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## Article

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## **Impact of Change in VAT In Kosovo and his Effect in Economic Development (2013-2016)**

**Gani Asllani<sup>1</sup>, Bedri Satovci<sup>2</sup>**

**Abstract:** The paper tries to analyze the effect of the change of tax rates for VAT for certain categories of goods in budget revenues and economic development of Kosovo. VAT in Kosovo is applied since 2001 and is indirect tax on consumption that brings the main revenue to the state budget. Therefore, the research focuses on whether the changes made to the VAT rates in September 2015 have had its increasing effects or decreases in some products' prices, increasing or decreasing their budgets and with this impact on development economic indicators expressed through the GDP. Through the econometric model and regression analysis for the period 2013-2016, is evaluate the impact of VAT on economic growth and development.

**Keywords:** VAT rate; bughet revenues; economic growth; taxation

**JEL Classification:** C32; F14; F63

### **1. Introduction**

The state and its institutions will not be able to exist and function without payment of tax obligations by citizens as well as enterprises, so the tax is part and parcel of the existence of the state and the payment of taxes is mandatory. Kosovo has built and continues to build a simple, tax system the application of low tax rates and with a free mode of trade (barriers and customs restrictions), is among the liberal countries in the region, which enables connection to the fast integrations. The fiscal system to us is relatively new, a system that is based on direct and indirect taxes. The capacity building has started since 1999 with the Regulation on customs, then in 2001 begin to apply and other taxes as tax untried (May 2000), VAT (May 2001), income tax (1 April 2002), property tax (June 2003), corporation tax (December 2004) on the road tax (March 2005) in royalties taxes and steadily and the application of other non-tax revenues. Since January 2005, tax policies begun with the initial tax amendments and with the application of new taxes such as Corporate Income Tax (CIT) as well as Personal Income Tax (PIT) and this continued until end of 2008. 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. In the recent years, there has been a continuous reform in the tax policy in Kosovo. Currently, the tax system in Kosovo is considered to be quite simple and harmonized.

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## **2. Literature Review**

The experiences of many countries suggest that the application of taxes, especially VAT, affects different economic ways. Taxes, as the main and most important tool for collecting public revenues, are presented in a variety of forms. In Kosovo legislation, given the moment of income generation and the moment of spending of these revenues, taxes are divided into direct and indirect taxes. Thus, according to this criterion, taxes paid at the moment of income generation represent the group of direct taxes, whereas those realized at the time of the income expense are included in the group of indirect taxes. (Jelčić, 1997) All preparations for the administration and operation of the value added tax should be in order to provide the necessary conditions for the practical application of the legal regulation. Carrying out this task requires serious and thoughtful action because any possible release of any part of the administrative procedure will not only slow down and hamper the operation of the tax but could cause a loss of tax revenue. (Cosanegro de Jantscher, 1990, pp. 171-179) Examining the impact of taxes on economic growth is observed the level of capital and intermediate goods tax has a significant effect on economic growth, countries with lower taxes grow faster than those applying high taxes (Philip Gerson). In an analysis of the relationship between taxes and the rate of economic growth in the 23 OECD countries for the period 1965-1990, not relying on any argument that there is any correlation between the tax rate and economic growth, it is concluded and gives support the idea that taxes have negative effects on economic growth. (Eidmalm, 1999) He concludes by means of econometric analysis that progressive taxation results to have a higher negative effect on real GDP. High taxes affect the reduction of consumer incomes and limit their economic freedom in the short run, but may also affect the reduction of economic efficiency and the reduction of long-term welfare. If expenditures were cut short this would immediately affect categories that benefit directly from government programs (Tanzi Vito). Given the size of the parameter, government revenues affect economic growth more than government spending. The economic growth is positively affected by productive and negative costs, but the first have a greater impact. (Gerti Shijaku, Arlind Gjokuta) Corporate high taxes discourage potential investors from realizing investments in the given country. (Beker, 2009) Corporations use the tax policy and tax rates as a means of attracting foreign investors. (Vill & Barreix, 2002)

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. (Gallagher & Babiç, 2004) Fiscal policy is the use of government expenditures and taxation which affect economic activity. (Dubrowski & Magdalena, 2001)

## **3. Research Methodology and Data**

The purpose of the research is to analyze how much the VAT law has changed with tax rates from 0-16% to those scaled to 0%, 8% and 18% for the comparative 2013-2016 GDP growth. Through the interconnection of variables it is attempted to understand and answer the role of VAT on economic development. To this end, the econometric model analyzes the relationship between economic variables such as:

*GDP as dependent variables, and VAT as independent variables.*

Research Methodology

For the purpose of developing this work, defining the main concepts of Value Added Tax (VAT), its elements and characteristics, comparative analysis methodology has been used, primary data and other secondary sources have been used.

