

## Collection of Value Added Tax in Kosovo and Its Effect on Economic Growth

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### Abstract

The revenue collected from the value added tax constitutes the main income of the Kosovo government. For this reason, this research has a great importance in the formulation of effective policies in Kosovo that will subsequently improve the efficiency of tax collection of Value Added and growing fiscal and budgetary stability. This research it will have a descriptive analysis of the trends of VAT collection in Kosovo from 2005- 2015 years using different analytical techniques to examine trends and data structure over the years. We have used two types of analysis; One is the descriptive analysis of trends and the other is the contrast of the descriptive analysis of trends that is the econometric technique used to analyze the VAT effect on economic growth in Kosovo. The source of data for this study is secondary through the Annual Financial Report of the Ministry of Finance of Kosovo and the IMF. In order to analyze the data generated for the study, the statistical tool utilized is OLS technique (multiple regression). One of the key findings in the collection of VAT has been its dependence on the border. Revenue collection is among the most pressing problems and such situation does not guarantee a country's budgetary stability. Also, based on the findings we noted that the VAT share of the gathering in gross domestic product of the Interior of the country has been low compared to other countries in Europe developing, reflecting a low level of economic development. Also from econometric analysis is confirmed that the regression coefficient shows that we have a VAT impact on GDP in Kosovo, because the level of significance is .000, or includes the rate of 1%. Also, the correlation between VAT and GDP shows a strong positive relationship, or statistically interpreted with the increase of VAT, will increase the GDP of Kosovo, these two elements conclude that VAT has a significant impact on economic growth in Kosovo. Furthermore, this research highlight some key issues that policy makers should consider dealing with the collection and effective use of revenue collected from VAT, to improve growth.

**Keywords:** Domestic Product, Tax, Economic Growth, Revenue, etc.

### Introduction

Kosovo in the 1990s experienced a total collapse of the economic and fiscal system. Immediately after the end of the armed conflict and after the declaration of independence from Serbia, it built a new economic system which enabled it to raise public revenues to cover public spending. At first it was a challenge for new institutions because the main purpose was to fill ark of the state and thus the low level of public revenue was a major obstacle to Kosovo's economic growth. Given this fact, the government undertook some concrete steps in reforming the fiscal system in order to maintain a positive growth trend (Shala, 2017). Based on fiscal policy instruments, Kosovo generates public revenues, namely budget resources from own sources. Based on economic development, budget funds have been increased for each budget year, which is expressed in the government's efficiency in performing general and shared obligations to citizens and advancement in capital investment (Badivuku-Pantina, 2008). Kosovo in the post-war period has built up a new fiscal system, oriented mainly towards harmonization with European standards. Taxes have played and remain of particular importance, both in terms of budget revenue collection and participation in Gross Domestic Product (GDP) (Berisha, 2015).

In Kosovo, Value Added Tax has started to be collected from July 1, 2001, through Regulation 2001/11 on Value Added Tax, and Amendments to Regulation No. 2002/17 of August 1, 2002. The revenues collected from the Value Added Tax constitute the main revenue of the Kosovo government. In 2014, the Government of Kosovo has taken some decisions that have had an impact on increasing budget expenditures, despite the fact that they were not planned in the Mid-Term Expenditure Framework (MF, 2013). Facing this, the International Monetary Fund has recommended to the Government of Kosovo to undertake some changes in the tax increase, and especially VAT, which will impact on the balancing of budget revenues and expenditures. Faced with this challenge, the Government of Kosovo in 2015 undertook a reform by changing the laws of the fiscal package, including the VAT law. By means of this law, the threshold of business registration is reduced

from EUR 50 thousand to the old law of EUR 30 thousand and the VAT rate rises from 16% to 18%. Also with the new law we have some other innovations such as the escalation of the VAT rate for some products and discounts that affect productivity growth and technological innovations.

