Taxation

- A critical discussion of the present tax system in Kosovo

Authors:  Egzona Gash
          Civilekonoprogrammet

Tutor:  Lars Andersson
Examiner:  Domonique Anxo
Subject:  Taxation
Level and semester:  Bachelor, Spring 2011
Abstract

Title: Taxation - A critical discussion of the present tax system in Kosovo

Institution: School of Business and Economics

University: Linnaeus University

Aim: The aim of this thesis is to characterize and critically discuss the present tax system in Kosovo, keeping in mind the fundamental problems presented in weak tax bases, informal economies, ethnic controversy and limited inflow of FDI in the country. Further, contributing with alternative designs of the tax system and argue advantages and disadvantages of these designs.

Method: The thesis will attempt to relate the descriptions and analysis of the tax system in existing and essentially established theory. Further a case study is performed using of quantitative, secondary data available on taxes in transition, with the purpose to enhance the understanding of tax systems in transition, and apply the knowledge on the case of Kosovo.

Conclusion: The corporate taxation should not be much lowered in the present, however, in the future a lowering of the corporate taxation could help bring up the employment level. The government should further consider inferring contribution and payroll taxes to broaden the tax base. The indirect taxation rate should not be increased in the long term, but the country has the opportunity to increase the VAT rate to 17 percent in shorter terms. A progressive, territorial tax system, with a deduction of taxation of roughly 80 Euros per month in income tax should be kept.

Keywords: Tax-policy, efficiency, allocation, transition, base, reform
Abbreviations

CIS: Commonwealth of Independent States
CSB: Central and Southeastern Baltic’s
EU: European Union
FDI: Foreign direct investments
GDP: Gross Domestic Product
IMF: International Monetary Fund
LFS: Labors Force Survey
NATO: North Atlantic Treaty Organization
OECD: Organization for Economic Co-operation and Development
PPP: Purchasing Power Parity
UN: United Nations
UNMIK: United Nations Mission in Kosovo
VAT: Value Added Tax
Table of content

1. Introduction .................................................................................. 6
   1.1 Historical background ................................................................. 6
   1.2 The present conditions in Kosovo .................................................. 7
   1.3 Problem discussion ...................................................................... 8
      1.3.1 Research question ................................................................. 9
   1.4 Aims and delimitations ................................................................. 9
   1.5 Method ........................................................................................ 10

2. Previous experiences .............................................................. 11
   2.1 The case of Estonia & Latvia ......................................................... 11

3. Theory ..................................................................................... 13
   3.1 Basic taxation concepts ............................................................... 13
   3.2 The four purposes of taxation ....................................................... 14
      3.2.1 Revenues ............................................................................... 15
      3.2.2 Redistribution ...................................................................... 15
      3.2.3 Reprising ............................................................................... 16
      3.2.4 Representation .................................................................... 16
   3.3 Budget deficit and political decisions ......................................... 17
   3.4 Socioeconomic optimal taxation .................................................. 18
      3.4.2 Tax and the welfare loss ......................................................... 19
      3.4.3 Balancing the efficiency and allocation goals ......................... 21

4. Kosovo and it’s tax system ....................................................... 22
   4.1 Kosovo ........................................................................................ 22
      4.1.1 Unemployment and manufacturing industry .............................. 23
      4.1.2 Black markets ...................................................................... 25
   4.2 Kosovo’s tax system ................................................................. 26
      4.2.1 Corporate income tax ............................................................. 27
      4.2.2 Personal income tax ............................................................. 28
      4.2.3 Value Added Tax, VAT ......................................................... 29
5. Taxing in transition ................................................................. 32
   5.1 Methodology ....................................................................................................................... 32
   5.2 The transition ..................................................................................................................... 32
       5.2.1 Public expenditure and taxing.................................................................................. 32
       5.2.2 Characteristics of the tax systems ........................................................................... 34
           5.2.2.1 Cross sectional comparisons ......................................................................... 34
           5.2.2.2 A comparisons over time ............................................................................ 35
           5.2.2.3 A visual perspective of the tax transition....................................................... 36
       5.2.3 Benchmark levels of indirect tax, income tax and security contribution and payroll tax ............................................................................................................................................. 38
   5.3 Taxation and investment climate ............................................................................... 39
       5.3.1 Taxation and Foreign direct investments ............................................................... 40

6. Result discussion ......................................................................................... 42

7. Conclusion ................................................................................................. 47
   7.1 Suggestions for further studies....................................................................................... 48

8. References ..................................................................................................... 49
   8.1 Electronic sources ............................................................................................................. 49
   8.2 Scientific sources .............................................................................................................. 51
   8.3 Literature sources: .......................................................................................................... 52
   8.4 Figure sources:............................................................................................................... 52

Appendix............................................................................................................ 54
# Table of figures

Figure 2.1, The Conflicts of interest are restricting the possibilities of economic policy…………………………………………………………………………………………………19  
Figure 2.2, Taxes socio-economic effects…………………………………………………………………………………………………………………………………..21  
Figure 4.1, Kosovo Labor force survey ………………………………………………………………………………………………………………………………………………….25  
Figure 4.2, Structure of budget revenues……………………………………………………………………………………………………………………………………………28  
Figure 4.3, The Corporate income tax…………………………………………………………………………………………………………………………………………………………….29  
Figure 4.4, The Personal income tax……………………………………………………………………………………………………………………………………………………………30  
Figure 4.5, Taxes in Kosovo……………………………………………………………………………………………………………………………………………………………………31  
Figure 4.6, Overview of the tax system in the region……………………………………………………………………………………………………………………………………32  
Figure 5.1, Public expenditure and income level per capita in transition countries……………………………………………………………………………………………………………………………………………………………………………………………..34  
Figure 5.2, The tax transition…………………………………………………………………………………………………………………………………………………………………………38  
Figure 5.3, Main Recipients of Foreign Direct Investment, 1992–95 and 1996-1999…………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………..42
1. Introduction

In order to establish fundamental points of departure for the description and analysis, and to be able to specify and delimit the corresponding purposes, present conditions in Kosovo and their background in recent history is clarified.

1.1 Historical background

In the early 1990’s, Kosovo was a province within the federal republic of Yugoslavia, ruled by Yugoslavian president Slobodan Milošević. Milošević decided to substantially decrease the degree of autonomy previously, since 1969, enjoyed by Kosovo. The ethnic Albanians, making up the great majority in the province, protested. They wished for an independent Kosovo, but their corresponding declaration of independence was not recognized by any other country, besides their close neighbour Albania. Milošević answered by intensifying the already apparent discrimination and repression of the Albanians in Kosovo, who made efforts to uphold an own society and acted as if Kosovo was independent of the Belgrade regime. During the course of the 1990’s the conclusion that an armed uprising had to be made grew among the Albanians and a guerrilla army was organized. The, since long existing, antagonism between different ethnic groups in Kosovo became even worse, especially between Albanians and Serbs.

At the end of the decade the vicious circle of violence and counter violence led to a state of war. International admonitions urged the Yugoslavian president to withdraw his military forces from Kosovo. In 1999, Milošević’s refusal to obey triggered devastating bombings of Serbia, carried out by North Atlantic Treaty Organization, NATO, military aviation. Milošević’s reacted by ordering the expulsion of a large number of ethnic Albanians from Kosovo. However, after three months of continued bombing he decided to withdraw his troops from Kosovo.¹

When the Serbs left the province, the United Nations, UN, marched in and Kosovo was taken over by the United Nations Mission in Kosovo, UNMIK. Their main tasks were to re-establish functioning social institutions in the province,

¹ [http://www.nato.int/kosovo/history.htm](http://www.nato.int/kosovo/history.htm), 030511
including a modernized tax system. Thus, the war resulted in many years of UN supremacy over Kosovo. However, in 17'\textsuperscript{Th} of February, 2008, Kosovo’s provisional parliament declared Kosovo as an independent nation.\textsuperscript{2} The unilateral declaration of independence became recognized by a large number of countries, including the USA and most European Union (EU) countries. Conversely, a likewise large number of countries around the world, following Serbia and Russia, have not yet recognized Kosovo’s independence.\textsuperscript{3} As a consequence, Kosovo has not yet become a UN member state. Its independence remains far from complete.\textsuperscript{4}

1.2 The present conditions in Kosovo

Kosovo has been under UN administration since the 1999 conflict and is the youngest state in Europe.\textsuperscript{5} The country is still facing challenges between different ethnic groups due to its past. Albanians, making up 92 percent of the population, and Serbs, Bosnians, Groan, Roma, Turkey etc making up the other 8 percent.\textsuperscript{6} The population in Kosovo is very young. It is estimated that 50 percent of the population is under the age of 25 and 40 percent under the age of 18. At the same time almost half of the population is living in relatively poverty, and a third of the relatively poor, 15 percent, are living in extreme poverty.

Further, Kosovo is facing great challenges in its economic development. The country has the lowest gross domestic product, GDP, in south east Europe and is the slowest growing economy. The unemployment rate is 45 percent, causing extended poverty since there is a lack of a constant income flow. Young people are hardest hit, with youth unemployment estimated to be 76 percent.\textsuperscript{7} Current growth rates are insufficient to absorb the new entrants into the labor market. The largest employer in terms of numbers is the agricultural sector, but it remains predominantly existence orientated. The private sector consists mainly of small scale and low capital intensive ventures in trade and construction. There is little domestic manufacturing.\textsuperscript{8} The massive trade deficit, 42 percent of GDP in April 2011,\textsuperscript{9} reflects the weak export capacity. Economic growth in the country highly depends on foreign direct

\textsuperscript{2} UNMIK, “Press Office, Press release 1628”, 10 January 2007
\textsuperscript{5} SDC, SECO, Swiss Cooperation Office Prishtina, “Cooperation strategy, Kosovo 2009-2012”, 2009, p 7
\textsuperscript{6} https://www.cia.gov/library/publications/the-world-factbook/geos/kv.html, 030511
\textsuperscript{7} http://www.globalpressinstitute.org/global-news/eastern-europe/kosovo/unemployment-rages-among-youth-kosovo/#ixzz1I6VZbFZl, 300311
\textsuperscript{8} SDC, SECO, Swiss Cooperation Office Prishtina, “Cooperation strategy, Kosovo 2009-2012”, 2009, p 7-8
\textsuperscript{9} http://www.state.gov/r/pa/ei/bgn/100951.htm, 030511
investments, FDI, which is limited. Foreign assistance and remittance make up for at least 22 percent of GDP. Kosovo is has a large group of advisors from the UN, the EU and other donors and international organizations and is still dependent of UNMIK and other organizations.

Improvements such as new labor laws and modest corporate taxes have been carried out and are commendable but do not solve the urgent issues, such as education, improvements of basic infrastructure from electricity to water sanitation, access to finance, and reliable legal framework and implementation of rule and law. The informal economy in the country is proven to be existing and large. Taxation crimes are among the most harmful crimes and it has been estimated that damages caused to the society by committing tax fraud are annually more than 100 million Euros. There is no existence of an efficient program to combat the black economy or specific policies and action plans for the prevention of money laundering.

There is a proven a challenge to be expected. The challenge is to construct a stable and sustainable economy. The economy should attract foreign investment, make use of resources efficiently and maintain a fiscal budget that can afford to provide public services. This requires the coordination of macroeconomics, fiscal- and tax policies.

1.3 Problem discussion
Like most of central and eastern Europe, Kosovo has been, and still is, undergoing a process of social, economic and political transformation. It is one of Europe’s poorest countries, with high unemployment rates and a poorly developed industrial production and agriculture. In addition, the country is facing challenges and disputes among different ethnic groups in the country, particularly, imminent controversy between Albanians and Serbs in Kosovo, still restricted to move pass its history.