Resarch question?

Will the macro-fiscal policies (VAT) affect the growth of economic development and the better collection of value added tax have a negative or positive effect on GDP?

Hypotheses

The hypotheses set out are: Hypothesis Ho and Alternative H1:

*H0 = Value Added Tax has a negative effect on the growth of the economic development affecting the reduction of GDP*

*H1 = Value Added Tax has a positive effect on economic growth, affecting GDP growth.*

**4. Value add Tax in Kosovo (Vat)**

Value Added Tax (VAT) has started to apply to imports and domestic supplies of goods and services since 1 July 2001 (according to UNMIK Regulation No. 2001/11 "On Value Added Tax" which was amended by UNMIK Regulation No. 2002/17 and 2004/35). Applied with the rate of 15% and with the zero scale (0%). Entities that are to be registered as taxable persons are persons with annual turnover over 50,000 € (and those who are under the threshold but who choose to be VAT declarants) apply and collect the VAT calculated by their buyers or customers and receive a lump-sum credit for the VAT paid on their domestic imports and purchases. Where the deductible VAT of the requested VAT exceeds the calculated tax on the VAT collected, the taxable person will have the right to lend VAT. Value Added Tax includes the application of total tax on goods and services consumption, which is exactly proportional to the price of goods and services. VAT is calculated at this rate according to the applicable rate, is charged at different stages of production, distribution and lifecycle of goods and services trade, and is ultimately charged to the customer. In 2008, the tax rates change from 15% and 0% to 16% and 0%, this change was in force until the new changes that are made in 2015.

**4.1. Amendment of VAT law, September 2015**

In September of this year, the reform of the VAT Law was reformulated, except for the other changes made, with the main ones:

The standard VAT rate increases from 16% to 18%

Reduced VAT rate 8% form 16% as it was earlier

For goods/services is assigned rate Tax rate 8%

The VAT threshold for VAT registration is reduced from € 50,000 to € 30,000 earlier

The period for VAT registration - calendar year (January - December)

Treating bad debt

Expanding the list of goods without VAT (raw materials and machinery)

## 5. Study Cases

The case study shows the impact of VAT on the country's economy, revenue growth and GDP over the years 2013-2016. As a case study is the change of the VAT law in 2015, and we will see how much this change has affected the state budget as well as the basket of the citizen. Also by analyzing and processing the data with the STATA program we will answer the research question and see if the hypotheses put forward or dismissed lie.

### 5.1. Analysis of Tax During The Period 2013-2016

The Kosovo Tax Administration during 2013-2016 has achieved significant results by realizing revenues that have passed the plan (compared to previous periods). The progress achieved refers to the provision of voluntary relief facilities, equal treatment of all taxpayers, and successful implementation of revenue collection planning.

The achieved success refers to the provision of professional, transparent and effective services and through the fair and uniform implementation of tax laws, the modernization of the large taxpayer unit, the extension of functions at the call center, the development of electronic declarations, of the capacities in the risk management unit and the tax investigation unit. Tax Administration of Kosovo has realized higher revenues from year to year by increasing voluntary compliance with tax obligations, as well as reducing the cost to taxpayers in performing their tax obligations.

**Table 1. Structure of revenues (2011-2015) on million euros**

Tax	2011	2012	2013	2014	2015	Comp. 2014-2015	For year 2015
1	2	3	4	5	6	7=6/5	8
VAT	122,327,310	131,394,869	149,184,989	136,939,023	153,877,977	112%	46.3
Cor. Tax	58,155,213	65,138,976	65,924,380	65,818,313	74,639,926	113%	22.5
Real Tax	80,640,640	87,365,088	90,342,564	100,937,655	103,763,147	103%	31
Total	261,123,163	283,898,932	305,451,932	303,694,991	332,281,049	109%	100

*Source: TAK - Annual reports for 2011-2015*

In the structure of revenues by type of taxes for years, the largest share has been VAT more than 45.1%, tax withholding at 22.3%, corporate tax with 18.2%, individual business tax with 10.8% , tax on interest, dividends, property rights, lottery winnings and games of chance 3.5%, preliminary tax with 0.05% and profit tax with 0.01%. In 2015, VAT changed, with the main change being the release of raw materials used in the production process and a reduction of 8% of a product group, while the increase was 16% to 18%. In revenues by main tax groups, the largest share for 2015 has Value Added Tax with 46.3%.