### Literature Review

At the beginning of the 2010s, more than 130 countries worldwide had VAT, and among the developing countries, around 70% (104 out of 144) had adopted this kind of indirect Taxation (Ebeke and Ehrhart, 2011). Even Kosovo after the armed conflict in the area of fiscal policy, which have influenced the formation of revenues, engaged in the construction of the tax system and other instruments, which are in the function of preserving the country's macro-fiscal sustainability (Kryeziu, 2012). In Kosovo, from 2005 up to now, there has been a steady increase in public revenues, especially in the collection of VAT. But the biggest concern that has been raised by domestic and international economists has been that this increase in revenue has had an impact on the country's economic growth? In order to verify the impact of VAT on economic growth, many researchers in the country and the world in general have taken over. Among the scholars who have dealt with this issue are: Aizenman, Jinjark, Peci, Lalarukh, Onwuchekwa, Aruwa, Haruna, Kumshe, Magaji and Bani, Njogu.

Countries all over the world, look for ways to boost their revenue, this facilitated many nations to introduce value added tax on goods and services. We examined the effect of value added tax on the economic growth of Nigeria. The result shows that VAT contributes significantly to the total tax revenue of government and by extension the economic growth of Nigeria. The growth pattern of GDP from 1994 (the year of inception) to 2009 was oscillating. It increased geometrically between 2010 and 2011. VAT revenue growth had consistent increase though the growth was not as explosive as that of the GDP. (Onwuchekwa, Aruwa, 2014).

In their paper the authors Haruna, Kumshe, Magaji and Bani, found the impact of value added tax (VAT) economic growth and development of Adamawa state from 2001 to 2014. Data for the study were sourced through CBN statistical Bulletin and Adamawa state Annual budget report and analyzed through the use of Ordinary Least Square Technique. The results of OLS revealed that increase in total actual revenue and value added tax (VAT) raised economic growth of Adamawa state. The coefficient of total actual revenue and value added tax (VAT) were statistically significant and consistent with the theoretical expectation. The F-statistics values in this study indicated that total actual revenue and value added tax (VAT) were jointly and significantly affecting economic growth of Adamawa state at 1 percent significant level. (Haruna, Kumshe, Magaji and Bani, 2015).

Bangladesh's Gross Domestic Product (GDP) has been growing satisfactorily in the last two decades. Contribution of Value Added Tax (VAT) to GDP growth of the country has remained undetected. Author Lalarukh analyzes the relationship between VAT and GDP growth in Bangladesh and investigates how the VAT contributed to Bangladesh's economic growth based on data for the years 1991/92 to 2011/2012. To this end, Johansen's co-integration technique was used to examine the relationship. The study shows that the value added tax has a positive impact on the gross domestic product and is contributing to the economic growth of the country. (Lalarukh, 2013).

According to findings from a study conducted by Jalata (2014), he found that compared to the sales tax, VAT promotes the overall economic growth of Ethiopia, but the question of regression similar to sales tax continues. During the period under review, the VAT growth rate was on average 66.27%. For sales tax periods, the average growth rates of GDP were only 2.53%. However, after the VAT executions, such growth rate averaged around 21.9%. The analysis also showed that the average ratio of VAT to GDP is 2.95%. The finding also reveals that VAT, general tax revenue and non-tax income, in addition to foreign income, were significant at 5% of importance, but all contributed positively to economic growth over the periods under review (Jalata, 2014).

### Methodology

We employ two procedures; one is the descriptive trends analysis (monitoring the trend) by using the various possible analytical techniques to examine the trends and structure of our data over time. We assumed that the changes in the variables are error free and if they are error free then they can be presented in tables and graphs.

The second procedure which is in contrast to the descriptive trend analysis is the econometric techniques that is employed to analyses the effect of VAT on economic growth in Kosovo. This section explains the procedures used by the researcher in eliciting the necessary and or relevant data needed for the study. It presents the methodology of the research. The source

of data for this study is secondary through Annual Finance Report by Finance Ministry of Kosovo and IMF. In order to analyze the data generated for the study, the statistical tool utilized is OLS technique (multiple regression).

