Tax Revenues and Their Impact on Economic Growth - The Case of Kosovo

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Abstract: *The purpose of this paper deals with the role that tax revenue to economic growth. The economic, political and social development of any country depends on the amount of revenue collected in that country. One of the main sources of government revenues are taxes that the state uses as an effective means to achieve his political objectives. While, to generate these revenues towards long-term economic growth, economic experts should take measures to reform the tax system, if necessary. The impact of taxes on economic growth in this work will be shown from various aspects of the evidence theoretical authorities, which show significant effects of taxes on economic growth, while empirical evidence derived from multiple authors show results controversial and weak tax effect on economic growth. To see the impact of tax revenues to economic growth in Kosovo was used a regression analysis which has resulted in a positive impact of taxes on growth of GDP per capita, although this effect is very small. The analysis shows that only 9.2% of income per capita is affected by tax revenues.*

Keywords: *tax revenue, economic growth, tax rate, tax reform.*

1. Introduction

Economic growth is the main objective of the government because it is the basis of growth of welfare. Fiscal policy affects the rate of growth through the effects and impact in tax policy and public expenditure.

Taxation plays an important role in promoting economic growth: it generates the income necessary to finance the economic development policies of governments and creates a framework for the development of private sector activities (IMF, 2012).

To perform certain functions of its administration, governments in every country require the collection of sufficient resources from the economy, to ensure the distribution and use them responsibly, efficiently and effectively (OECD, 2004).

"In general, the art of government consists in collecting as much money from one class of the population, to transfer them to the benefit of another group" (Rosen. H, 2003).

One way for governments to contribute to the economic growth of their country is reforming their tax systems. These reforms should include amongst others the structure and tax rates in order to promote economic growth and prosperity. Tax reform is a continuous process of tax policy makers and tax administrators to reflect the appropriate tax systems and economic changes. In this regard, tax experts should in clear terms to say that the tax system should be reformed in order to reform the tax system to adapt to changing economic. In this way, since the establishment of the new tax system in Kosovo in 2000, tax reforms have been undertaken continuously. While reforms in tax rates that have been undertaken in Kosovo and European Union countries after the financial crisis of 2008 are deemed necessary by the experts to maintain economic stability and to create a sustainable economic growth. Therefore, the objective of this paper is to analyze the impact of tax reforms in Kosovo rates and compared them with those of the EU countries as well as to present the impact of these reforms on economic growth in Kosovo. While, the main question around which this paper focuses is how the political tax affects economic growth?

2. Review of Literature

The great contribution of the many theories of economic growth and factors influencing growth in recent decades has aroused great interest of economists to identify and explain the links between fiscal policy and economic growth. The conclusions arising from the theory has been accepted by all, however, empirical results suggest different conclusions emerge. The following will appear a number of theories and results of empirical studies on the effect of taxes on economic growth.

Taxes occupy the largest share of revenues of the state budget. They are not an end in itself and can not be only for the state resources inflows. With them and through them their governments implement policies in the service of progress and development of economy, culture and social life (Bundo, 2007).

By Dwivedi economic growth is steady growth per capita. This means that the rate of growth in total output should be greater than the rate of population growth. The study of economic growth through tax reforms in OECD countries show that economic growth as measured by GDP per capita has a significant effect on the generation of government revenues, to take social costs desirable that they will translate into economic growth manufacturing and real per capita basis (Ogbonna, 2012).

Several empirical studies done on the impact of taxes on economic development by Engen and Skinner, the results of their studies show that the effects of a modest growth of 2-3% show a response to a major reform. They stated that such small effects can have a significant impact on living standards.

An analysis of the relationship between tax rates and economic growth were developed by Mendoza, Milesi-Ferreti, and Asea in 1997 and their findings were when the regression is included GDP - the default, tax rates are irrelevant. An opposite result had given Leibfritz findings, Thornton and Bibbee (1997), the regression of the sum of the growth rate for the OECD countries in the period 1980-1995 shows that measures to increase the tax rate that reduces the rate of growth economic. They come to the conclusion that an increase in the tax rate to 10% reduces the growth rate to 0.5%, and reduce direct taxes increased by more than indirect taxes. While Dowrick (1993) and De la Fuente (1997) showed how fiscal policy affects the structure of economic growth, most specifically they investigated how the rate is linked to the composition of economic growth and spending levels. Results from Fuente show that if public spending (as a share of total expenditure to GDP) grow, then the growth rate reduced and explains that an increase in government spending of 5% of GDP reduces the growth rate 0.66 %. Dowrick study tax revenues of several OECD countries and showed that personal income tax has a negative impact on economic growth, while taxes on corporate income does not have any effect on economic growth (Myles, 2000).