**5.2. The impact of VAT Change on the Consumer Basket**

By analyzing the prices of some basic products over the years 2013-2016 we will see how much the change of VAT has affected the price of these products, which are reflected directly in the consumer basket, thus in GDP. This analysis involves dividing products into two groups, those basic products for which the VAT rate has dropped from 16% to 8%, and the second group that includes luxury goods for which the VAT rate has increased from 16% to 18%.

**Table 2. Price of some basic products over for years**

Designation	Quantity	2013	2014	2015	2016
Oils	1 kg	1.53	1.15	1.15	1.16
Wheat flour	1kg	0.40	0.39	0.38	0.39
Meat	1kg	6.80	6.85	6.95	7.00
Milk	1lit.	0.91	0.92	0.90	0.91
Sugar	1kg	0.77	0.76	0.66	0.68

Source: Statistical Yearbook of the Republic of Kosovo

**Table 3. Prices of some luxury products over four years**

Designation	Quantity	2013	2014	2015	2016
Beer	1lit.	0.58	0.61	0.61	0.66
Alcohol	1lit.	8.55	8.55	8.71	8.78
Cigarettes	1pac.	1.16	1.22	1.33	1.40
Grilled coffee	1kg	7.04	7.10	7.07	7.09

Source: Statistical Yearbook of the Republic of Kosovo

**6. Empirical Analysis on the Test of Vat Effects in Gdp**

Following the specification of the log-log model and the valuation method, the data are analyzed in the empirical work, they are calculated from the model and interpretation of the results is done. Finally, the validity of hypotheses defined in the research has been checked.

*Specification of econometric model and evaluation log-log (OLS):*

Through the simple linear regression method and the log-log method applications, the effects of VAT on GDP in the Republic of Kosovo have been tested.

Therefore, the specification of the linear dimmed regression model is as follows:

$$Y = B1 + B2 + Ui$$

Or

$$Y (GDP) = +B1 B2 (VAT) + UI$$

The specification of the linear dimmed regression model for 2013-2016 is as follows:

Y- represents a dependent variables (variables that are clarified, regressant, endogenous, predicted, etc.), in the case of this research as a dependent variable is GDP.

X- represents the independent variable (regressor, exogenous, predicting etc), in our case as an independent variable is:

B1- is the constant parameter, whereas

B2- are the parameters of the independent variables assessment or the valuation coefficients.

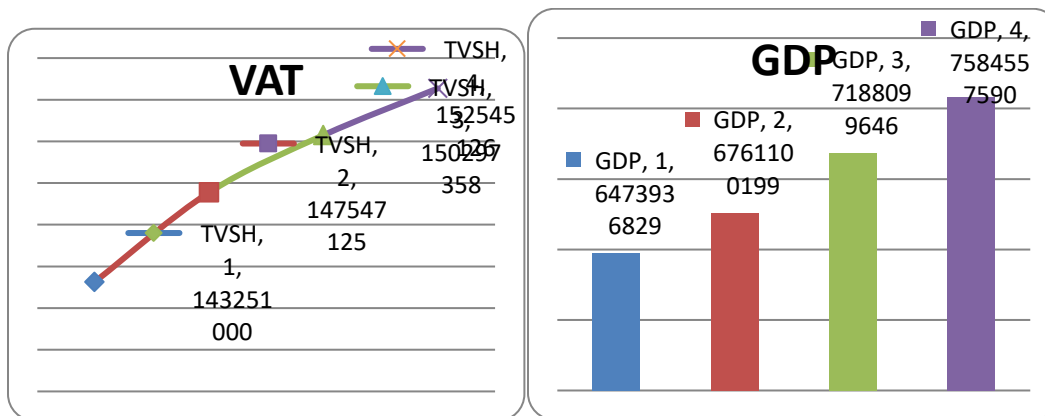
U<sub>i</sub>- is stochastic or error term variables (contains all the factors or variables that are not foreseen in the model and is a random variable, receives positive and negative values).