To establish the relationship between economic growth represented by Gross Domestic Product (GDP) and Value Added Tax (VAT); this study adopted the model by (Orwuchekwa, Aruwa, 2014). The same model is also used by (Haruna, Kumshe, Magaji and Bani , 2015). Therefore, the model for this research is specified as follows:

### Specification of the model

The models for this study are specified as follows:

$$GDP_t = C + \beta_1 VAT_t + \varepsilon$$

Where:

GDP - shows economic growth for period t;

VAT - the total value added tax for the period t;

C - Constants for variables

E - random error for period t

T - 2005 to 2015

### Results

#### Trends of the Value Added Tax in Kosovo 2005-2015

This paper aims to present VAT trends, tax rates, characteristics and function and the economic and financial contribution of VAT, during its application. During this period in Kosovo some very effective measures have been taken in building a suitable environment for the implementation of tax policy. New laws, regulations and guidelines have been issued that make the tax system more compatible with the market economy. The results achieved are encouraging in terms of increasing revenues from VAT. It is important to build a sustainable tax policy in Kosovo. Income from value added tax is an important item of budget revenues. VAT revenues account for about 40.00% of total revenues in Kosovo's budget. So, as seen, VAT is the main revenue in the country's budget. Based on this we can conclude that this tax is also the main contributor to the economic growth of the country based on the findings of other authors that government revenues have a positive impact on the economic growth of the country.

Table 1. Participation of VAT on general government revenues 2005-2015

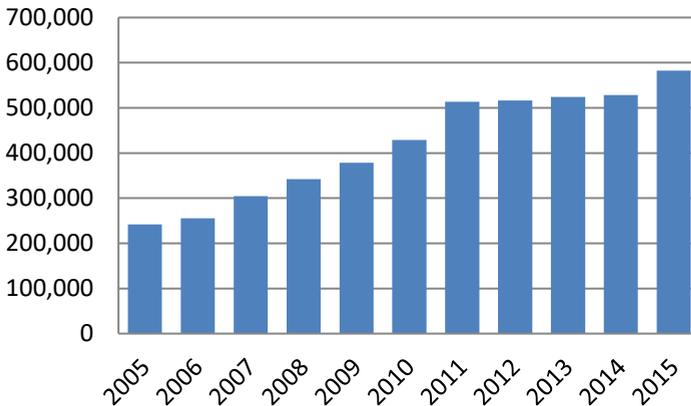
Total revenues	VAT	% of VAT on GDP	The rate of increase in VAT	The rate of revenue
628,000	241,592	38.47		
722,000	255,082	35.33	105.58	114.97
898,000	304,240	33.88	119.27	124.38
943,000	342,097	36.28	112.44	105.01
1,151,000	378,303	32.87	110.58	122.06
1,164,000	428,688	36.83	113.32	101.13
1,305,000	513,396	39.34	119.76	112.11
1,322,000	516,396	39.06	100.58	101.30
1,312,000	524,220	39.96	101.52	99.24
1,334,000	528,164	39.59	100.75	101.68
1,453,000	582,121	40.06	110.22	108.92

Source: (IMF, 2005-2015)

The trend of increasing VAT collection in Kosovo has been quite high. This is best seen in Table 1 and Graph 1. This trend has been positive year-on-year. The lowest growth was recorded in 2012, 2013 and 2014, while the highest in 2007, 2011

and 2015 was 110.22%. This trend of VAT growth has also been accompanied by the increase of total budget revenues. In this research we have noticed that after an interruption in the increase of budget revenues and VAT, the Kosovo government has undertaken some fiscal reforms and immediately starting from 2015 the growth trend continues to be quite high reaching with plus 10%. This positive trend of revenue growth has also positively impacted the growth of GDP of the country, contributing directly to increased government spending (BQK, 2016).

Chart 1. Value Added Tax 2006-2015 (000).