Ploser (1992), reported a strong empirical link between taxation and economic growth. He had calculated the correlation between the growth rate of GDP per capita and tax OECD countries, and found that a portion of the proceeds, income from profit had negative correlation of -0.52 in the rate of growth GDP. Koester and Kormendi (1989) found that increasing marginal tax rates lead to negative effects on economic activities. Also a similar model have used Mullen and Williams (1996) for the US and concluded that lower marginal rates of taxation have a significant positive impact on economic growth (Myles, 2009).

Gordon and Lee (2005) in their studies have found that high rates of personal income tax has insignificant effect on economic growth. A trivial effect of higher tax rate than the incomes in personal growth have also found Katz, Mahler and Franz (1983).

The empirical results of Levin and Wright (2004) have shown that higher tax rates force manufacturers to lower the prices of their products before taxes as an answer to the high rates of tax, for the reduction of prices is profitable to the fact that absorbs a tax. In such cases, therefore, higher tax rates are detrimental to governments because they cause loss of taxes, but may not always be the case. The reason is that high tax rates can either raise or lower pre-tax prices depending on demand and cost of the product.

3. Tax reforms in Kosovo and in EU-27 countries

The tax system in Kosovo after the war continuously since 1999, has undergone reforms in the structure as well as the tax rate. Reforms of tax rates in 2009 were made with the aim of increasing the taxable base, increasing investment and reducing tax evasion to contribute to economic development.

Recent reforms of tax systems in the EU countries in 2011 and 2012 are driven typically by the need to restore sustainable growth, medium and long term, after the financial and economic crisis that began in 2008 and which has resulted with a deterioration of public finances in many EU countries. Therefore, most member states began taking fiscal consolidation measures include cuts in public spending on the one hand, and increase tax revenues to the other side (European Commission, 2012).

An important feature of the tax system in many countries is the dominance of consumption taxes or indirect taxes in general. Consumption taxes account for more than half of total government revenues in the poorest countries, personal taxes 30%, while taxes on corporate income 13% (Agenor, et.al, 2012). The structure of tax revenues in Kosovo and in 27 countries of the EU will be presented by the following tables:

TABLE I: Tax structure in Kosovo, as % of GDP

Description Structure /Year	2005	2006	2007	2008	2009	2010	2011	2012	2013
Indirect Taxes	**19.60**	**16.14**	**17.69**	**18.27**	**18.04**	**19.91**	**20.59**	**19.68**	**18.78**
Value Added Tax	9.86	8.29	9.49	10.08	10.35	11.66	11.77	11,10	10.72
Excise	6.70	3.70	3.89	3.64	3.81	3.89	4.35	6.13	5.76
Customs Taxes	3.04	4.15	4.31	4.55	3.88	4.36	4.47	2.45	2.32
Direct Taxes	**3.40**	**3.85**	**3.99**	**4.45**	**3.11**	**2.66**	**3.02**	**3.08**	**2.99**
Personal Income Tax	2.25	2.85	2.05	2.17	2.01	1.76	1.75	1.77	1.73
Corporate Income Tax	1.15	1.00	1.94	2.28	1.10	0.90	1.27	1.31	1.26
Total:	**23.00**	**19.99**	**21.68**	**22.72**	**21.15**	**22.57**	**23.61**	**22.76**	**21.79**
Pensio**n Contribution**	**2.12**	**1.83**	**1.93**	**2.01**	**2.07**	**2.34**	**2.39**	**2.20**	**2.29**

Source: Tax Administration of Kosovo (TAK); Statistical Agency of Kosovo (SAK); Ministry of Finance of Kosovo (MFK); International Monetary Fund (IMF); World Bank (WB).