**6.1. Data on the Econometric Model**

In calculating the regression, data on GDP and VAT have been used by the Central Bank of Kosovo, the financial reports of the Ministry of Finance and the World Bank, Kosove's statistics office. Given the limited access to the data required for this model, data interpolation is made at certain time periods relevant for 2013-2015.

VAT, year =2013-2016

GDP, year = 2013-2016



**Figure 1. Graph of revenue and GDP data**

Source: Tax Administrations of Kosovo, 2006

**6.2. Econometric Improvement and Interpretation of Results**

Through regression analysis we aimed to check the validity of the hypotheses set out at the beginning of this paper. In the model are included two variables, independent variables, exogenous such as VAT, and dependent variables, the regressant in our case is GDP. In the following we will specify the model as a regression to calculate it.

The econometric model (1) can be written as:  $Y = \beta_1 + \beta_2 X + u$

Correlation calculation, the correlation coefficient of the sample is 0.97 positive. This correlation coefficient shows that there is a positive linear relationship between GDP and VAT.

*Linear Model with constant*

B1 = is the constant estimator parameter, which explains that the value -1.06 indicates the average value of GDP when the VAT is zero.

B2 = 118.58, if VAT increases by 1% then GDP decreases on average to -1.06%

*Linear Model without constant*

B2 = is a coefficient of estimation which shows the average VAT growth for 1% then on average will affect the GDP growth of 47.22%

*Specification of the results of the following two models, the difference between the two models:*

The pattern based on the constant model is -1.06, whereas the model with no constant value is 47.22 since the model without constant constant is better (clarifies the model with a high%). Based on the results of both estimating models, the first model with constant has negative values, so the non-constant model has a very high positive ratio and accept the second model. The coefficient of corruption between the two models has a very small difference and the bargaining will not be interpreted because the independent variable clarifies to dependently on an average of 0.97%.

Estimates of the test on the constant model, and the F-test in these models shows us hypothesis *H0* and accept *H1*.

*H0 = Value Added Taxes have adverse effects on the growth of economic development that affect the reduction of GDP.*

*H1 = Value Added Taxes have a positive effect on the growth of the economic development, affecting the growth of GDP.*

At the test in question, at the significance level 0.05.

The F-test 37.45 is of significance because it is larger than 4.

GDP= -1.06 .+118.VAT

(se)	6287	19.377		
			(t)	-3.68      6.12

*Source: Stata13*

Calculation of the evaluation coefficients in model (1) and the interpretation of the obtained results:

*LogVAT= 13.46 (const) 0.282 (Incigarettes) + 0.003 (lnalcohol) +0.221*

Coefficient B1 = is constant when x 1 and x 3 are zero. Coefficient B2 = 0.282, indicates that the increase of 1% of tobacco will affect on average 0.282% of the increase in VAT. Coefficient B3 = 0.003, indicates that the increase of 1% of alcoholic beverages will have an average effect of 0.003% on the increase of VAT.

*The empirical research results suggest that the impact of tobacco, alcoholic beverages have a major effect on VAT. If all the coefficients are collected, we gain 0.506, which shows that Economic Development in Kosovo has an average increase in yields. Based on the t-test the evaluation coefficients have significance.*

Calculation of the evaluation coefficients in model (2) and the interpretation of the obtained results.  
*LogVAT = 12.43(const) 0.000 (lnalcohol) + 0.382 (lnmeat) +2.648*



Coefficient B1 = is constant when x1 and x3 are zero

Coefficient B2 = 0.000, indicates that the increase for 1% of alcoholic beverages will affect on average 0.000% increase in VAT.

Coefficient B3 = 0.382, indicates that the increase of 1% of meats will have an average impact of 0.382% on the increase in VAT. The empirical research results suggest that the influence of alcoholic beverages and meats have a major effect on VAT. If all the coefficients are collected, we gain 3.03, which shows that the economic level in Kosovo has an increase above the average yield level because it is larger than 1.