Fundamental problems in Kosovo present itself in weak tax bases and informal economies. Taxes can benefits all of society and contribute to a more developed infrastructure. The entire society would benefit from a higher education
level and improved public health. There is a great need for public spending and transfers in the country, being one of the poorest in Europe. The challenge is finding stable tax bases that can provide significant tax revenues. Further, the taxation framework contributes to considerable extent. However, Kosovo’s weak institutions results in low enforceability and a growing informal economy which complicates the practical application of current regulations. The remaining uncertainty about the future status of Kosovo, along with the informal economy, weak institutions and the political instability contributes to a highly limited inflow of foreign direct investments.  

The current tax code has been said not to be an effective response to the economic and fiscal needs in the country. Currently, the tax base in Kosovo is not broad enough to fulfill its purpose. Over 50 percent of tax revenues are continued to be collected at the border. As more trade agreements with Kosovo’s neighboring countries are executed the current tax base system in Kosovo will erode. The author Melinda Bair expresses this by stating “It is not competitive enough to attract foreign investment. It does not promote compliance but instead invites litigation. It does not consider the nation’s regulatory and business culture”.  

1.3.1 Research question
The objective of the thesis is to characterize and critically discuss the present tax system in Kosovo, and to contribute to the discussion about the feasibility and appropriateness of some conceivable changes in this system in view.

1.4 Aims and delimitations
The main purposes of this thesis are to characterize and critically discuss the present tax system in Kosovo, keeping in mind the fundamental problems presented in weak tax bases, informal economies, ethnic controversy and limited inflow of foreign direct investments in the country. This is to be done with the use of established current concepts and approaches of tax theory.

17 Bair, Melinda, “Tax Policy as a Mechanism to Secure Kosovo’s Independence: A Proposal to Reform the UNMIK Tax Regulations”, 2007, section 2 
18 European Commission, “Kosovo* 2010 progress report”, 2010, p. 32 
19 Bair, Melinda, “Tax Policy as a Mechanism to Secure Kosovo’s Independence: A Proposal to Reform the UNMIK Tax Regulations”, 2007, section 2
On the basis of this description, further discuss to what extent and in what way this tax system is related, and takes into account, the fundamental problems. In addition, contributing with alternative designs of the tax system and argue advantages and disadvantages of these designs.

The study is limited to available information in this regard. In the case of alternative tax designs, the discussion is bounded to include one or more proposals brought forward in the debate. Further, corporate income tax, personal income tax, indirect tax and contribution and payroll tax are in focus.

1.5 Method
The thesis contains established theory of taxation and identifies the tax system of Kosovo. It will attempt to relate the descriptions and analysis of the tax system in existing, essentially established, relevant theory. Previous experiences, to illustrate that a change in the tax regime could contribute to an increase in growth and GDP, are briefly discussed below. The case of Estonia and Latvia are chosen and considered to be relevant since the two countries experienced an “independency battle”, when breaking out of the Soviet Union and formed independent countries. The Soviet Union can be compared to the Baltic area, in terms of similar languages and culture.

Further a case study is performed on quantitative, secondary data available on taxes in transition with the purpose to enhance the understanding of tax systems in transition and apply the knowledge on the case of Kosovo. The discussion is to result in alternative tax designs in the country Kosovo, with the specific problems of the country in view.
2. Previous experiences

To enhance the understanding of the papers objectives, previous experiences are briefly discussed.

2.1 The case of Estonia & Latvia

An effective tax policy can be defined by the taxes levied and the rates at which they are levied. Further by the international system of taxation. If countries would achieve the optimal tax policy, economic benefits would be obtained. Two such countries who managed to achieve this are Estonia and Latvia.

Estonia and Latvia are notable examples of nations with effective tax systems that have stimulated their economies. Prior 1991, the two former states of the former Soviet Union did not have independent economies. Before gaining their independence, the Baltic nations inherited stifled financial systems where an invasion of capital was needed and the industry had to be privatized. In tax policy, Estonia and Latvia rapidly moved to introduce comprehensive tax reforms. A powerful objective was the desire for accession to the EU. These reforms introduced modern tax systems similarly to those in place in EU countries, but also with individual features reflecting the circumstances of each country. They adopted a flat tax regime, maintained balanced budgets and pegged their currencies to Euro. Further, favorable laws for foreign investors where established with stunning results. As of 2006, Estonia was the biggest recipient per capita of foreign investments in Europe. Estonia, with 11, 6 percent growth rates in living standards, and Latvia, 7, 8 percent growth rates, enjoyed higher living standards with an increasing witnessed mortgage lending by 90 percent and the credit card lending doubled. However, Estonia got to experience the negative effect as well. In 2007 the economic machine in Estonia started to fall. And the previously bountiful banks pulled the brakes, the property went out of control, people began to keep in their wallets and the demand reduced. When the global financial crisis hit in 2008 the economy experienced a total halt in growth.

21 http://www.economist.com/node/8417995/story_id=E1_RQTSJY, 210411
23 http://www.economist.com/node/8417995/story_id=E1_RQTSJY, 210411
and until now the Estonian economy has fallen significantly, for approximately 20 percent with a large increase in the unemployment rate.\footnote{http://sverigesradio.se/sida/artikel.aspx?programid=3265&artikel=2452501, 080611}

Weather other nations will achieve similar success and face the same risks as Estonia and Latvia may depend on how successful they are at establishing a comprehensive plan of tax reform. Transition economies usually grows fast as part of convergence process, but transition economies with flat tax systems are growing more rapidly than those with a progressive tax rate. However, this may lead to a greater fall in the economic growth in bad times. According to the Economist Intelligence Unit flat taxes are successful when attempting to signal a move towards a free market, when being adopted as a part of a wider package of reforms. Flat tax systems are unlikely to undermine government revenues and the ultimate objective is often to increase their attractiveness to foreign investors.

The economic argument for implementing a flat tax is strong. However, weather economies actually adopt the flat tax will depend as much on political considerations, as economic ones. As a result, a flat tax regime is not the right system for every country.\footnote{Basham, Patrick, “Lessons from abroad; International evidence shows flat tax benefits ”, 2008, p. 13-15}
3. Theory

The theory consists of the explanation of tax and its purpose, objectives and effects on the society. The discussion results in the conclusion that the choice of tax design includes balancing the allocation and efficiency goals.

3.1 Basic taxation concepts

The rules and regulations regarding taxation are different in various countries and sometimes the classification of the type of tax is different as well. Taxes are a major source of income for a country, and they can broadly be categorized into two categories; direct tax and indirect tax. A direct tax is a tax imposed on the individual paying them, the taxpayer. Examples of direct taxation include property tax and income tax. The indirect tax, that is also known as collected tax, is collected by intermediaries. They eventually file a tax return and pass to the respective department. Examples of indirect taxes include Value Added Tax (VAT) and sales tax. The type of tax describes a class of a person taxed or a goods or service taxed. Common taxes levied are corporate income tax, personal income tax, value added tax, custom duties, rent withholding tax, excise tax and municipal property tax.

There are three different types of tax rates, progressive, regressive or flat. A progressive tax rate generally indicates a tax which rises with income. This can accomplished through a basic deduction or through a marginal tax rate, i.e. the tax on an additional income which increases with income. Progressive rates are based on the theory that individuals with higher income can afford to pay more tax than people with lower incomes, and as a result, progressive rates redistribute wealth. On the contrary, a regressive tax is when the tax rate decreases as the amount to witch the rate is assigned increases. Regressive rates result in a shift of tax liability from people with higher income to the ones with lower income. Flat tax refers to when the average tax is independent from the size of the income, according to the first definition. According to the second definition, it is when the marginal tax is

---

26 http://finance.mapsofworld.com/tax/ , 060411
27 http://www.finance-glossary.com/define/direct-taxation/413 , 060411
28 http://www.economywatch.com/budget/india/direct-taxes.html, 060411
29 Economic Initiative for Kosova, “Company foundation, taxes and employment law in Kosovo”, 2007 , p. 25
independent from the size of the income. 30

What constitutes a taxpayer’s taxable income and determines how it should be taxed is the method of taxation. The primary methods of taxation are the territorial system and the residence system. Under the territorial system capital income tax burden is dependent upon where the income is earned, and not upon the consumer’s country residence. On the contrary, under a residence system tax burdens depend upon country of residence and not where income is earned. All income earned abroad by a resident is taxed as if it was earned domestically. The territorial system encourages foreign investments. It enables foreign and resident taxpayers to compete on the same tax base. The residence system attempts to discourage domestic taxpayers from investing abroad. This can often result in double taxation to a multinational investor. 31

3.2 The four purposes of taxation

Taxes, as well as public spending, occur through policy decisions and are imposed on different legal entities and individuals by local authorities. Therefore both are a function of governmental commitment. 32 The regulations of taxation are complicated in nature and they are differing from one country to another. The taxation law settles on whom a tax should be imposed and the tax rate is the percentage on which a tax is imposed. 33

The taxation framework of a country contributes to the economy and finance to a significant extent. Taxes are imposed for four reasons, the four “R’s “. (i) Revenues are the main need for taxation. The money collected by governments in the process of taxation is spent for building social infrastructure and public utility investments. (ii) Redistribution refers to a balanced distribution of wealth among the sectors in a society. (iii) Reprising is used when imposing tax to control the consumption, like tobacco and alcohol and (iv) representation means that taxation represents accountability and improved governance. 34

33 Skatteväxlingskommiten, “Statens offentliga utredningar, Skatter, miljö och sysselsättning”, 1997, p 253-255
34 http://finance.mapsofworld.com/tax/, 060411
3.2.1 Revenues
The tax systems, fiscal, main task is to finance the public sector.\textsuperscript{35} The public sector concludes the part of the economy concerned with providing fundamental government services, and consists of public consumption and transfers.\textsuperscript{36} The public sectors operations include healthcare, schooling, welfare, transfers, child benefits, pensions etc., and are primarily financed by taxes. Some of the spending is also financed by different charges.\textsuperscript{37} The public sector can also provide services which benefit all of society instead of just the individual who uses the service, which non payers cannot be excluded from. Examples of such services are public parks, education or street lightning.\textsuperscript{38} High income earners usually pay significantly more in mandatory charges, than what is given back to them during sickness or unemployment, because there is a ceiling for the compensation amount.\textsuperscript{39}

There are two main reasons for these activities to be conducted in public management. The first one is the positive externalities that come with good healthcare and education. The second reason for operating these sectors in a public management is due to distributional motives. If healthcare, education and other similar activities are financed by taxes and are distributed for free or cheaply, the less prosperous citizens will have the opportunity to obtain good education and healthcare.\textsuperscript{40}

3.2.2 Redistribution
The second task of the tax system is to change the distribution of income and wealth that the market brings, and to allocate resources more evenly trough the population. This is done through a higher tax charged to high income- and wealthy citizens than to the less fortuned ones. It is also about partly reallocating between periods in individuals life. A higher tax is paid during higher income periods and contributions are received during periods with low income. Public transfers, being one of the main public welfare components are collected monetary funds in form of taxes that are immediately paid out again, primarily to households but also to companies and organizations. The transfers are reallocated such as pensions and child benefits.\textsuperscript{41}

\textsuperscript{35} Eklund, Klas, "Jakten på den försvinnande skatten: Globalisering och rörliga skattebasar", 1998, sid 12-13
\textsuperscript{36} \url{http://www.investorwords.com/3947/public_sector.html}, 120411
\textsuperscript{37} Eklund, Klas, "Jakten på den försvinnande skatten: Globalisering och rörliga skattebasar", 1998, sid 12-13
\textsuperscript{38} \url{http://www.investorwords.com/3947/public_sector.html}, 120411
\textsuperscript{39} Eklund, Klas, "Jakten på den försvinnande skatten: Globalisering och rörliga skattebasar", 1998, sid 12-13
\textsuperscript{40} Eklund, Klas, "Vår ekonomi: En introduktion till samhällsekonomin", 2010, sid 189-192
\textsuperscript{41} Eklund, Klas, "Vår ekonomi: En introduktion till samhällsekonomin", 2010, sid 189
How redistributive the tax system is differs between nations. In principle, the higher countervailing ambitions, results in higher taxes. High taxes, which are reallocated, necessarily mean high taxes on people with high incomes and great wealth. However, this assumes that these people allow themselves to be taxed. The dilemma is that in an gradually globalized economy, it is the wealthy and the highly paid that are becoming increasingly more mobile. When the wealthy threatens to move with its assets, it becomes more difficult to achieve redistributive goals.42