Note: Value Added Tax entered VAT collected at the border and VAT collected from customers in the country; Pension Contributions are not part of the budget revenues in Kosovo, but they are managed by the Kosovo Pension Trust.

As shown in Table 1 includes indirect taxes an average of 18.74% of GDP for the period from 2005 to 2013, while direct taxes fall by an average of 3:40% of GDP for the same period.

TABLE II: Tax structure in the EU-27, as % of GDP

Description Structure /Year	2000	2002	2004	2006	2008	2010	2012
I**ndire**c**t Taxes**	**13.50**	**13.20**	**13.20**	**13.40**	**12.90**	**12.90**	**13.30**
Value Added Tax	7.00	6.70	6.60	6.80	6.80	6.90	6.90
Excise&Consum Taxes	2.70	2.70	2.60	2.50	2.30	2.40	2.40
Customs Taxes&Other	3.80	3.80	3.90	4.10	3.70	370	4.00
Direct Taxes	**13.00**	**12.10**	**11.90**	**12.60**	**12.70**	**11.80**	**12.70**
Personal Income Tax	9.10	8.70	8.30	8.50	8.90	8.70	9.20
Corporate Tax& Other	3.90	3.40	3.60	4.10	3.80	3.10	3.40
Pension Contribution	**14.50**	**14.30**	**14.30**	**14.10**	**14.10**	**14.40**	**14.60**
Total	**40.90**	**39.50**	**39.20**	**40.00**	**39.60**	**39.00**	**40.40**

Source: Commission Services

As shown in the table above in the EU-27 countries the participation of taxes in GDP is 40.4% in 2012, the share of indirect taxes is 13.3%, direct taxes 12.7%, pension contributions 14.6%. It is important to note that the types of special participation tax to GDP in EU countries over the years has changed little. But if we compare this tax structure with that of Kosovo we see: indirect taxes in Kosovo are much higher participation 18.8% in 2013; direct taxes in Kosovo are very low 2.99 compared with the EU countries; income from social contributions participatory also extremely low 2.29 although they are not part of GDP, but is managed by an independent body called Savings Trust. Pension assets held in personal accounts of individuals who pay them.

3.1. Reforms of tax rates in Kosovo and the EU-27

The financial and economic crisis that began in 2008 has resulted in a deterioration of public finances in many countries including the EU. Consequently, fiscal policies in 2011 and 2012 are typically driven to bring public finances on a sustainable path. However, tax reforms in the EU in 2011 and 2012 are the answer in the necessary consolidation of public finances, including the revenue side, which is reflected in the increase of the tax burden in general, including social security (European Commission, 2012). Reforms in tax rates in Kosovo after the 2008 crisis resulted in major reductions in tax rates, unlike many other countries that raised tax rates. A reflection of these reforms will be presented in the following tables:

TABLE III: Tax rates in Kosovo, in%

Description	Before reforms (December 2008)	After reforms (From January 2009)
Value Added Tax	15 %	16 %
Personal Income Tax	0 % 5 % 10 % 20 %	0 % 4 % 8 % 10 %
Corporate Income Tax	20 %	10 %

Source: Tax Administration of Kosovo

As shown in the table, the tax rate of VAT that there had been major changes, it increased by 1% in 2009. The proportional tax rates on personal income, suffered changes to their bases. After 1 January 2009, those changes include: For annual income up to 960 €, tax rate does not change, it is 0%; For annual income from 960 to 3000 €, tax rate varies from 5% to 4%; For annual income from 3000 to 5400 €, tax rate varies from 10% to 8%; For the annual income tax rate on 5400 €, tax rate varies from 20% to 10%.

