Through customs policy, the state increases export and reduces import, and by this it reduces the deficit in the payments balance and improves the value of the national currency. Fiscal policy can also impact on the regional development and the improvement of economic structure.

2.5 Fiscal policy changes and reform

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 warning 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 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 analysing 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.

2.6 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.

Law no. 05 / I -037 on value added tax

On 1 September 2015, entered into force, mf Administrative Instruction no. 03/2015 on the implementation of 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%.

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 €.

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.

3. CONCLUSIONS AND RECOMMENDATIONS

3.1 Conclusions

- 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.
- Fiscal policy constitutes a state economic policy components used for macroeconomic purposes to influence the level of product, employment and prices.
- Restrictive fiscal policy is applied to close the expansion gap in a way that it affects the reduction of aggregate demand through public spending cuts. While the recession gap closes through fiscal expansion by increasing public spending to influence the growth of aggregate demand.
- The issue of the budget deficit and its coverage represents a special problem, as it is directly linked to inflation as a phenomenon with negative effects on the

economy, and the level of savings of the population, which is necessary for future investments.

- Quite often it happens that the state proves unable when it comes to fiscal policy either due to incorrect information or erroneous forecasts regarding the effects resulting from measures and actions taken in order to achieve the objectives of fiscal policy. Another reason for failure is the failure to coordinate fiscal policy with monetary policy, thus suffocating each other's results.

3.2 Recommendations

- In this paper we have tried to recall the tax system in the past, transition, achievements and challenges of the tax system in general and personal income tax in particular.
- Kosovo as a new state has managed to create a stable tax system and highly competitive with other countries in the region, regarding the low tax rates. Still a lot of work remains to be done in Kosovo, to secure greater revenues from taxes, in order to ensure its budget, as a country that wants to join the EU.
- The biggest and most difficult issue for Kosovo is its extension to its northern part and the collection of taxes there.
- Tax Administration should increase the number of inspectors in the field so that the number of informal employees reduces to as little as possible.
- The existence of an effective tax administration is also essential, not only to facilitate trade and business development and create an environment that will attract and secure foreign investment, but also to provide a functional system of revenue at all levels government.
- Tax reforms in Kosovo are necessary both in terms of tax policy as well as the professional aspect of the tax authorities. As a conclusion, for a more effective implementation of tax reforms, more works should be done on the completion of certain preconditions: ensure institutional infrastructure; provide professional training for Tax Administration of Kosovo (TAK) staff through various trainings with international experts; exchange of experience with tax institutions in developed countries and developing countries that have passed the stage of transition; awareness of the taxpayers or the principle of self-declaration, etc.
- Establishment of the Kosovo tax system was intended to be in harmonisation with the system of taxation and legal framework of EU, as well as European standards.
- For this purpose, this system, since then, has underwent through a number of filters, changes and modifications. Also with donor support, especially in terms of drafting legislation, policies and capacity building, the aim was to develop an overall modern system of administration for the collection of revenue.
- 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 efficient use of a system for the registration of taxpayers and a risk management system.

- VAT threshold should be determined in accordance with the initiatives for the creation of new jobs and for this reason should be returned to the value of 50,000 euro;
- The Government of Kosovo alongside fiscal changes should take measures to improve the rule of law as a factor which influences the growth of domestic and foreign investment;
- Before and after the implementation of these fiscal policies, the Ministry of Finance should evaluate respectively continuously monitor the effects of these reforms to increase investment and employment.
- From the development of fiscal policy, there are part of the revenues that the budget loses. These effects with a deductive value, are calculate as income which the budget will not include in the future. But, on the other hand, when fiscal policies are approved with incentives for investments, the instruments for a good management should be taken into consideration (as part of a visionary strategy of economic development).
- This combination allows the budget to gain other parts of even greater income in the future and for longer periods of time, thus contributing towards fiscal strengthening and consolidation.
- What the government should achieve is the promoter strength of the effect of tax incentives for rapid recovery of value invested and compaction value-added by investors. These elements are observed with an insights into values of investments and their distribution in the economy.
- There are evident disproportions between revenues collected at the border and those within Kosovo.
- Tax collection within Kosovo is still small. Change of these reports is a prerequisite for ensuring a sustainable budget towards increasing public demands;
- The capacity of the tax administration in Kosovo is still in disharmony with the tasks put in front of it and with the need to increase efficiency in collecting taxes;
- The collection of property tax, profit tax and wage tax is still in its beginning and still much work needs to be done to increase the efficiency in their collection. Quite a lot of remarks are recorded regarding the amount of tax rates in relation to the solvency of the citizens and the amount of the tax base.
- There are still unsolved issues regarding tax relief on equipment and agriculture, problems that stem from a unified system of taxation fees that discourages investment.
- Among the key issues is tax evasion, which deserves more attention and concrete measures.

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