Calculation of the evaluation coefficients in model (3) and the interpretation of the obtained results.

$$\text{LogVAT} = 13.75 (\text{const}) + 0.39 (\text{Inmill}) + 0.49 (\text{Insugar}) + 0.028 (\text{Innutrients}) - 0.84 (\text{Inmilk}) + 0.66$$

Coefficient B1 = is constant when x1 and x5 are zero. Coefficient B2 = 0.39, indicates that growth by 1% of mill will have an average impact on 0.39% increase in VAT. Coefficient B3 = 0.49, indicates that the growth of 1% of sugar will have an average impact of 0.49% on VAT growth. Coefficient B4 = 0.028, indicates that growth by 1% of nutrients will affect on average 0.028% in VAT growth. The coefficient B5 = - 0.84, indicates that the increase for 1% of milk will affect on average - 0.84% in the reduction of VAT.

The empirical research results suggest that the impact of mill, sugar, nutrition, and milk has a huge effect on VAT. If all the coefficients are collected we earn 0.73, which shows that the economic level in Kosovo has an average increase in yields.

Therefore, based on the econometric analysis, changes in VAT have had a positive effect, which has affected GDP growth in Kosovo. Through the econometric model, the effects of VAT on the GDP ratio were tested, where two elementary and elemental product classifications were made. In the product group, VAT movements have had a high effect on the average at 3.03%. The econometric analysis in the elementary product group shows that the VAT deduction from 18% to 8% had a positive effect that affected the growing GDP 0.73%. As a conclusion, these changes in VAT, made in recent years by the government, suggest that there is a lot of room for improvement in our economy, using public revenue more efficiently.

### 6.3. Model Commentary

#### a. Group of luxury products

*Based on the results obtained by calculating the data with STATA-13, through the log-log model, the results obtained will be computed as follows: therefore they only represent the impact of value added taxes such as variables, tobacco, and alcoholic beverages as independent variables. Interpretation of  $r^2 \rightarrow 0.998 \gg 99.8\%$ , reflects that the determination coefficient is high with 99.8%, which means that the independent variable clarifies for 99.8%, the dependent variable. Referring to the results we see that from  $p >$  to the alpha ( $\alpha$ ) interval of 0.05, the higher significance has cons because it approaches 0.05 with 0.010, while the others are larger.  $\text{Prob} > F 0.0359$  means that with 36% we reject  $H_0 \rightarrow H_0 = \text{Value Added Taxes have adverse effects on the growth of economic development that affect the reduction of GDP. } H_1 = \text{Value added taxes have a positive effect on economic growth, affecting the growth of GDP.}$*

**b. Group of basic products**

On the basis of the results obtained by calculating the data with STATA-13, through the log-log model, the obtained results will be commented as follows: therefore they only represent the impact of value added taxes such as variables, sugar, nutritious oils and cucumber as independent variables. Interpretation of  $r^2 \rightarrow 0.99$  "99.%, reflects that the determination coefficient is high at 99%, which means that the independent variable clarifies for 99%, the dependent variable. Referring to the results we see that from  $p > \alpha$  interval of 0.05, the higher significance has cons because it approaches 0.05 with 0.031, while others are larger.  $Prob > F$  0.069 means that with 69% we reject  $H_0 \rightarrow H_0 =$  Value Added Taxes have adverse effects on the growth of economic development that affect the reduction of GDP.  $H_1 =$  Value added tax has a positive effect on the growth of the economic development, which affects the growth of GDP

**Table 4. GDP and VAT**

**APPENDIX: Calculation table in STATA**

	Year	VAT	GDP
1	2013	143251	6.50+06
2	2014	147547	6.80+06
3	2016	150297	7.20+06
4	2016	152545	7.60+06
.Correlations GDP (obs-4)		GDP	VAT
GDP		1.0000	
VAT		0.9743	1.0000