TABLE IV: Tax rates on personal income in the EU-27, in %

Description	**Tax rates on Personal Income**					
Country/Years	2000	2005	2010	2011	2012	2013
Belgium	60.6	53.7	53.7	53.7	53.7	53.7
Bulgaria	40.0	24.0	10.0	10.0	10.0	10.0
Czech Republic	32.0	32.0	15.0	15.0	15.0	22.0
Denmark	62.9	62.3	55.4	55.4	55.4	55.6
Germany	53.8	44.3	47.5	47.5	47.5	47.5
Estonia	26.0	24.0	21.0	21.0	21.0	21.0
Ireland	44.0	42.0	41.0	41.0	41.0	41.0
Greece	45.0	40.0	49.0	49.0	49.0	46.0
Spain	48.0	45.0	43.0	45.0	52.0	52.0
France	59.0	53.5	45.8	46.7	46.8	50.2
Italy	45.9	44.1	45.2	47.3	47.3	47.3
Cyprus	40.0	30.0	30.0	30.0	38.5	38.5
Latvia	25.0	25.0	26.0	25.0	25.0	24.0
Lithuania	33.0	33.0	15.0	15.0	15.0	15.0
Luxemburg	47.2	39.0	39.0	42.1	41.3	43.6
Hungary	44.0	38.0	40.6	20.3	20.3	20.3
Malta	35.0	35.0	35.0	35.0	35.0	35.0
Netherlands	60.0	52.0	52.0	52.0	52.0	52.0
Austria	50.0	50.0	50.0	50.0	50.0	50.0
Poland	40.0	40.0	32.0	32.0	32.0	32.0
Portugal	40.0	40.0	45.9	50.0	49.0	56.5
Romania	40.0	16.0	16.0	16.0	16.0	16.0
Slovenia	50.0	50.0	41.0	41.0	41.0	50.0
Slovakia	42.0	19.0	19.0	19.0	19.0	25.0
Finland	54.0	51.0	49.0	49.2	49.0	51.1
Sweden	51.5	56.6	56.6	56.6	56.6	56.6
Britain	40.0	40.0	50.0	50.0	50.0	45.0
Total (Average)	**44.8**	**40.0**	**37.9**	**37.6**	**38.1**	**38.9**

Sources: Eurostat (European Commission, 2014)

As shown in the table above most countries in the EU have significantly reduced tax rates on personal income in 2013 compared with 2000, and if the tax rates applied in 2013 compared to 2010, we see that only 4 countries the EU (Greece, Latvia, Hungary and the UK) have lowered tax rates; many countries of the EU (Czech, Spain, France, Italy, Cyprus, Luxembourg, Portugal, Slovenia, Slovakia and Finland) have raised tax rates, while tax rates on personal income to 13 other countries in the EU have remained unchanged.

However, if the tax rates in the personal revenues are in the EU countries we compare with those of Kosovo in the EU see that they are extremely higher. While, the average rate of personal income tax for all EU countries in 2013 was 38.9%, in Kosovo high rates of progressive personal income tax is 10%.

TABLE V: Tax rates on corporate income in the EU-27, in %

Description	Tax rates on Corporate Income					
Country/Years	2000	2005	2010	2011	2012	2013
Belgium	40.2	34.0	34.0	34.0	34.0	34.0
Bulgaria	32.5	15.0	10.0	10.0	10.0	10.0
Czech Republic	31.0	26.0	19.0	19.0	19.0	19.0
Denmark	32.0	28.0	25.0	25.0	25.0	25.0
Germany	51.6	38.7	29.8	29.8	29.8	29.8
Estonia	26.0	24.0	21.0	21.0	21.0	21.0
Irland	24.0	12.5	12.5	12.5	12.5	12.5
Greece	40.0	32.0	34.0	30.0	30.0	26.0
Spain	35.0	35.0	30.0	30.0	30.0	30.0
France	37.8	35.0	34.4	34.4	36.1	36.1
Italy	41.3	37.3	31.4	31.4	31.4	31.4
Cyprus	29.0	10.0	10.0	10.0	10.0	10.0
Latvia	25.0	15.0	15.0	15.0	15.0	15.0
Lithuania	24.0	15.0	15.0	15.0	15.0	15.0
Luxemburgu	37.5	30.4	28.6	28.6	28.6	29.2
Hungary	19.6	17.5	20.6	20.6	20.6	20.6
Malta	35.0	35.0	35.0	35.0	35.0	35.0
Netherlands	35.0	31.5	25.5	25.0	25.0	25.0
Austria	34.0	25.0	25.0	25.0	25.0	25.0
Poland	30.0	19.0	19.0	19.0	19.0	19.0
Portugal	35.2	27.5	29.0	29.0	31.5	31.5
Romania	25.0	16.0	16.0	16.0	16.0	16.0
Slovenia	25.0	25.0	20.0	20.0	20.0	17.0
Slovakia	29.0	19.0	19.0	19.0	19.0	23.0
Finland	29.0	26.0	26.0	26.0	24.5	24.5
Sweden	28.0	28.0	26.3	26.3	26.3	22.0
Britain	30.0	30.0	28.0	26.0	24.0	24.0
Totali (Mesatarja)	**31.9**	**25.5**	**23.7**	**23.4**	**23.5**	**23.0**