3.2.3 Reprising
The third task of the tax system is to influence the economic and social development over time. The state acts paternalistic, i.e. they have the desire to steer the behavior of the citizens towards a certain direction. It can be achieved through varying the tax rates over time, when trying to smooth the business cycle.43 Further, it can focus on combating certain kinds of environmentally harmful production or consumption, or on the contrary encourage the consumption or production of certain goods. This may include specific taxes on certain goods, such as tobacco or alcohol, that the legislature wants the public to consume smaller amounts of. It can be anything from carbon tax to food VAT. These taxes have an important function in that they can contribute to such negative environmental effects by taking them into account and internalizing the costs.44

International agreements referring to not discriminate foreign trade makes it harder to disfavor domestic producers through taxation. Increasingly border trade and smuggling are known means to avoid parliamentary paternalists. Globalization of production makes it possible for companies to mitigate energy- and environmental taxes by moving their production overseas. The national policy to intervene in its citizen’s behavior decreases with globalization.45

3.2.4 Representation
The tax systems sometimes conflicting objectives are to be met within the framework of the society law. The taxes are bound to obey certain legal principles and the economic side effects of taxes are to be minimized. They should preferably affect the

43  Ibid
44  Skatteverket, ”Skatter i ett ekonomiskt och historiskt perspektiv”, 200411, p. 18
45  Eklund, Klas, ”Jaktens på den försvinnande skatten: Globalisering och rörliga skattebaser”, 1998, sid 14-15
consumers, businesses and employed workers behavior so that no undesirable effects occur, such as slower growth, tax fraud or tax evasion.46

It is harder to predict the globalization effects on representation. Taking what has been said above into account, the increasingly mobile tax bases raises the difficulties to cope with all three requirements above, funding, reallocating and influencing, simultaneously. Goal conflicts arise inevitably with globalization and a typical example is the dilemma between the funding and the redistribution. If the highly paid and wealthy are in fact more mobile than the low paid, and threatens to move with its assets if higher taxes are implemented on them, the tax system will fail in both the capacity to fund the public sector and the task of allocating recourses. The solution of funding could be a tax cut for the rich on the expense of the poor, but at the price of less redistributive policies. If the redistributive task is prioritized, lowering the tax burden overall could be the solution.47

3.3 Budget deficit and political decisions
The fiscal policy has one main rule; to tighten governmental finances during good times and to expand during a recession. This refers to reduce the fluctuations in the economy, but there are some complications and limitations when the rule is translated into practice. If the public sector incurs deficits in order to boost the economies purchasing power, the deficit and its financing can have undesirable side effects. 48 A deficit occurs when expenditures are greater than revenues.49 Sometimes tax revenues are not enough to finance government spending. When the consolidated public sector incurs a budget deficit, the financial savings in the economy are reduced, which may cause a current account deficits, when imports exceeds exports.50 A growing public debt can contribute to opaque and possibly skewed distributional consequences.51

The macroeconomic situation is also dependent on political decisions. Figure 2.1 illustrates the solution area, the small coloured surface, in which the various interest groups demands are met.

46 Eklund, Klas, ”Vår ekonomi: En introduktion till samhällsekonomin “, 2010, p. 193
47 Eklund, Klas, ”Jakten på den försvinnande skatten: Globalisering och rörliga skattebaser “, 1998, p. 15
48 Eklund, Klas, ”Vår ekonomi: En introduktion till samhällsekonomin “, 2010, sid 189, 197
49 Ibid
50 Eklund, Klas, ”Vår ekonomi: En introduktion till samhällsekonomin “, 2010, p 197-198
51 Eklund, Klas, ”Vår ekonomi: En introduktion till samhällsekonomin “, 2010, p 199-200
Conflicts of interests are restricting the possibilities of economic policy. The freedom of action is restricted significantly partly because of the economic- and political measures must be economically sensible, and partly because the measures must meet different interest groups demands.  

3.4 Socioeconomic optimal taxation
A central point of view in theory of optimal taxation is the desire to construct an efficient tax system. The aim is for the tax system to provide a given tax revenue with little loss of efficiency and a fair income distribution. In addition to that taxes affect the resource distribution between private and public sector. They also affect the efficiency of private use of resources.

Taxes create a difference in what the buyer pays and what the seller receives. Distortional taxes raises so called tax wedges. Payroll tax is an example of tax wedges, as well as value added taxes. Distortions only arises for goods that households value positive and not for performance related taxes that are intended to reduce emissions and other things that do not contribute to the welfare of the individual households. Thus, performance related taxes have a true reversal effect on prices. A proposed finding to avoid the skewed effect on the economy is to use lump sum taxes. However, this creates difficulties in achieving a fundamental

References:
52 Ekonomiska rådets årsbok, 1998, Vad kan en finansminister göra?, s 61
54 Skatteverket, “Skatter i ett ekonomiskt och historiskt perspektiv”, 200411, p. 18
objective of taxation, redistribution, and can be perceived as unfair. Usually, the
optimal system of taxation combines a flat tax marginal tax rate with a lump sum
grant to all individuals, such as the average tax rate rises with income even as the
marginal tax rate does not. 56

A well-known theory for optimal taxation is referred to as the Ramsey
rule, named after an English economist Frank Ramsey. Under some restrictive
conditions Ramsey showed that commodity taxes are to be in inverse proportion to
the good’s price sensitivity. Products with low price elasticity should be relatively
higher taxed compared to products with higher price sensitivity. Note that products
with low price elasticity of demand are often so called necessities, such as milk,
potato, bread, etc., whose share of total expenditure is relatively high for low income
households. Taxation in accordance with Ramsey rule will thus affect poor
households more than rich, the tax incidence falls on the poor. 57 With a tax incidence
economists refer to who ultimately pays the tax. 58 A tax burden does not always
charge the one who seems to be paying the tax. Sometimes there exists opportunities
to pass the tax costs over on others. 59

3.4.2 Tax and the welfare loss

The socioeconomic tax cost can be considered as follows. Suppose that the
government pays back the tax revenue as a lump sum to firms and households. In
such case, should businesses and households accept the tax? Generally the answer is
no. In general, Households and firms’ total willingness to pay to avoid a distorted tax
excides the state tax revenues.

Assume that the market initially produced Q1 units before tax, at price
P1, and further that the circulation declined to Q2 units after tax, at price P3 (P2 +
tax). If firms and households would get the tax payments back for all units up to Q1,
the difference in quantity between Q2-Q1 needs to be discussed, only. Before the tax
was introduced, consumers were willing to pay producers to produce Q2-Q1 units.
The tax creates a wedge in the mutually beneficial contract between buyers and
sellers. The producers, more or less, lose the profit they otherwise would receive for
producing Q2-Q1. Similarly, the consumer loses the difference in what their
maximum would be willing to pay for Q2-Q1, and the price that would be paid if the

57 Finansdepartamentet, ”Statens offentliga utredningar, Skatter, miljö och sysselsättning”, 1997, p 272-273
58 Ibid
59 Finansdepartamentet, ”Statens offentliga utredningar, Skatter, miljö och sysselsättning”, 1997, p 273-274
tax did not exist. Producers lose what is referred to as producer surplus, illustrated by area BCE in the graph. While consumers, analogy seen, loses the consumer surplus for the same amount of units, illustrated by area ACE in the graph.\footnote{Ibid}

**Figure 2.2 Taxes socio-economic effects**

![Graph illustrating taxes socio-economic effects](image)

<table>
<thead>
<tr>
<th>LS = Supply</th>
<th>D = Demand</th>
<th>T = Tax</th>
</tr>
</thead>
</table>

Source: swlearning.com\footnote{http://www.swlearning.com/economics/nicholson/nicholson9e/quiz09/ch09.html, 250411}

The graph is illustrating the increase in the market price, the price of the buyer, simultaneously as the produced quantity and the sellers’ price decreases. Buyers and sellers share the burden of taxation in accordance with respective operator’s price sensitivity, while the economy works less efficiently. The efficiency loss, illustrated by area ABC in the graph, is direct linked to the shortfall in productivity. Goods that previously were profitable to produce are no longer offered on the market.

The distribution of the tax burden will differ in longer terms. The market prices tend to be driven down to the unit cost for the production. This leads to companies leaving the market because of not being profitable any longer and a falling supple. Thus, prices increase and the tax burden will completely fall on the households in longer terms.\footnote{Feldstein, Martin, 1999, pp. 674-680, "Tax Avoidance and the Deadweight Loss of the Income Tax", p. 675-676}

Some argue that small open economies should not impose source based tax, such as corporate income tax on capital income and are better off with lower tax rates. As capital is becoming more mobile and small economies are considered as price takers in the world capital market, capital cannot bear the incidence of taxation and are more sensitive to the tax. Firms would only continue to
invest within the country with source based tax if other factor prices, such as prices for land and labour, drop by enough to compensate the firms for the higher amount that have to be generated before tax and to provide the capital owners the going rate of return after tax. Controversially, large economies have an incentive to take advantage of their market power in world capital markets. 63

3.4.3 Balancing the efficiency and allocation goals

Different taxes can provide various high welfare losses. It is a fundamental notion behind the idea of the so called optimal taxation. The optimal taxation is levied in such way that the total efficiency loss is minimized. In theory this is possible, but in practise it is often difficult to design an optimal tax structure. In addition to administrative problems, the knowledge of the demand and supply price elasticises for different goods or services can be inadequate. Moreover, there needs to be an updating combination with the distribution policy objectives. If subscribing to the principle of horizontal equity is current, this suggests uniform taxes rates. If the principle of vertical equity instead is subscribed, a conflict can arise. It is then relatively common for necessities such as food, where the demand is relatively price inelastic as mentioned above, to constitute a large proportion of low incomes consumption. The actual tax policy needs to be balanced between efficiency and distribution objectives. 64 Next chapter will identify Kosovo’s present conditions and tax system.

4. Kosovo and it’s tax system

Chapter four identifies Kosovo’s current economic situation and its tax system.

4.1 Kosovo

Since the end of the conflict in 1999-2000, Kosovo has faced serious social problems. Today, Kosovo is an expectant country since the beginning of 2008. The country is facing challenges between different ethnic groups, especially between the ethnic Albanians and Serbs. Further, there is a remaining uncertainty about the future status of Kosovo, since it has not been recognized by all EU countries. The country still takes part in the cooperation EU has with various countries in the westerns Balkans and in a member of the International Monetary Fund, IMF. This may aim at a future membership in the EU.  

GDP reached 5.4 billion in 2011 according to the World Banks estimations. The EU is also the largest donor and supported Kosovo with 350 million euro between the years 2009-2011. Nearly 13 percent of the country's GDP consists of assistance and aid, and if including foreign remittance, it makes up for more than 22 percent of GDP. The country's constitution is in line with European standards and many of the laws are of international standards. The problem is that the capacity to implement them is low. The Government plans to take on measures, with the goal of being ranked within the 40 best countries for doing business until 2014.  

The economy in Kosovo is among the most open economies in the region. They are actively trying to improve the business environment and the investment climate to attract FDI. They have been able to privatize half of its government controlled enterprises by number, and 90 percent by value.