Source: (MF, Annual Financial Report ,

2005-2015)

One of the challenging problems for domestic institutions in collecting VAT is dependence on the border. Based on the data we have received from the Ministry of Finance and the IMF it can be seen that on average since 2005 around 81.90% of the VAT collected in the Kosovo budget is at the border and only 18.10% within the country. This trend of collecting budget revenues and especially collecting VAT from border points discourages Kosovar businesses because they are forced to pay VAT on the border still without selling the goods. Due to this policy, Kosovar businesses have problems with financial liquidity and are often forced to go bankrupt or enter into commercial banks' loans and thus to deepen their liquidity trend (Shala T. , 2016).

Since the Value Added Tax (VAT) is the main revenue of the Budget of the Republic of Kosovo we have carefully analyzed the collection of this tax over the years and have ascertained that its average participation in relation to GDP for the period is on average 9, 57%. The most recent participation was presented in 2011 with 10.65% and the lowest in 2005 about 8.05%.

Table 2. VAT collected at the border and inside the country

Years	VAT at the border	VAT inside	Total VAT	% of VAT at the border	% of VAT at the border
2005	195,239.44	46,352.96	241,592.39	80.81	19.19
2006	210,608.00	44,474.00	255,082.00	82.56	17.44
2007	254,760.00	49,480.00	304,240.00	83.74	16.26
2008	304,398.00	37,699.00	342,097.00	88.98	11.02
2009	327,288.00	51,015.00	378,303.00	86.51	13.49
2010	360,697.00	67,991.00	428,688.00	84.14	15.86
2011	419,079.00	94,317.00	513,396.00	81.63	18.37
2012	417,864.00	98,532.00	516,396.00	80.92	19.08
2013	410,989.00	113,231.00	524,220.00	78.40	21.60
2014	422,776.00	105,388.00	528,164.00	80.05	19.95
2015	455,294.00	126,827.00	582,121.00	78.21	21.79

Public revenue are the main factor for calculating Gross Domestic Product (GDP). (Shala, 2017). The share of VAT in GDP is an important indicator that expresses the level of economic growth of a country. Starting from the previous arguments, we have made an analysis of these trends in the collection of VAT and its impact on economic growth. To complete our analysis, we have obtained data for Kosovo and compared it with data from other countries in the region. From the findings of the analysis, we have noted that the lowest share of VAT in relation to GDP for 2015 is Greece (7,37%), while the highest Bosnia and Herzegovina (18,19%). Kosovo in this year the participation of VAT in relation to GDP was 10,06%, which is at the lowest level in the region.

Table 3. VAT Participation in GDP by 2005-2015

Years	VAT	GDP	%
2005	241,592.39	3,002,760.00	8.05
2006	255,082.00	3,120,410.00	8.17
2007	304,240.00	3,460,770.00	8.79
2008	342,097.00	3,882,800.00	8.81
2009	378,303.00	4,069,600.00	9.30
2010	428,688.00	4,102,000.00	10.45
2011	513,396.00	4,818,500.00	10.65
2012	516,396.00	5,058,700.00	10.21
2013	524,220.00	5,326,600.00	9.84
2014	528,164.00	5,567,500.00	9.49
2015	582,121.00	5,788,300.00	10.06

**Source:** (IMF, 2005-2015)

According to the data that are part of our analysis, we have concluded that VAT has a positive impact on the economic growth of the country. Countries with a greater economic development have higher levels of VAT participation in GDP. Kosovo compared to other countries in the region has a floating rate of increasing VAT collection as a result of undertaking some fiscal reforms and increasing efficiency in collecting VAT, but the ratio with GDP is low and this way also reflects the inadequate level of the country's economy