Source: Eurostat (European Commission, 2014)

As shown in the table above almost all EU countries that have significantly reduced tax rates on corporate income in 2013 if they are compared with 2000, and if the tax rates applied in 2013 compared with 2010 seeing that only five EU countries (Greece, Slovenia, Finland, Sweden and the UK) have lowered tax rates; 4 from EU countries (France, Luxembourg, Portugal and Slovakia) had raised tax rates, while tax rates on corporate income in the 18 other EU countries that have remained unchanged. However, if tax rates on corporate revenues are applied in EU countries compare with those of Kosovo in the EU see that they are very high. While the average rate of corporation tax for all EU countries in 2013 was 23%, in Kosovo this rate is 10%.

TABLE VI: Tax rates on Value Added Tax in the EU-27, in %

Description	Tax Rates on Value Added Tax					
Country/Years	2000	2005	2010	2011	2012	2013
Belgium	21.0	21.0	21.0	21.0	21.0	21.0
Bulgaria	20.0	20.0	20.0	20.0	20.0	20.0
Czech Republic	22.0	19.0	20.0	20.0	20.0	21.0
Denmark	25.0	25.0	25.0	25.0	25.0	25.0
Germany	16.0	16.0	19.0	19.0	19.0	19.0
Estonia	18.0	18.0	20.0	20.0	20.0	20.0
Irland	21.0	21.0	21.0	21.0	23.0	23.0
Greece	18.0	19.0	23.0	23.0	23.0	23.0
Spain	16.0	16.0	18.0	18.0	18.0	21.0
France	19.6	19.6	19.6	19.6	19.6	19.6
Italiy	20.0	20.0	20.0	20.0	21.0	22.0
Cyprus	10.0	15.0	15.0	15.0	17.0	18.0
Latvia	18.0	18.0	21.0	22.0	22.0	21.0
Lithuania	18.0	18.0	21.0	21.0	21.0	21.0

Luxemburgu	15.0	15.0	15.0	15.0	15.0	15.0
Hungary	25.0	25.0	25.0	25.0	27.0	27.0
Malta	15.0	18.0	18.0	18.0	18.0	18.0
Netherlands	18.0	19.0	19.0	19.0	19.0	19.0
Austria	20.0	20.0	20.0	20.0	20.0	20.0
Poland	22.0	22.0	22.0	23.0	23.0	23.0
Portugal	17.0	21.0	21.0	23.0	23.0	23.0
Romania	19.0	19.0	24.0	24.0	24.0	24.0
Slovenia	19.0	20.0	20.0	20.0	20.0	20.0
Slovakia	23.0	19.0	19.0	20.0	20.0	20.0
Finland	22.0	22.0	23.0	23.0	23.0	24.0
Sweden	25.0	25.0	25.0	25.0	25.0	25.0
Britain	18.0	18.0	18.0	20.0	20.0	20.0
Totali (Average)	**19.2**	**19.6**	**20.4**	**20.7**	**21.0**	**21.2**

Sources: Eurostat (European Commission, 2014)

As shown in the above table, the average tax rates of tax on value added in the countries of the EU countries, in 2013 compared with 2000 followed an increase of 2%, and if the tax rates applied in 2013 compared with 2010 see EU countries as Qekia, Ireland, Spain, Italy, Cyprus, Hungary, Poland, Portugal, Greece, Slovakia, Finland, and Britain had raised tax rates, increase ranging from 1-3%; none of the EU countries had not reduced tax rates in this period, while the VAT tax rates than in other EU countries that have remained unchanged. However, if VAT rates in EU countries compare with those of Kosovo, in the EU see that they are significantly higher. While the average rate of VAT for all EU countries in 2013 was 21.2%, in Kosovo this rate is 16%.