Given the lack of monetary policy instrument, fiscal policy is the main instrument for macroeconomic stability. Since 2008, the government started imposing a budget deficit and shifted towards an expansionary stance, this because Kosovo needed to address severe infrastructure and social gap in the country. To cover costs of implementing the proper institutions as a result of its independence was another
factor of the imposed deficit. And today, the government in Kosovo is facing a severe budget deficit. A draft budget that was submitted by the government for the year 2011 had a 370 million euro budget deficit in March, 2011, which represents around 7 percent of the GDP level. Last year IMF, granted a loan of 109 million Euros, expected over an 18 months period. Part of the money was expected to 2011 years budget, however, since the government violated an agreement with the IMF which stated to not have a budget deficit, this money are said not to be distributed. The lack of finance could bring Kosovo’s state institutions close to collapse. Further, the country faces a massive trade deficit of 42 percent of GDP in April, 2011. This reflects a weak export capacity.

The countries citizens are the poorest in Europe, with an annual per capita income of roughly 1 880 euro. At least half the country's population lives in rural towns where inefficient, near subsistence farming is common. This, as a result of small plots, limited mechanization and lack of technical expertise. The unemployment in Kosovo is a big economic issue and reaches to approximately 45 percent, with youth unemployment reaching 76 percent. The poorly developed manufacturing industry, migration and black markets are key concerns.

### 4.1.1 Unemployment and manufacturing industry

Since 2001, Statistical office in Kosovo has published data for the labor force in Kosovo. The employment level since 2001 has risen from 19.6 percent to 26.4 percent, in 2009, which indicates that unemployment has decreased. The figure below illustrates the unemployment and employment in the country during 2008-2009. The numbers in brackets represent the latest labors force survey (LFS), and conversely the numbers that are not in brackets represent LFS in 2008. It demonstrates that unemployment is continuously decreasing, while employment is increasing. The unemployment remains at high levels.

---

68 [http://www.rferl.org/content/kosovar_budget_deficit/2326599.html](http://www.rferl.org/content/kosovar_budget_deficit/2326599.html), 040511
69 [http://www.state.gov/r/pa/ei/bgn/100931.htm](http://www.state.gov/r/pa/ei/bgn/100931.htm), 030511
70 [http://www.state.gov/r/pa/ei/bgn/100931.htm#econ](http://www.state.gov/r/pa/ei/bgn/100931.htm#econ), 210411
71 Ibid
73 Statistical office of Kosovo, “Results of the labor force survey 2009”, 2010
Figure 4.1 Kosovo Labor force survey

Source: Statistical office of Kosovo, 2010

Basic concepts:
(1) Activity rates or labor force participation rate: percentage of the labor force in the working age population;
(2) Employment rate: percentage of employed persons in the working age population;
(3) Unemployment - population ratios: percentage of the unemployed persons in the working age population.
(4) Unemployment rates: percentage of unemployed persons in the labor force.
(5) Inactive persons

The agricultural sector is the biggest employer in terms of absolute numbers, though it remains subsistence orientated. Youth unemployment is particularly high as mentioned above, and female unemployment is very low, specified in the column employed persons. The long term unemployment is alarming in the country, as well. Apart from building materials, some furniture production and food processing sector,
the domestic manufacturing in Kosovo is poorly developed. The private sector consists of small scale and low capital intensive ventures in trade and construction.  

Economic migration is a widespread livelihood strategy, and has been for decades for the citizens of Kosovo. However, it is not easy to identify the patterns of migration in the country. According to LFS 2009, almost 41 percent of all males, age 15 years and above, and 65 percent of all females, age 15 years and above, had completed less than secondary school. Only, every twelve male and every sixteenth female has a college or university education. Further, for those who go to college, more than half expresses hopes to leave the country, which may cause a national "brain drain", the knowledge is taken out of the country.

4.1.2 Black markets

It is hard to quantify the extent of informal black economy. For the informal, it is necessary to stay hidden in order to exist. Informal, "black”, entrepreneurs occupied in illegal activities such as drug dealing, prostitution, human trafficking, smuggling, tax fraud or other financial crimes try to avoid criminal sanctions. By staying in the informal area of the economy or go formal through money laundering, criminal sanctions are avoided. These activities do not show up in the GDP measure. There is a need for increasing the ability to identify these types of crimes. The lowest levels of measured informal economy in the country is 26, 7- 34, 75 percent of GDP in 2006. Tax offences are financial crimes linked to the informal economy. It is estimated that damages caused to the society by committing tax fraud/evasion are annually more than 100 million Euros. Taxation crimes are among the most harmful financial crimes in Kosovo. It is presumed to be a component of organized crime. Production costs of corporations trying to avoid informal activities are increasing, as a result of inadequate collection of tax, which in turn results in the upholding of a high tax rate. A large scale informal economy is harmful to the government's fiscal interest and infrastructure of the society, due to declining tax income.

76 Statistical office of Kosovo, "Results of the labor force survey 2009", 2010, p. 14
78 European Agency for Reconstruction, "Strengthening Kosovan capacity to combat money laundering and corruption", 2007, p. 30-40
Kosovo does not have an efficient program to combat the black economy. Moreover, they do not have specific policies, strategies nor action plans for the prevention of money laundering.79

4.2 Kosovo’s tax system

Kosovo’s tax base is very small by regional standards. The revenue-to-GDP ratio differs significantly across countries in the region80. Kosovo’s tax revenue reaches roughly 21 percent of GDP, if including donor grants the tax revenue reaches to 28 percent.81 Transition economies usually raise 30-45 percent in GDP revenues.82 The general tax level in Kosovo is concluded to be low. In year 2000, after the wartime, government expenditure was as high as almost 40 percent of GDP. The countries government expenditure in year 2008 was estimated at 19, 1 percent of GDP and in 2009 it decreased to roughly 18,4 percent. The largest spending, consisting of 18,8 percent of the total tax revenue, is accounted for social welfare. A large share of expenditure is also allocated to economic affairs, which consists of energy, mining, telecommunication, transport and agricultural sector, 18,4 percent. The health sector is largely tax funded from tax revenues as well, while private sources largely contribute an estimation of 40 percent, or more83.

The recent tax system, written by United Nations Interim Administration Mission in Kosovo, UNMIK, has been created from scratch since year 1999.84 A tax reform was initiated in 2009, and has made the country more competitive within the region. In January 2010, adjustments where adapted to the laws on personal and corporate income tax. The taxation of residents versus nonresidents’ persons and firms was clarified, avoiding double taxation and specifying the procedures of tax declaration, this is to be done through the territorial tax system focusing on where income is earned. The regulations objective is to strengthen the development of the economy.85 Modern European taxation standards and practices have been introduced in the country. Due to this, the tax system is the

---

79 European Agency for Reconstruction, "Strengthening Kosovan capacity to combat money laundering and corruption", 2007, p. 30-40
81 Selim Thaci, Republik of Kosovo, 2010
84 http://www.eciks.org/english/invest.php?action=total_invest&main_id=8, 260411
simplest and least burdensome in the region. Most of the Kosovo's taxes are collected at the border, 55 percent. The figure below illustrates the tax revenues and its structure for year 2009, in absolute numbers and percent, the currency being million Euros.

*Figure 4.2 Structure of budget revenues*

Currently, the tax base in Kosovo is not broad enough to achieve revenues to fund the public fiscal policy and create a more effective infrastructure. More than half of the tax revenues are earned at the border, referred to as custom duties, and is when tax is levied on imports, and sometimes exports. This is done by the costume authorities of a country to raise state revenue. It can also be implemented as a tariff when protecting domestic industries from more efficient or predatory competitors from abroad. The largest tax base faces the risk of eroding, as more trade agreements with the neighboring countries are executed.

### 4.2.1 Corporate income tax

The corporate tax base is calculated as revenues minus input costs in a corporate, with deduction of the depreciation for assets with longer duration and interest charges. The

---

86 http://www.eciks.org/english/invest.php?action=total_invest&main_id=8, 260411
87 Selim Thaci, “Republik of Kosovo”, 2010
88 [http://www.businessdictionary.com/definition/customs-duty.html](http://www.businessdictionary.com/definition/customs-duty.html), 150411
89 Bair, Melinda, “Tax Policy as a Mechanism to Secure Kosovo’s Independence: A Proposal to Reform the UNMIK Tax Regulations”, 2007, section 2
function of corporate tax varies. It gives instrument to tax foreign investors for their investments in the domestic country. Another function may be that the state wishes to control the investments through the use of corporate taxes. In January, 2005, the UNMIK regulation no. 2004/51 on corporate income tax was introduced. It was latest altered by UNMIK regulation no. 2007/22, 2008.

The corporation income tax rate is 10 percent of taxable income. Corporate tax is paid quarterly in advance, based on net income predictions, every year. The graph below illustrates the domestic legal entities and permanent establishments of foreign legal entities tax burdens.

**Figure 4.3 The Corporate income tax**

<table>
<thead>
<tr>
<th>Annual income €</th>
<th>37.5 € / quarter</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - € 5,000</td>
<td></td>
</tr>
<tr>
<td>€ 5,001 - €50,000</td>
<td>3-10% of income</td>
</tr>
<tr>
<td>€ 50,000</td>
<td>10% of income</td>
</tr>
</tbody>
</table>

**Source:** Economic initiative for Kosovo, eciks

Figure 4.3 illustrates a progressive corporate income tax with the scale 3-10 percent. Annual incomes of 5000 Euros or less are obligated to pay 150 Euros per year. The object of taxation for a resident taxpayer is income from Kosovo and foreign sources. For a nonresident taxpayer the object of taxation is the income from Kosovo sources.

### 4.2.2 Personal income tax

Income taxes are usually paid in the form of taxing income or capital gain. Each individual should be taxed on their income. The rate on personal income tax is dependent on annual income. The personal income tax rate is a progressive system,

---

91 Economic Initiative for Kosovo, “Company foundation, taxes and employment law in Kosovo”, 2007, p 24-33
92 Appendix, Law No. 03/L- 113, on Corporate income tax
93 [http://www.eciks.org/english/publications/investing_in_kosovo/content/iguide_12.html](http://www.eciks.org/english/publications/investing_in_kosovo/content/iguide_12.html), 170411
94 Appendix, Law No. 03/L- 113, on Corporate income tax
with a 10 percent maximum tax rate. The table below illustrates when the different tax levels becomes applicable. For each tax period tax shall be charged as follows in the table.

**Figure 4.4 The Personal income tax**

<table>
<thead>
<tr>
<th>Annual Income</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>€0 - €960</td>
<td>0%</td>
</tr>
<tr>
<td>€960 - €3,000</td>
<td>4% of the amount over €960</td>
</tr>
<tr>
<td>€3,001 - €5,400</td>
<td>€81.6 + 4% of the amount over €3,000</td>
</tr>
<tr>
<td>&gt;€5,400</td>
<td>€273.6 + 10% of the amount over €5,400</td>
</tr>
</tbody>
</table>

**Source:** Economic initiative for Kosovo, eciks

Figure 4.4 demonstrates that a monthly income of 80 euros is an exception from tax, and is treated as a deductive income. A value higher than 80 euros per month is taxable in a progressive rate. Residents and non-residents who receive income in Kosovo are taxable persons. The object of taxation for a resident taxpayer is the income from the domestic and foreign country. For a non-resident, income from Kosovo source shall be taxed. The only dispensation for the taxation of foreigners is that they do not need to pay personal income tax on the accommodation provided for them or on school fees.

### 4.2.3 Value Added Tax, VAT

The value that a producer adds to his raw materials or purchases before selling the new and improved product is the value added. The VAT system in Kosovo follows the main principles of VAT. It is a tax that is added to the sale of goods and services. Goods imported into Kosovo and businesses with an annual income in excess of

---

96 Appendix, Law No. 03/L-115, on Personal income tax  
97 [http://www.eciks.org/english/publications/investing_in_kosovo/content/iguide_12.html](http://www.eciks.org/english/publications/investing_in_kosovo/content/iguide_12.html), 051411  
98 Appendix, Law No. 03/L-115, on Personal income tax, 2009  
99 Economic Initiative for Kosova, “Company foundation, taxes and employment law in Kosovo”, 2007, p 29  
50,000 Euros are generally subjected to VAT. The common VAT rate is 16 percent, with exceptions for certain agricultural and capital goods where the VAT is zero percent. Exporters receive full VAT reimbursement of exported goods.