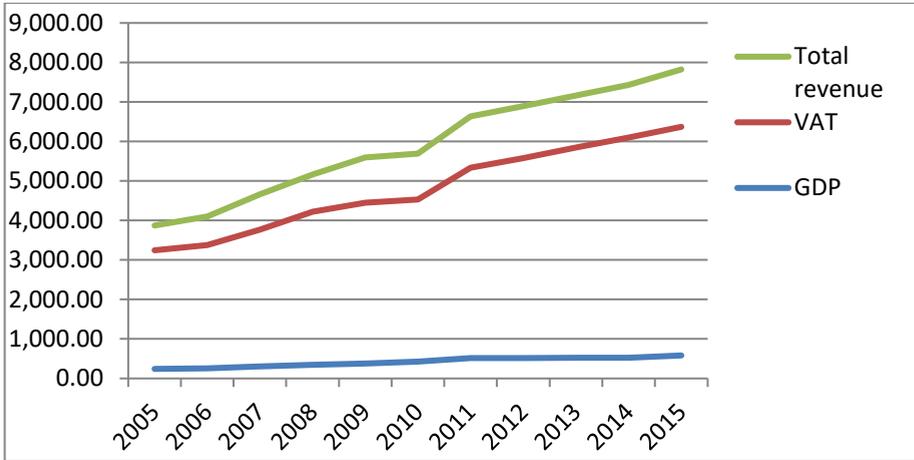
Table 4. Participation of VAT on country GDP in South East European countries by 2005-2015 (in%).

Country	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Albania	9.04	9.90	11.11	12.60	12.50	12.54	12.63	12.18	11.05	12.97	12.69
Bosnia and Herzegovina							18.43	17.88	17.04	17.73	18.19
Bulgaria	7.33	8.19	8.56	9.81	8.37	8.75	8.78	9.80	10.02	9.64	9.98
Croatia	10.45	10.69	11.16	11.76	11.76	11.62	11.59	12.91	13.06	13.29	13.61
Hungary	10.82	10.46	11.77	12.26	13.61	14.87	14.97	16.41	15.44	16.28	17.25
Kosovo	8.05	8.17	8.79	8.81	9.30	10.45	10.65	10.21	9.84	9.49	10.06
FYR Macedonia	7.95	8.92	10.54	12.06	9.89	11.52	13.58	14.31	14.37	13.07	14.18
Romania	5.07	5.18	6.49	7.19	6.28	7.60	9.10	9.50	9.49	9.18	9.94
Serbia	8.03	7.98	8.89	10.75	10.45	10.41	11.01	11.95	12.05	13.21	13.32
Greece	6.48	7.14	7.59	7.94	7.15	7.73	7.95	7.75	7.38	7.33	7.37

**Source:** (IMF, 2005-2015)

Another interesting data that has been found from the research suggests that the rate of increase of revenues from VAT is proportional to the rate of growth of Gross Domestic Product and this has happened precisely from the tax reform and the filing of revenue collection budget.

Graph 2. Growth trends of GDP, VAT and general incomes 2005-2015



Source: (IMF, 2005-2015)

**Results and Interpretation of the Econometric Model**

The econometric model analysis is built on a simple econometric model view, whereby the significant influence of independent variables on the dependent variable will be measured.

**Table 5. Descriptive analysis for the econometric model variables**

Statistics		GDP	VAT
N	Valid	11	11
	Missing	0	0
Mean		4381630909.0909	419481763.0909
Std. Error of Mean		296825387.30082	36577082.00365
Median		4102000000.0000	428688000.0000
Mode		3002760000.00 <sup>a</sup>	241592394.00 <sup>a</sup>
Std. Deviation		984458437.92874	121312456.93218
Variance		969158416009091070.000	14716712206921786.000
Skewness		.013	-.251
Std. Error of Skewness		.661	.661
Kurtosis		-1.458	-1.566
Std. Error of Kurtosis		1.279	1.279
Range		2785540000.00	340528606.00
Minimum		3002760000.00	241592394.00
Maximum		5788300000.00	582121000.00
Sum		48197940000.00	4614299394.00

a. Multiple modes exist. The smallest value is shown

Descriptive analysis of model indicators shows that the average value of Kosovo's GDP for the period 2005-2015 is € 4,381,630,909, while the average value of VAT is € 419,481,763. The statistical values of the standard deviation and the lack of statistical values show that the model has a stable econometric basis, as such has the basis for interpretation and analysis of the results of the data of the econometric model.