4. The performance of tax revenues in Kosovo

To better understand the performance of tax revenues and the level of their revenues to the state budget, through graphs next presented internal revenues tax (tax on personal income, corporate income tax, tax on value added) conducted by the million years, the growth rate of these revenues over the years in% and the attendance of such proceeds in the Kosovo budget, in %.

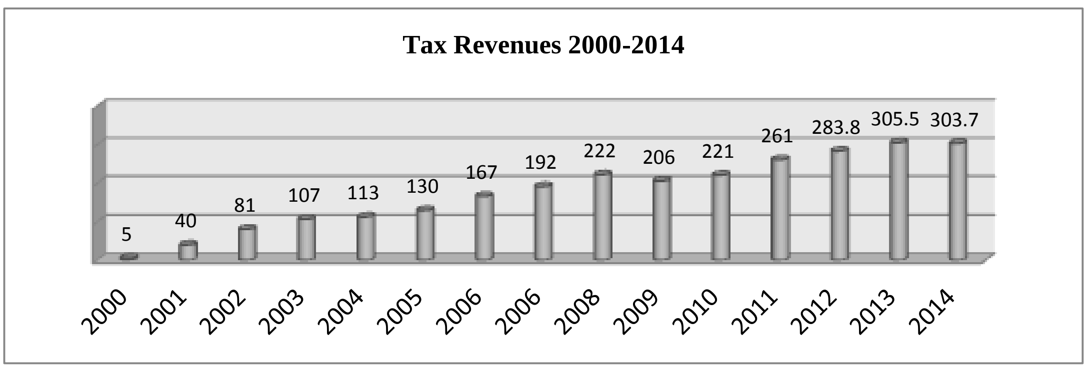

Fig. 1: Tax revenues realized in Kosovo by years, in mil. €

Sources from the Kosovo Tax Administration show as: Fig. 1 clearly show the progress of income tax each year. With the exception of 2009 and 2013, the other over the years indicates an increase in tax revenues compared to previous years, but that is insufficient and too small in comparison with EU countries. But, annual growth of tax revenues is much lower after application of reforms in the tax rate reduction in January 2009. Since, precisely in 2009 had decreased from 7.20 % in the realization of income tax.

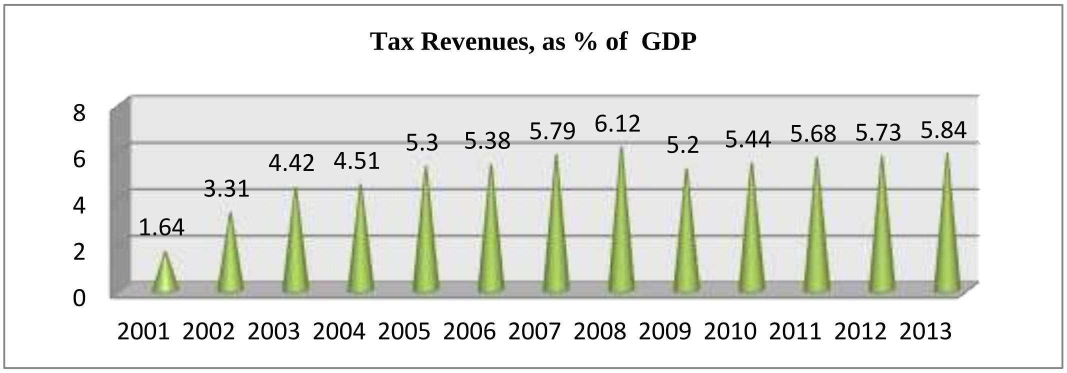

Fig. 2: Tax revenues in Kosovo by years, as% of GDP

Sources from TAK, SAK, MFK, IMF and World Bank, as shown in Figure 3, the total revenue of the state budget, tax revenues participate with 5.84 %, in 2013. The same amount also observed in previous years, with any small difference. This shows a very low level of participation in tax revenues in the state budget revenues in Kosovo, which is a very low turnout compared to other countries in the region and EU countries.