To sum up the discussion about Kosovo’s tax design, figure 4.5 below, illustrates the different tax revenues to GDP percentage share, and figure 4.6 illustrates a comparison of tax rates with its neighboring countries. The numbers shown in the figure 4.5 for the year 2009 has occurred, the years 2010-2015 are projections made by the IMF.

![Figure 4.5 Taxes in Kosovo](image)

**Source:** IMF Country Report, 2010

The share of direct taxes in total tax revenue reaches around 16 percent in Kosovo, and the share of domestic indirect taxation in total tax revenues reaches roughly 87 percent. The indirect taxation base, significantly the VAT, creates the highest tax revenues.

An overview of the comparison of the Kosovo tax rates with its neighbouring countries is shown in figure 4.6 below. The figure illustrates VAT, corporate tax and income tax. To clarify, FROM in the figure refers to the Former Yugoslavian republic of Macedonia.

---

101 Economic Initiative for Kosovo, “Company foundation, taxes and employment law in Kosovo”, 2007, p. 30
102 Appendix, Law No. 03/L-114, on Value Added Tax
104 Ibid
Comparing, Kosovo has the lowest VAT in the region. The corporate tax is generally low in the region with 10 percent, with exception of Croatia and Germany. Bosnia has a lower tax rate than Kosovo on income tax, in the lower levels of income, but Kosovo’s rate is still considerably low. Kosovo is a small country close to its neighbours, with similar languages. The country faces fundamental problems, which presents difficulties in presenting an efficient tax system.

Next, the taxing in transition in different country groups will be presented.
5. Taxing in transition

The study illustrates how tax systems evolved in the transition countries of Eastern Europe and the former Soviet Union.

5.1 Methodology

The study of taxing in transition is established by secondary, quantitative data, discovered in earlier empirical studies. It is focused on two groups of transition countries during the 1990-2000. By using quantitative country specific data and studying the changes in early to late transition in the tax design, a general graphing of the tax structure in the two country groups can be established. One of these country groups presents the Baltic area, being in the same region as Kosovo. Thereby making the comparison possibility between Kosovo and the transitional countries more comprehensive, and easier to follow and understand.

5.2 The transition

The transition countries of Eastern Europe and the former Soviet Union successfully resumed growth by the end of the first decade of transition, 1999. They made progress towards a market economy by imposing market discipline on the enterprise sector, and more importantly, established an investment climate conducive to creation of new firms. This raises the question; what are the reforms in tax policy on which attention should be focused?

5.2.1 Public expenditure and taxing

The purpose of taxation is to finance government expenditure on key public goods by raising resources. Key public includes creating a stable macroeconomic environment, a legal and judicial system and the provision of basic social services. Therefore, taxation and expenditures should preferably be analyzed together.

Figure 5.1 illustrates the relationship between public expenditure and the level per capita in transition countries during 1992-2000. Central and Southeastern Baltic’s are referred to as CSB, including Albania, Bosnia, Bulgaria, Croatia, Czech
Linnaeus University

Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Poland, Romania, the Slovak republic and Slovenia. CSB represents one transition country group. Country group specific details can be found in the appendix. The second country group is represented by Commonwealth of Independent States, CIS, and includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldavia, Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. The figure plots countries’ shares of government expenditure in GDP alongside with the log of their per capita income, adjusted for purchasing power parity, PPP, across samples of developed and developing countries.

*Figure 5.1 Public expenditure and income level per capita in transition countries*

The figure allows for two points to be made. (1) The magnitude of expenditure adjustment during 1992 was greater in the CIS countries. They started in levels of 45-50 percent in the pre transition years, comparable to the OECD at 42 percent. The share of expenditure in the CIS countries later fell to levels comparable to those countries, dots in the figure, at similar per capita income levels. Conversely, the share of government expenditure in the CSB countries was nearly a third higher than the indicated by the figure for countries at comparable per capita levels. It does not necessarily state that government expenditure in CSB is excessive since the size of the government is shaped by both views about the role of the , and the cost of tax systems

---

106 Mitra, Pradeep and Stern, Nicholas, “Tax systems in transition”, 2003, p 4
107 Appendix, Table 1; Functional Structure of Public Expenditures : Country Groups
needed to support public expenditure at different levels. (2) The size of government expenditure increases with the level of income per capita. Public expenditure as a proportion of GDP is on average 29 percent in CIS countries, and they made limited progress with the transition to a market economy comparing to the CSB countries. The CSB countries, with just under 41 percent of government expenditure\footnote{Based on the Exchange rate in 06-05-11}, are further advanced in the transition, comparing to the CIS country group. These may be compared to the high income OECD countries,\footnote{The OECD countries include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Iceland, Japan, Luxembourg, New Zealand, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom and the United States of America} with an average of 42 percent.\footnote{Mitra, Pradeep and Stern, Nicholas, “Tax systems in transition”, 2003, p 5 -8}

The functional structure of public expenditure varies between the different country groups. Social security and welfare account for a third of the public expenditure in the OECD and the CSB countries, and for roughly a quarter in the CIS countries. Health is more spent on, as well, in the OECD and the CSB countries. However, health expenditures are around twice as large in the CIS, comparing to education.\footnote{Appendix, Table 1: Functional structure of Public expenditure; Country groups}

5.2.2 Characteristics of the tax systems

Cross sectional comparisons have been made by comparing features of the tax systems in the CIS countries, with the CSB countries and the high income OECD countries. Tax systems in transition countries are set in comparative international perspective. The figures and instruments used to make these comparisons possible can be found in the Appendix.\footnote{Appendix, Table 2; Tax structure of industrial and transition countries, Table 1 and Table 3; country specific details in early and late transition}

5.2.2.1 Cross sectional comparisons

The cross sectional comparisons, at the end of the first decade of transition, 1999-2000, resulted in four differences.

(1) The share of tax revenue in GDP is 22 percent in the CIS countries, and rises to 33 percent in CSB to 37 percent in the OECD. This, obviously, illustrates a higher share of tax revenue in GDP in high income countries. (2) The share of direct taxes, personal and corporate income taxes and social security contributions payroll taxes, in total tax revenue increases from 43 percent in the CIS countries to 54 percent.
in CSB countries. In the high income OECD countries this number reaches 63 percent. The share of personal income taxes in total tax revenue increases, while the corporate income taxes fall piercingly. Further, it should be noted that the share of social security contributions payroll taxes is higher in the CBS countries compared to the OECD countries. (3) The share if domestic indirect tax, i.e. VAT, turnover, sales and excise taxes, in total tax revenue declines from 44 percent in CIS countries to 38 percent in the CSB countries, and 30 percent in the high income countries. The share of excise taxes is illustrated to remain roughly unchanged. This concludes that the share in VAT, turnover or sales taxes, decreases. (4) Trade taxes have proven themselves to be relatively unimportant in transition economies. The contribution of trade taxes to tax revenues is almost insignificant in the industrial countries.113

5.2.2.2 A comparisons over time

In understanding the tax systems design in the transitional countries, it is necessary to compare the evolution of tax structures of the CIS countries, as well as those of the CSB countries from over time, from the early years of transition to those at the end of its first decade, 1990-2000.114 By doing so, the stylized fact emerging from the comparisons can be summarized into three different resulting.

(1) The share of tax revenue to GDP decreased from 24 percent to 22 percent in the CIS countries. A decrease was noted in the CSB countries as well, from 35 to 33 percent from the beginning to the end of 1990’s, illustrating the reduction in public expenditure noted in section and figure 5.1. The CIS and the CSB countries where left with a lower tax revenue to GDP ratio in the ending of the decade. In the high income countries the tax revenue to GDP ratio was at 37 percent during the same period. (2) The share of direct taxes to total tax revenue decreased from 56 percent to 43 percent in the CIS countries. The CSB countries saw a decrease from 59 to 54 percent. The OECD countries enjoyed a share of 63 percent in direct taxes to total tax revenue. The transitional countries were left with lower share of direct tax to total tax revenue. The fall in the direct taxation was greatly due to a significant fall in the corporate tax income, from 25 to 13 percent in the CIS countries and from 13 to 7 percent in the CSB countries. Both transition groups enjoyed an increase in the individual income tax in total tax revenues. The social security contribution payroll taxes to total tax revenue, included in the direct taxes, fell in the CIS countries to level below the

113 Appendix, Table 2; Tax structure of industrial and transition countries
114 Mitra, Pradeep and Stern, Nicholas, “Tax systems in transition”, 2003, p 8
OECD economies. The share remained similar in the CSB countries. Conversely, the share of domestic indirect taxes rose in the transition countries, from 37 to 44 percent in the CIS and from 32 to 38 percent in the CSB countries. There was an increase in VAT, sales and turnover taxes, as well as excise taxes. This left the transitional country groups with a higher share of indirect taxes to total tax revenue than the industrial high income countries, which corresponds 30 percent.

The decline in the share of domestic direct taxes to total tax revenue can be reflected in the increased share of domestic indirect taxation to total tax revenue. 115

5.2.2.3 A visual perspective of the tax transition

A visual perspective is provided on the composition of tax revenues and how it differs between OECD, CSB and CIS countries in cross section and over time comparisons in figure 5.2 below. Since trade taxes account for a very low proportion of total tax revenues, they will be ignored. The figure will focus on the shares if income tax, social security contributions cum payroll taxes and domestic indirect taxes, under the restriction of a closed economy. The total tax revenues in the figure will be less than the tax revenues including trade and the three different tax types represent the largest shares of tax revenue. Points A in the triangle, figure 5.2, represents 100 percent of tax revenue of personal and corporate taxes, apart from trade. Point B represents 100 percent of social security contributions cum payroll taxes and point C represents 100 percent of domestic indirect taxation. To demonstrate the figures function, a point on the line AB corresponds to a level equal to zero in domestic indirect taxation. A point on the line BC corresponds to a level equal to zero in income and corporate taxes and a point on the line AC corresponds to a level equal to zero in social security contribution cum payroll taxes. The high income OECD countries are represented by the yellow star in the figure, CSB countries are represented by the circle and the CIS country group is represented by the triangle. The three points shows the weighed averages for the different country groups in late transition. 117

115 Appendix, Table 2; Tax structure of industrial and transition countries
116 Appendix, Table 2; Tax structure of industrial and transition countries
117 Mitra, Pradeep and Stern, Nicholas, “Tax systems in transition”, 2003, p 14
Figure 5.2 The tax transition

The figure illustrates that the high income OECD country group is on average closer to the income tax corner and the axis AB. This can be interpreting as that the OECD countries earn a higher share of individual and corporate income revenue, comparing to CIS and CSB country groups. The CIS countries are in average closer to the domestic tax indirect corner and the axis AC in comparison to the OECD and CSB countries. The CSB countries are closer to the security contribution cum payroll taxes and towards the axis BC, compared to the CIS countries. The conclusion drawn from the figure is that the OECD country structure earns a higher of income revenue, in comparison to the transition economies. The CSB country group structure usually generate a higher share of security contributions cum roll taxes, and the CIS countries structure are more dependent to domestic indirect taxation.

The path from early transition to late transition in the CIS and CSB countries is illustrated in the appendix, “Taxes in transition”. The figures conclude that on average the CSB and CIS countries in late transition, 1999-2000, had moved further away from the income tax corner and closer to the domestic indirect taxation corner, compared to the early transition. In the CSB country group the share of social contributions cum payroll taxes revenue remained roughly unchanged, but in the CIS
country group, the share of social contribution cum payroll taxes declined, while the share of domestic indirect taxation revenue increased.\textsuperscript{118}

5.2.3 Benchmark levels of indirect tax, income tax and security contribution and payroll tax

The discussion of if the transition economies can finance its economy, part through socio-political and economic judgments about the role of taxation, without creating significant distortions in the private sector is an important question. To be able to answer the question consideration about the levied tax rates has to be made.