Source: STATA data

**Table 5. Luxury products (tobacco, alcoholic beverages, meat)**

Source	SS	df	MS	Number of obs = 4		
Model	.0021976	2	.0010988	F(2, 1)	=	386.96
Residual	2.8396e-06	1	2.8396e-06	Prob > F	=	0.0359
Total	.00220044	3	0.00073348	R-squared	=	0.9987
				Adj R-squared	=	0.9961
				Root MSE	=	.00169
InVAT	Coef.	Std.Err.	t	P> t	(95% conf. interval)	
Inalcohol.	.0034938	.0125489	0.28	0.827	-.1559547	.1629423
Intabaco	.28266547	.02012204	13.98	0.045	.0257298	.5395796
-cons	13.47635	.2218792	60.74	0.010	10.65711	16.2956
Source	SS	df	MS	Number of obs = 4		
Model	.002027423	2	.001013712	F(2, 1)	=	5.86
Residual	.00173e-16	1	.000173016	Prob > F	=	0.2804
Total	.00220044	3	.00073348	R-squared	=	0.9214
				Adj R-squared	=	0.7641
				Root MSE	=	.01315
InVAT	Coef.	Std.Err.	t	P> t	(95% conf. interval)	
Inmeat	.3825135	.2565291	1.49	0.376	-2.876997	3.64202
Inalcohol	.0007706	.1144699	0.01	0.996	-1.453708	1.45524
-cons	12.43361	2.648824	4.69	0.134	-21.22289	46.0901

Source: STATA data

**Table 6. Basic products (sugar, oils, flour, milk)**

Source	SS	df	MS	Number of obs = 4		
Model	.009993074	1	.009937014	F(2, 1)	=	68.73
Residual	.000288997	2	.000144499	Prob > F	=	0.0142
Total	.010288991	3	.00340657	R-squared	=	0.9717
				Adj R-squared	=	0.9576
				Root MSE	=	.01202
InGDP	Coef.	Std.Err.	t	P> t	(95% conf. interval)	
InVAT	2.12439	.2562578	8.29	0.014	1.021808	3.226984
-cons	-24.21856	4.821549	-5.02	0.037	-44.96401	-3.47310
Source	SS	df	MS	Number of obs = 4		
Model	0.00218708	2	.001093542	F(2, 1)	=	81.69
Residual	.000013554	1	.000013335	Prob > F	=	0.0779
Total	.002200443	3	.000733482	R-squared	=	0.9939
				Adj R-squared	=	0.9818
				Root MSE	=	.00365
InVAT	Coef.	Std.Err.	t	P> t	(95% conf. interval)	
Insugar	.049145	.09669084	0.51	0.701	-1.182192	1.280483
Inmilk	.3910196	.0587869	6.65	0.095	-.3559391	1.137978
-cons	13.755501	.669165	20.56	0.031	5.252462	22.25756
Source	SS	df	MS	Number of obs = 4		
Model	.00219416	2	.001902794	F(2, 1)	=	175.47
Residual	6.2525e-06	1	6.2525e-06	Prob > F	=	0.0533
Total	.00220044	3	.00073348	R-squared	=	0.9972
				Adj R-squared	=	0.9915
				Root MSE	=	.0025
inVAT	Coef.	Std.Err.	t	P> t	(95% conf. interval)	
Inflour	.4713594	.0462025	9.78	0.065	-.141112	1.083831
Inoils	.0267159	.022112	1.30	0.418	-.2523706	.0398025
-cons	13.11336	.7557468	17.35	0.037	3.510639	22.71604
Source	SS	df	MS	Number of obs = 4		
Model	.0001714	1	.000171049	F(2, 1)	=	0.17
Residual	.0020293	2	.001014223	Prob > F	=	0.7212
Total	.0022004	3	.00073340	R-squared	=	0.0777
				Adj R-squared	=	-0.3834
				Root MSE	=	.03185
InVAT	Coef.	Std.Err.	t	P> t	(95% conf. interval)	
Inmillk	-.841218	2.046678	-0.41	0.721	-9.65683	7.974913
-cons	27.34504	20.77531	1.32	0.319	-62.0439	116.734

Source: STATA data

## 7. Conclusions

To enhance the role and the financial effect as well as the economic effect of value added tax in Kosovo should:

Continuing VAT escalation for luxury goods, services and consumer goods and better control by tax authorities.

The exemptions from the VAT calculation are as low possible and reduction of opportunities for evasion and avoidance.

Expansion of the tax base through the reduction of the value added tax threshold, reduction of gross margin for VAT payers, so bring Kosovo in line with the EU for the VAT threshold. Continuity of joint projects between the two main revenue collection agencies, Kosovo Tax Administration and Kosovo Customs towards functional integration and VAT collection within the country rather than at the border as it is now.

Fulfillment of objectives under the stabilization and association agreement with the EU in the field of taxes and VAT.

TAK modernization and capacity building in the field of risk management.

Reduction of customs tariffs for capital and reproductive material from 10% to 2% and their corresponding diversion. Also, the reduction of the VAT rate on imports of capital equipment and especially for investors.

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