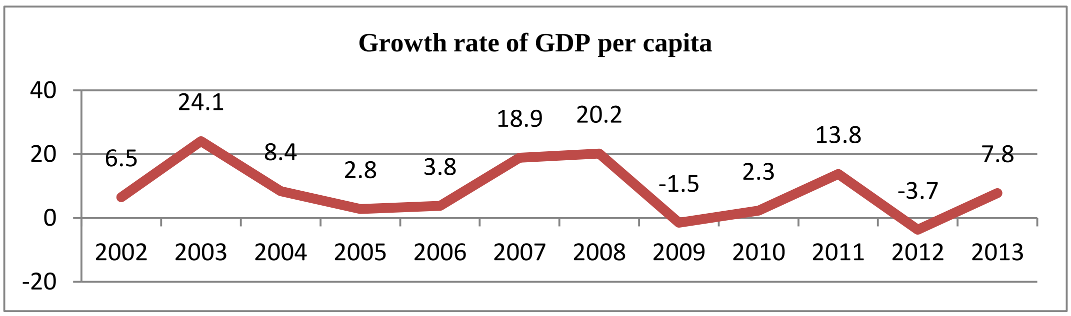

Fig. 3: Annual growth rate per capita from 2002 to 2013, in %

5. The Results of Empirical Analysis

To see the role of tax revenue to economic growth is using a regression analysis. The data obtained in the study belong to periods 2002 - 2013 and are annual. The data are limited to the period 2002-2013 because since 2002 they settled the tax bases of the new tax system in Kosovo. To have a clearer idea about the performance of the variables over the years, their values are summarized in Figure 1 (independent variable) and in Figure 4 (the dependent variable).In equation regressive tax revenues expressed in euros were defined as independent variable, while economic growth per capita, expressed in percentage was defined as the dependent variable. Initially seen the degree of correlation between the values of two variables. Correlation is positive but showing a weak correlation between the variables ($r = .303$). The regression equation (in our case the logarithmic model) showed no statistically significant amount $F(2,6) = .304$, $p = .749$, with mass explanatory power for only $R2 = 9.2\%$. The results showed that only 9.2% of the level of economic income can be explained by the values of tax revenues, while 91.8% of the level of economic income is explained by other factors. In our case:

$$y = -31{,}636 -0{,}001 +0{,}372 \quad (1)$$

The results derived in this paper show that the impact of taxes on growth is very small and consistent with the findings of some other authors who have studied these factors, and are inconsistent with the findings of others, the analysis of which have not found impact of taxes on economic growth.

6. Conclusions and Recommendations

To achieve his goal, this paper presents some theoretical views and empirical studies focused on the impact of taxes on growth. Theoretical views, almost are acceptable to all. While, empirical studies are highly controversial. The contribution of fiscal policy is crucial to the stabilization of macroeconomic variables and economic growth in general. Making appropriate fiscal measures is very important, something that did not happen in the case of Kosovo. Fiscal reforms that were undertaken in 2009 in terms of drastic reduction of tax rates had a negative impact on the realization of revenues necessary for the state budget. Reducing tax rates by policymakers was to increase the tax base, attracting foreign investors and reducing tax evasion, but these did not materialize. During, these years the growth rate of revenue was lower in some years there was a negative trend, showed the trend of declining investments, while tax evasion is on the rise. The tax rates are very low compared with those of the EU countries, the structure of income tax is different, since the EU dominate direct taxes, indirect taxes dominate in Kosovo. Participation of taxes versus GDP in Europe reaches over 40%, while in Kosovo, it is 6%. Regarding the impact of taxes on growth in different countries, there are many empirical studies, which have a wide variance of results. This is explained by variables that are taken into consideration, the selected sites which can be developed economy, or developing or heterogeneous choice of countries included in the study. Most studies have shown a very small impact of taxes on economic growth. One such effect have produced the results emerging from this paper, in Kosovo. The empirical results show that only 9.2% of income per capita is affected by tax revenues. Given the findings in this paper, it is recommended as follows:

- To consolidate fiscal policy in terms of increased tax rates. They should be equated not with the developed countries of the EU but to approximate the tax rates of the countries of the region.
- To Become major reforms in public administration, in terms of increasing working efficiency and to act as the rule of law for public officials as well as businesses involved in illegal activities, including tax evasion.

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