VAT raises around 7 percent of GDP in the high income OECD countries. Empirical studies based on CIS and CSB country groups states that in countries where VAT collects more than 7 percent of GDP, there seems to be a clear trade-off. The trade-off seems to be between a high tax rate and a broad tax base. Evidence also suggests that the time VAT has been in place has an impact. The longer a VAT has been in place, the higher the rate of compliance with the tax, which results in higher enforceability. Thus, it seems rational to suppose that transition countries with limited experience of VAT, could not expect more than to raise 6-7 percent of GDP over the next few years, without encountering problems with compliance or creating distortions in the economy. Excise taxes, generally levied on alcohol and tobacco, are expected to yield around 2-3 percent of GDP, otherwise it implies high rates of taxation. As trade taxes become less important, later transition, the indirect taxes can thus be expected to yield 8-10 of GDP.

Income taxes yield around 15 percent of GDP in the high income countries, personal income taxes being roughly three or four times more important than corporate income tax. With an average rate of income tax of 20-25 percent, taking the trade-off between a high tax rate and a broad tax base, the income tax can be expected to raise between 6-9 percent of GDP in transition economies, dependent on the countries’ per capita income. With a well-functioning tax administration, the need to use corporate income taxes decreases. A high corporate income tax runs the risk of possibly discouraging investments.

Social security contributions and payroll taxes yield around 11 percent of GDP in the high income and CSB countries. In the CIS countries the security contributions, on average, account for less than 5 percent of GDP. Once again, taking the trade-off

\textsuperscript{118} Appendix, Taxes in transition

118
effect between a broad tax base and high tax rate, a payroll tax should be averaging 20-30 percent, and can be expected to yield 6-10 percent of GDP.

On the basis of these benchmarks above, taking efficiency considerations into account, it is suggested that transition countries, depending on the stage of development, aim for tax revenue to GDP ratio of 22-31 percent. This containing a VAT rate of 6-7 percent, excises of 2-3 percent, income tax of 6-9 percent, security contribution cum payroll tax of 6-10 percent and other taxes, such as trade and property of 2 percent.\textsuperscript{119}

5.3 Taxation and investment climate

Improving the investment climate for domestic and foreign investment is an important issue for the CIS and the CSB countries. An institutional policy facing governments across the region has been creating of an attractive and competitive investment climate. In which, restructured and new firms would have incentives to absorb labor and assets, reduce inexpensive by downsizing of timeworn and unviable enterprises and invest in expansion. The challenge includes reducing high marginal tax rates, simplifying regulatory processes, creating security of property rights and providing basic infrastructure. This while upholding a smooth leveled play field among old, restructured and new firms.

Countries in transition during 1990-2000, such as Hungary, the Czech Republic, Estonia and Latvia, witnessed a quick return to growth, followed by the transitional recession. By the end of the 1990’s, more than half of all employment and value added where generated by medium and small enterprises, defined as firms with 50 employees or less. The firms flourished and became the most dynamic sector of the economy. This was made possible under the constraint that the imposition of market discipline and the creation of an attractive investment climate went hand in hand.\textsuperscript{120} A study, conducted by European bank for reconstruction and development and the World Bank, identified different variables influencing the investment climate. The variables resulted in microeconomic variables, including taxes and regulations, macroeconomic variables, including policy instability, inflation and exchange rates and lax and order, including judicial function, corruption, crime, disorder and informal economies. It resulted in that the respondents ranked the taxes and

\textsuperscript{119} Mitra, Pradeep and Stern, Nicholas, "Tax systems in transition", 2003, p 23-26

\textsuperscript{120} Mitra, Pradeep and Stern, Nicholas, "Tax systems in transition", 2003, p 1-3
regulations consistently as the most important variables to expansion by new enterprises.121

The hardening of a budget constraint on all enterprises has also been important for growth in successful transitional economies. The experience of the transitional economies during the 1990’s suggests a sharp and early decline in the total employment, thus output. Proceeded by a rapid growth of new firms, which was useful when financing and investments was not forthcoming. At the time the proportion of employment in small firms reached a threshold of roughly 40 percent, the sector evolved into an active competitor with a rapidly increased share of employment. In countries where employment picked up, it was often a result of the recovery of the total output. Conversely, in countries where the threshold was not reached, as in the CIS and some CSB, output remained at a lower level. The employment did not start to fall until late in the process.

The observations result in a suggestion where a sequence of old sector declines before the new sector can grow, due to an imposition of hard budget constraints. Therefore, it is said to be extremely important to have a complementary between the hardening of a budget constraint and the improving of the investment climate.

5.3.1 Taxation and Foreign direct investments
In advanced reforms, where few large privatizations are left, major challenges are facing policy makers. They have to create an investment climate that can continue to attract foreign direct investments, FDI, without undermining the domestic fiscal position through the provision of tax incentives. (p.42)

During the years 1996-1999, over 70 billion US dollars122, expressing 49,18 billion Euro123, in FDI flowed to the CIS and CSB regions, approximately 70 percent of it to the CSB countries.124 Figure 5.3 below illustrates the main receiving FDI counties in the CIS and CSB country groups. The shares of GDP are period averages based on medians for the groups. The figure also presents the gross domestic investment as a percentage of GDP for a comparison purpose.

---

122 Mitra, Pradeep and Stern, Nicholas, “Tax systems in transition”, 2003, p 40-42
123 According to the exchange rate 120511
Figure 5.3 Main Recipients of Foreign Direct Investment, 1992–95 and 1996-1999

<table>
<thead>
<tr>
<th>Country</th>
<th>1992–95 $ millions</th>
<th>Percent of GDP</th>
<th>Memo item Gross Domestic Investment as a percent of GDP</th>
<th>1996–99 $ millions</th>
<th>Percent of GDP</th>
<th>Memo item Gross Domestic Investment as a percent of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSB</td>
<td>21,691</td>
<td>0.5</td>
<td>19.3</td>
<td>50,558</td>
<td>3.3</td>
<td>24.7</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>4,821</td>
<td>2.9</td>
<td>29.4</td>
<td>10,104</td>
<td>4.6</td>
<td>31.3</td>
</tr>
<tr>
<td>Estonia</td>
<td>647</td>
<td>3.9</td>
<td>26.9</td>
<td>1,050</td>
<td>5.2</td>
<td>28.2</td>
</tr>
<tr>
<td>Hungary</td>
<td>9,399</td>
<td>5.7</td>
<td>20.3</td>
<td>6,979</td>
<td>3.8</td>
<td>28.3</td>
</tr>
<tr>
<td>Poland</td>
<td>2,540</td>
<td>0.6</td>
<td>17.9</td>
<td>17,096</td>
<td>2.9</td>
<td>24.8</td>
</tr>
<tr>
<td>CIS</td>
<td>8,272</td>
<td>1.0</td>
<td>26.2</td>
<td>22,901</td>
<td>2.5</td>
<td>20.8</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>237</td>
<td>4.2</td>
<td>15.1</td>
<td>3,222</td>
<td>20.9</td>
<td>30.8</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>2,357</td>
<td>2.7</td>
<td>25.0</td>
<td>4,971</td>
<td>6.4</td>
<td>15.1</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>3,965</td>
<td>0.3</td>
<td>28.1</td>
<td>8,412</td>
<td>0.7</td>
<td>19.6</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>427</td>
<td>3.5</td>
<td>-</td>
<td>334</td>
<td>3.0</td>
<td>43.5*</td>
</tr>
</tbody>
</table>

* Averages of 1997-1999

Source: World Bank staff estimates and country statistical offices

Figure 5.3 illustrates a growing FDI share in the different country groups, comparing the two different periods. In the CIS country group FDI has been mainly limited to the energy rich countries. Azerbaijan, Kazakhstan and Russia received 75 percent of the total amount. Estonia managed to raise its FDI through lowering, or removing, the corporate income tax to zero percent. Much FDI were driven by asset sales to foreign investors. Cumulative FDI is greatly correlated with cumulative privatization revenues. FDI created two advantages in the domestic country. Firstly, a higher technology and skills level, in some cases, the standards of the investor’s home country. Secondly, it brought a source of foreign financing, which the transitional economies can benefit from. A highly accumulated FDI, often a good indication of a more attractive investment climate in the host country, is associated with a higher degree of employment in small firms.

---

125 World Bank staff estimates and country statistical offices cited in Mitra, Pradeep and Stern, Nicholas, “Tax systems in transition”, 2003
6. Result discussion

Policy makers in Kosovo faces a hard time pleasing different ethnic groups, especially the contradictions between the Albanian majority and the Serb minority, where there are still controversial problems rooted deep in the history. Since conflicts of interest can restrict possibilities of economic policy, it’s very important for Kosovo’s government to be fair to all different groups in the society and minimize the issues, though the “acting areas” could be small. More importantly, policymakers need to address the fundamental problems in the country, consisting of informal economies, weak institutions and tax bases and further, bring down the unemployment rates and create jobs. This could be established through a larger inflow of FDI. However, since the economy suffers from the large extent of informal economies and weak enforceability the inflow of FDI is limited.

Since Kosovo do not have an independent monetary policy, fiscal policy is the country’s main instrument, amplified by the current account deficit. Taking this in consideration with the narrow, or not broad enough, tax bases in the country, earning most of its revenue through the costumes by VAT, is alarming. As mentioned before, the costumes taxes faces the risk of eroding as more trade agreements are executed. Keeping the optimal taxation theory in mind, there should be a balance between efficiency and distributional objectives. Kosovo’s government needs to consider the effects that their choice would bring. Aiming for more efficient tax bases would imply lump sum taxes in the extreme case, which is not recommended. Another path is taxing inelastic goods, often necessities as food, at higher rates, which would imply higher tax revenues and by this the possibility to improve health care, education and infrastructure. However, the tax revenues would be created at the cost of charging the poorer people in the economy and could be perceived as unfair. This would lower their consumption levels. Flat taxes could also be a solution. They could minimize the tax-distortional effect for Kosovo, with a lump sum grant to the lower incomes, instead of the progressive tax rate that is in place today. However, this could imply a reduction of tax revenues, keeping other variables constant, in the country. Further it may not fulfill the redistribution objective of taxation.
The general tax rates in Kosovo are low and simple, with a progressive rate. If considering raising the tax rates, the globalization effects have to be taken into consideration. One of taxations main goals is the redistribute the wealth by taxing wealthier individuals at higher rates. However, as the world is getting more globalized, including Kosovo, wealthier people are getting more mobile and are not to be assumed to accept higher tax rates. Kosovo is an open economy, close to its neighbor countries, with similar languages and a territorial tax system, which means that people do not need to travel far, or make big adjustments to escape the high tax rates, if the neighbor countries tax designs offer lower ones. This risk imposes a constraint of Kosovo’s tax design, which means that the tax design has to be similar to its neighbor countries, or at least not depart from it to a larger extent. The globalization effects are especially important in Kosovo, since migration is already a problem and the youth is looking for a way to leave the country. This could be a reason for inquiring a flat tax system.