Table 6. Summary of the Econometric Model Summary<sup>b</sup>

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.980 <sup>a</sup>	.961	.957	204235487.96797	.961	223.344	1	9	.000	1.910

Predictors: (Constant), VAT  
Dependent Variable: GDP

To overcome the econometric model data, we used the SPSS statistical program. Based on calculations made of the econometric model, the results obtained from the model data show that the dependent variable has a strong correlation with the explanatory variables at the level of .980, respectively 98 percent. While R2 in our analysis is .961, which indicates that 96.1% of the dependent variables are explained by independent variables. Adjusted R2 is equal to .957, which indicates that 95.7 percent of the variance of the dependent variable is explained by the variation of independent variables. In our analysis for verification of model stability, it was used the serial correlation. The Durbin-Watson correlation value may be in the range of 0 to 4. If the value of Durbin-Watson is approximately zero, then the serial correlation indicates that the data in the model has a high positive impact between the residual value. If the correlation Durbin Watson is offered a value of four (4), it indicates that the data has a negative serial correlation. The model can be considered stable when the Durbin-Watson results are close to the value range of two (2). The Durbin-Watson test is it considered to have no serial correlation within the range of 1.5 to 2.5, indicating that the residual value has no serial correlation or there is no autocorrelation between the residual value. Therefore, based on this interval, the findings in our study show that Durbin-Watson is in the value of 1,910, which is within the interval value, and that is why the model is stable.

Table 7. ANOVA or F-Test ANOVA<sup>a</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	9316174949181268000.000	1	9316174949181268000.000	223.344	.000 <sup>b</sup>
	Residual	375409210909643140.000	9	41712134545515904.000		
	Total	9691584160090910000.000	10			

Dependent Variable: GDP  
Predictors: (Constant), VAT

Table 8. Coefficient of the econometric Coefficient model<sup>a</sup>

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations			Collinearity Statistics		
	B	Std. Error				Beta	Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	1044090720.349	231660147.728		4.507	.001					
	VAT	7.956	.532	.980	14.945	.000	.980	.980	.980	1.000	1.000

a. Dependent Variable: GDP

F-test equals .000 indicates that all coefficients together are statistically signified and different from zero. Also, the correlation statistics show that the VIF factor with the highest value in the regression coefficients is 1,000, which means that all independent variables are less than 10 (VIF <10), this shows that there is not much collinearity Up but relatively

strong, which implies that the multicollinearity of the data within the model does not pose any problems with the data that is being exploited.

The regression coefficient shows that we have a VAT impact on GDP in Kosovo, because the level of significance is .000, or includes the rate of 1%. Also, the correlation between VAT and GDP shows a strong positive relationship, or statistically interpreted with the increase of VAT, will also increase the GDP of Kosovo, these two elements conclude that VAT has a significant impact on GDP Of Kosovo.

### Conclusions

From the descriptive analysis of this research we have noticed that revenues from VAT constitute around 40% of total budget revenues of Kosova. Given this fact that VAT is the main revenue, then we can say that this income is also the main contributor to the growth of public investments that directly affect the economic growth of the country. The trend of revenue growth from VAT in the research period was quite high, which was followed by the growth of general revenues, revenue which have positively impacted the GDP growth. A challenging problem for Kosovo's institutions is the dependence on collecting revenues from the border. Revenues collected from VAT at the border were on average over 80%, which does not guarantee a fiscal stability for the country. Even though the share of VAT in relation to GDP was not high compared to the countries in the region, our analysis shows that the VAT impact on GDP growth was high and we can say freely that VAT has contributed to the country's economic growth. This fact is also confirmed by the econometric analysis. The regression coefficient shows that VAT has an impact on GDP in Kosovo, since the level of significance is .000, or includes a rate of 1%. Also, the correlation between VAT and GDP shows a strong positive relation, or statistically interpreted with the increase of VAT will also increase the GDP. So these two elements conclude that VAT has a significant impact on GDP growth in the country.

This research recommends the country institutions to have more attention to the most effective VAT administration, acting urgently in order to shift the tax collection from the border into the countryside and thus achieve a more stable fiscal and financial stability of the country.

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