The comparisons below between the case of Kosovo and the study “taxing in transition” should be considered with great caution, since all individual countries are different. Using the same methods, one country’s success may not contribute to the same success in another country. With this in mind the main task of taxation is to finance government expenditure on key public goods and bring revenues. As the study “taxing in transition” revealed, the magnitude of the share of expenditure to GDP was greater in the early transition years, both in the CIS countries and the CSB. Looking at the data of Kosovo’s expenditure to GDP, between year 2000 and 2009, expenditure share to GDP fell from roughly 40 percent to 18.8 percent. Comparing to the CIS and the CSB countries, at an average of 29 and 41 percent, Kosovo’s expenditure to GDP share fell at lower levels. The high expenditure to GDP share in year 2000 can be highly correlated to the after war time, and rebuilding the region. As illustrated in the study and figure 5.1, the size of government expenditure rises with the level of income per capita. Kosovo has a small tax base with low revenues, so it should not be a surprise that the government expenditure in the country is low. However, the CSB country group is in the same region as Kosovo, and the average rate on expenditure is significantly higher. The CIS country group is in an earlier transition stage if comparing to the CSB countries, and still the expenditure rate to GDP is higher in the CIS counties than in Kosovo. By this,
the conclusion that Kosovo’s share of expenditure to GDP seems to be too low can be drawn.

The share of tax revenue to GDP is at 22 in the CIS country group, 33 percent in the CSB countries and 37 percent in the OECD. Kosovo’s share of tax revenues to GDP is at 21 percent, similar to the CIS country group. Kosovo’s tax revenue share is at low levels, comparing to the countries in the region, the CSB country groups. Further, the composition of tax revenues differs, where Kosovo has greater domestic indirect taxation revenues, roughly 87 percent as a share of GDP. It’s almost the double amount of the ratio in the CIS countries, and three times as big as the high income countries, and significantly higher comparing to the countries in the region. During the transitional period the indirect taxation, VAT, sales, excise and turnover taxes, increased in total tax revenue ratio. Controversially, the tax revenue to GDP ratio in direct taxation decreased, mostly due to a fall in corporate taxes, and of course, to the rise in indirect taxation. In the CIS and the CSB countries, direct taxation yield 43 and 54 percent, but only 16 percent in Kosovo, with the absence of contribution and payroll taxes. If taking the case study in consideration, as the transitional countries approached a market economy the share of direct taxation to total tax revenue, tend to be higher, but still decreasing. If this is the general case, Kosovo’s tax composition is still in an early transitional state. This is further certified by the large revenue share, of the total tax revenue, that trade taxes contribute to their economy. In transitional and industrial economies trade taxes are relatively unimportant.

The general tax composition of high income, CIS and CSB country groups are illustrated by figure 5.3, where high income countries are on average closer to the income tax corner, the CIS are closer to the domestic indirect taxation corner, and the CSB countries are on average closer to the social contribution and payroll taxes. It should be noted that Kosovo tax design lacks the existence of social contribution and payroll taxes.

In transition economies with limited experience with VAT, more than 6-7 percent of GDP in revenue through VAT should not be expected. Kosovo being an expectant country, with not to long experience of VAT earn higher revenues in comparison the expectant amount. VAT increased to roughly 10, 4 percent in revenue to GDP in Kosovo 2009, illustrated in figure 4.5 above. Comparing, Kosovo’s VAT to GDP ratio contributes to large revenues, but the country seems to be experiencing a
trade-off between high VAT revenues and a broad tax base. This is consistent with the study “taxing in transition” suggestions and the high VAT revenue to GDP appears to have contributed to a narrower tax base in the country. The high revenues are beneficial to the economy, but in the long run the high VAT revenues could hurt the economy. A broader tax base should be prioritized because it could lead to a larger share of total tax revenues to GDP in the future. The excise taxes in Kosovo rose 5.3 percent to GDP in 2009. Usually, excise taxes should contribute to around 2-3 percent to GDP in revenues. Kosovo’s excise taxes indicate high rates of taxation. In the short run this is, once again, beneficial to the economy, but in the long run it can have the opposite effect, for the same reasons mentioned above. The distortional effects in Kosovo should be increasing with the high share of VAT and excise tax revenue to GDP, which is unwished.

Income taxes yield around 15 percent of GDP in the OECD countries, which is much higher than Kosovo’s share, with 2.9 percent to GDP in 2009. The average rate of income tax is 20-25 percent. In Kosovo it is 10 percent at the highest. In transition economies, income tax can be expected to yield roughly 6-9 percent of GDP, depending on the countries per capita income. Since Kosovo in one of Europe’s poorest countries, the low share of income tax revenue may not be a surprise. Further, social contributions and payroll taxes account for roughly 5 percent to GDP in transition economies. In Kosovo this tax source in non-existing, and is urged to be implemented, since it could contribute to a broader tax base with higher total share of tax revenues. A payroll tax should be roughly 20-30 percent in accordance to the taxing in transition, thus previous experiences. Taking efficiency considerations into account, transition countries, depending of the stage of development, should aim for a tax revenue to GDP ratio between 22-31 percent, Kosovo’s being too low.

Comparing to figure 5.2, Kosovo’s recent tax design is comparable to the latter transitional CIS country group, making most of its tax revenues through domestic indirect taxation. If treating the figure as a process of different levels of transition and further trying to figure out Kosovo’s case, their tax transition should be directed towards a higher share of social contribution and payroll taxes to make a move for the better in the “transition scale”, similar to the CSB countries, since they are in the same region. Therefore, a development of efficient and fair, long term social contribution and payroll taxes needs to take place in Kosovo.
Governments across the region have been trying to create an attractive and competitive investment climate through institutional policy, including Kosovo. The challenge includes reducing high marginal tax rates along with simplifying processes and creating security of property rights. Countries in transition during 1990-2000 witnessed a quick return to growth after the transitional recession. Small and medium enterprises generated to more than half of the employment and value added in some economies and the firms became the most dynamic sector in the economy. That’s why Kosovo, as well as other transitional countries, constantly tries to improve the investment climate. With the unemployment rate being high, Kosovo has much to gain by increasing the FDI, and therefore the country imposed a low corporate tax income and simple tax laws as the theory and empirical studies suggest. Low corporate taxation is ranked as the most important variables to the expansion by new enterprises. But macroeconomic variables, such as policy instability, corruption, crime, disorder and informal economies, are proven to discourage investments and FDI and also happen to be large issues in Kosovo. There is a need to increase the ability to identify these types of crimes where it is estimated that tax fraud and evasion are annually more than 100 million Euros and is harmful to the society. Investors might be afraid to invest in such a country with low enforceability where there are no guarantees and high risks. Even if corporate income tax would be further reduced in Kosovo, taxpayers may not pay if they have the opportunity to escape the taxation, as a result of the informal economies and black markets.

The tax performance must to be upgraded. A well administrated tax system, covering a broad tax base with low rates could encourage tax compliance among enterprises, instead of driving them underground. The investment climate can not only be improved by simple tax laws and privatizations of firms as Kosovo, among other things, has tried to do.

Further, to create a more favorable investment climate in Kosovo is a key issue, but a hard one as well. It has to be done by improving the conditions, long term. Possibly, one can hope that a future EU compliance can help break the deadlock and bring the countries together, thus leading to a higher inflow of FDI and increased credibility. However, the EU now finds itself in a crisis and cannot be dependent on.

The society has to be developed as a whole. Along with a hardening of a budget constraint new firms are allowed to flourish as old and inefficient firms disappear, decreasing the unemployment level in the country.
7. Conclusion

Kosovo is a small, open economy. It’s not hard to escape unfavourable tax laws by moving to a neighbour country. Thus, tax design cannot differ to any large extent from their neighbour countries without facing the risk of a higher migration. In my belief, a corporate tax cut will not be beneficial to the country to a large amount yet, or at all, due to the informal economies, weak infrastructure and the ethnic contradictions preventing a growth generating economy and much needed FDI in the country. Further, Kosovo has a simple tax system with low taxation and since there is no existence of contribution and payroll taxes, the rates of taxation are probably already one of the lowest in the region. However, the narrow tax base is one of Kosovo’s main issues and faces the risk of eroding, due to future trade agreements. Indirect taxation yields the undoubtedly highest tax revenues in the country, and unusually high revenues in comparison to the CIS and CSB countries. It can contribute to higher distortional effects and further, the tax burden is predicted to fall on the poor in the society.

Therefore, the corporate taxation should not be much lowered until fundamental problems in the country are dealt with, or more under control. However, in the future, a lowering of the corporate taxation to 5 percent or lower could help bring up the employment level, and thus the taxation revenues within the country. The government should further consider inferring contribution and payroll taxes to broaden the tax base. The indirect taxation rate should not be raised, but if in need of finances in short term, they opportunity exists to increase the VAT rate to 17 percent.

The country's tax design with a progressive tax rate and a territorial system should be kept. This upholds a simple tax system.

It is essential that the reduction of informal economies needs to be further prioritized. The tax design in the country is not the main problem, the tax reporting, undeveloped infrastructure, manufacturing industries and informal economy are.
7.1 Suggestions for further studies

After studying the tax system in Kosovo, a further study in the countries tax reporting and means to supervise the taxpayers to fulfil their taxation duties would be insightful. It could give additional understanding to the extent of the problems that the country is facing, and even possible solutions to the specific problems.
8. References

8.1 Electronic sources

http://www.fraseramerica.org/commerce.web/product_files/LessonsfromabroadUS.pdf, 050411

Blair, Melinda, 2007, Tax Policy as a Mechanism to Secure Kosovo’s Independence: a Proposal to Reform the UNMIK Tax Regulations, accessed at:
http://pbosnia.kentlaw.edu/melinda-bair-ROLXFinalBair.htm, 300411

Business dictionary, 2011, “Customs duty: accessed at:
http://www.businessdictionary.com/definition/customs-duty.html, 150411

Central intelligence agency, 2011, Kosovo, accessed at:


Eciks, 2011, Investing in Kosovo, accessed at:
http://www.eciks.org/english/publications/investing_in_kosovo/content/iguide_12.html, 170411

Economic Initiative for Kosova- ECIKS, 2007, Company foundation, taxes and employment law in Kosovo”, accessed at:


Economy watch, 2011, Direct taxes, accessed at:
http://www.economywatch.com/budget/india/direct-taxes.html, 060411

Economy watch, 2011, Kosovo Economic Statistics and Indicators, accessed at:
http://www.economywatch.com/economic-statistics/country/Kosovo/#yearListing, 150511

European Agency for reconstruction, 2007, Strengthening Kosovan capacity to combat money laundering and corruption, accessed at: http://www.eulex-


International Monetary Fund country report No. 10/24, 2010, *Republic of Kosovo: Request for Stand-By Arrangement*, accessed at: 

Investorwords, 2011, “*Public sector*”, accessed at: 

Maps of world finance, 2009, *Tax information*, accessed at: 


NATO’s role in Kosovo, 1999, NATO's role in relation to the conflict in Kosovo, accessed at: 
[http://www.nato.int/kosovo/history.htm](http://www.nato.int/kosovo/history.htm), 030511

New Kosova report, 2008, *Government: Kosovo tax reforms will increase investments*, accessed at: 

Radio Free Europé, 2011, *Kosovar Government Faces Severe Budget Deficit*, accessed at: [http://www.rferl.org/content/kosovar_budget_deficit/2326599.html](http://www.rferl.org/content/kosovar_budget_deficit/2326599.html), 040511

Selim Thaci, 2010, *Republic of Kosovo*, accessed at: 

Sida, 2011, *Kosovo mejslar ut sin framtid i Europa*, accessed at: 


Figure 5.1, *Public expenditure and income level per capita in transition countries*, accessed in:


### 8.2 Scientific sources


Mankiw N. Gregory, Matthew Weinzierl and Yagan Danny, 2009, Optimal taxation in theory and practise, Citeseer, pp 1-34

Mitra, Pradeep and Stern, Nicholas, 2003, Tax systems in transition, citeseer, pp 1-57


8.3 Literature sources:

Eklund, Klas (1998), Jakten på den försvinnande skatten: Globalisering och rörliga skattebaser, Stockholm SNS

Eklund, Klas (2010), Vår ekonomi: En introduktion till samhällsekonomin, Norsted

Ekonomiska rådets årsbok 1989 (1990), Vad kan en finansminister göra?, Konjunkturinstitutet

Hansson, I. and Norrman, E. (1996), Skatter: Teori och praktik, SNS förlag

Skatteväxlingskommittén (1997), Statens offentliga utredningar, Skatter, miljö och sysselsättning, Stockholm Fritze

8.4 Figure sources

Figure 2.1, 1990, Vad kan en stadsminister göra?, accessed at: Ekonomiska rådets årsbok

Figure 2.2, Perfect competitive market before and after the imposition of tax, accessed at: http://www.swlearning.com/economics/nicholson/nicholson9e/quiz09/ch09.html

Figure 4.1, 2009, Kosovo Labor force survey, accessed at: Results of the labor force survey


Figure 4.5, 2010, Taxes in Kosovo, accessed at: IMF Country Report, "Republic of Kosovo: Request for Stand-By Arrangement”

Figure 4.6, 2010, Overview of the tax system in the region, accessed at: http://www.eciks.org/english/publications/investing_in_kosovo/content/iguide_12.html.

Figure 5.1, 2002, Public expenditure and income level per capita in transition countries, created by Alam & Sundberg

Figure 5.2, 2003, The tax transition, accessed at: Mitra, Pradeep and Stern, Nicholas, Tax systems in transition

Appendix

Republic of Kosovo

Law No. 03/L-113
ON CORPORATE INCOME TAX

Article 2
Taxpayers
1. The following persons shall be taxpayers under this Law:
   1.1. a corporation or other business organization that has the status of a legal person
        under the law applicable in Kosovo;
   1.2. a business organization operating with public or socially owned assets;
   1.3. an organization registered as a non-governmental organization under legislation on
        the Registration and Operation of Non-Governmental Organizations in Kosovo; and
   1.4. a non-resident person with a permanent establishment in Kosovo, subject to
        provision of paragraph 2 of Article 3 of this law;

Article 3
Object of Taxation
1. The object of taxation for a resident taxpayer shall be taxable income from Kosovo source
   income and foreign source income.
2. The object of taxation for a non-resident taxpayer shall be taxable income from
   Kosovo source income.

Article 4
Taxable Income
1. A taxpayer with annual gross income of five thousand and one (50.001) euro or greater shall calculate taxable income by preparing financial statements and adjusting income and expenses recorded in such statements in the manner prescribed in this Law.
2. A taxpayer with annual gross income of five thousand (50.000) euro or less shall calculate taxable income:
   2.1. in accordance with sub-article 2.1 and 2.2 of paragraph 2 of Article 31 of this law; or
   2.2. by preparing financial statements and adjusting income and expenses recorded in such statements in the manner prescribed in this Law
3. Taxpayers who opt to calculate taxable income and prepare financial statements pursuant to
   sub-paragraph 2.2. of paragraph 2 of this law in any tax period shall be required to calculate
   taxable income and prepare financial statements in that manner for each subsequent tax period.
4. As an exception to the sub-paragraphs above, taxpayers whose principal activity is the
insurance or reinsurance of life, property, or other risks shall calculate taxable income and pay income tax in accordance with Article 28 of this law.

Article 5
Tax Rate
For the tax period 2009 and subsequent tax periods, the corporate income tax rate shall be ten percent (10%) of taxable income.

Law No. 03/L-115
ON PERSONAL INCOME TAX

Article 2
Taxpayers
Taxpayers, for the purpose of this Law, shall mean resident and non-resident natural persons who receive or accrue gross income described in Article 6 of this law during the tax period.

Article 3
Object of taxation
3.1 The object of taxation for a resident taxpayer shall be taxable income from Kosovo source income and foreign source income.
3.2 The object of taxation for a non-resident taxpayer shall be taxable income from Kosovo source income.

Article 4
Taxable income
Taxable income for a tax period shall mean the difference between gross incomes received or accrued during the tax period and the deductions allowable under this Law with respect to such gross income.

Article 5
Tax rates
1. For each tax period, income tax shall be charged at the following rates;
   1.1. for taxable income nine hundred sixty (960) euro or less, zero percent (0%);
   1.2. for taxable income over nine hundred sixty (960) euro up to three thousand (3,000) euro, four percent (4%) of the amount over nine hundred sixty (960) euro;
   1.3. for taxable income over three thousand (3,000) euro up to five thousand four hundred (5,400) euro, eighty one point six (81.6) euro plus eight percent (8%) of the amount over three thousand (3,000) euro; and
   1.4. for taxable income over five thousand four hundred (5,400) euro, two hundred seventy three point six (273.6) euro plus ten percent (10%) of the amount over five thousand four hundred (5,400) euro.
Law No. 03/L-114
ON VALUE ADDED TAX

Article 2
Value Added Tax
1. Value added tax or VAT, shall be charged, in accordance with the provisions of this law, on the taxable value of imports, intra inflows and taxable supplies.  
2. The value added tax shall be chargeable at the rate of sixteen percent (16%) on the taxable value of imports, intra inflows and other taxable supplies except for zero-rated supplies.  
3. The value added tax shall be chargeable at the rate of zero percent (0%) on the taxable value of a zero-rated supply as set out in Article 10.

Article 3
Obligation to Register
1. A taxable person shall apply to be registered for value added tax purposes with the Tax Administration within thirty (30) days of the entry into force of this Law.  
2. Where a person becomes a taxable person after the entry into force of this law, the person shall apply to be registered for value added tax purposes within fifteen (15) days from the date that person becomes a taxable person.  
3. The turnover for the purposes of determining whether a person is a taxable person as defined in section 1 to definitions shall be calculated based on the total consideration received by the person.  
4. Registration threshold, which established at the level of fifty thousand (50,000) euro per calendar year.  
5. A taxable person who imports, exports shall apply to be registered for value added tax purposes regardless of the threshold set out in paragraph 4 of this article.  
6. Central Bank of Kosovo may, as required, issue an administrative instruction specifying the procedure by which any supplier, who is not required to register, may opt to be registered for value added tax purposes.

Article 10
Zero-rated Supply
1. The following supplies shall be zero-rated supplies:  
   1.1. Exports and imports of goods;  
   1.2. supply of goods and services in connection with;  
      1.2.1. the international transportation of goods or passengers,  
      1.2.2. irrigation of farming lands and 1.3. imports and supply of goods marked in the Annex of this law  
2. The proof required to ascertain presentation of an export shall be set forth in an administrative instruction to be issued by the Tax Administration of Kosovo.

Article 11
Exclusions
1. No value added tax shall be charged on the following:  
   1.1. import of a traveler’s personal effects as permitted under the applicable customs provisions;  
   1.2. import of tourist duty-free goods as permitted under the applicable customs provisions;  
   1.3. imports, or supplies funded from the proceeds of grants made to for Ministries and Departments governmental or non-governmental organizations in
support of humanitarian and reconstruction programs and projects in Kosovo;
1.4. imports or inflows made by, or supplies made to, diplomatic representatives or liaison offices.
    1.5. imports or inflows made by, or supplies made to, the United Nations or any of its organs including UNMIK (as defined in UNMIK Regulation No. 2000/47 of 18 August 2000 on the Status, Privileges and Immunities of KFOR and UNMIK and Their Personnel in Kosovo), the specialized agencies of the United Nations, KFOR, the World Bank and international inter-governmental organizations and
1.6. imports or intra inflows of medicines, medical services, pharmaceutical products, or medical and surgical instruments and apparatus; and
    1.7. a fine or penalty levied by public authorities.
Taxes in Transition
Figure 8 below compares CSB country group in early and late transition, to a constant OECD country group.

Figure 9 below compares the CIS country group in early and late transition, to a constant CSB country group on average.

Source: Mitra, Pradeep and Stern, Nicholas, Tax systems in transition, 2003
<table>
<thead>
<tr>
<th>Year</th>
<th>Column 1</th>
<th>Column 2</th>
<th>Column 3</th>
<th>Column 4</th>
<th>Column 5</th>
<th>Column 6</th>
<th>Column 7</th>
<th>Column 8</th>
<th>Column 9</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>10</td>
<td>20</td>
<td>30</td>
<td>40</td>
<td>50</td>
<td>60</td>
<td>70</td>
<td>80</td>
<td>90</td>
</tr>
<tr>
<td>2021</td>
<td>11</td>
<td>21</td>
<td>31</td>
<td>41</td>
<td>51</td>
<td>61</td>
<td>71</td>
<td>81</td>
<td>91</td>
</tr>
<tr>
<td>2022</td>
<td>12</td>
<td>22</td>
<td>32</td>
<td>42</td>
<td>52</td>
<td>62</td>
<td>72</td>
<td>82</td>
<td>92</td>
</tr>
</tbody>
</table>

### Notes
- Columns 1-9 represent different financial data categories.
- The table includes data from various years, starting from 2020.
- Each row represents a different fiscal year.

### Sources
- Department of Finance documents.
- IMF and World Bank data estimates.

### Additional Information
- Excludes extraordinary funds.
- Includes extraordinary funds.
- Excludes extraordinary funds.
Table 2. Tax Structure of Industrial and Transition Countries \(^1\)
(in percent of GDP)

<table>
<thead>
<tr>
<th></th>
<th>Total Revenue &amp; Grants</th>
<th>Tax Revenue &amp; Grants</th>
<th>Other Revenue &amp; Grants</th>
<th>Taxes on Income, Profits, and Capital Gains</th>
<th>Social Security &amp; Payroll tax</th>
<th>Domestic Taxes on Goods &amp; Services: of which</th>
<th>International Trade Taxes</th>
<th>Wealth &amp; Property Taxes</th>
<th>Other Tax Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total Individual</td>
<td>Corporate</td>
<td></td>
<td>Total Individual Corporate</td>
<td>General Sales, turnover</td>
<td>Of which Import duties Export duties</td>
<td>Total Import duties Export duties</td>
<td></td>
<td></td>
</tr>
<tr>
<td>High income OECD</td>
<td>21.9</td>
<td>35.5</td>
<td>6.5</td>
<td>14.4</td>
<td>10.1</td>
<td>2.6</td>
<td>10.8</td>
<td>6.1</td>
<td>3.1</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>European Union(^2)</td>
<td>51.2</td>
<td>39.4</td>
<td>5.8</td>
<td>14.3</td>
<td>9.8</td>
<td>5.6</td>
<td>16.8</td>
<td>6.7</td>
<td>3.7</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEE (early transition)</td>
<td>40.8</td>
<td>35.0</td>
<td>5.8</td>
<td>9.7</td>
<td>5.3</td>
<td>4.5</td>
<td>11.2</td>
<td>8.4</td>
<td>2.8</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEE (late transition)</td>
<td>40.7</td>
<td>35.0</td>
<td>5.8</td>
<td>9.7</td>
<td>5.3</td>
<td>4.5</td>
<td>11.2</td>
<td>8.4</td>
<td>2.8</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEE (early transition)</td>
<td>25.3</td>
<td>24.4</td>
<td>4.9</td>
<td>9.0</td>
<td>1.7</td>
<td>8.2</td>
<td>16.6</td>
<td>8.9</td>
<td>7.7</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEE (late transition)</td>
<td>25.5</td>
<td>24.1</td>
<td>5.2</td>
<td>9.3</td>
<td>2.0</td>
<td>7.3</td>
<td>11.2</td>
<td>6.1</td>
<td>5.1</td>
</tr>
</tbody>
</table>

Tax Structure of Industrial and Transition Countries \(^1\)
(in percent of tax revenues)

<table>
<thead>
<tr>
<th></th>
<th>Total Revenue &amp; Grants</th>
<th>Tax Revenue &amp; Grants</th>
<th>Other Revenue &amp; Grants</th>
<th>Taxes on Income, Profits, and Capital Gains</th>
<th>Social Security &amp; Payroll tax</th>
<th>Domestic Taxes on Goods &amp; Services: of which</th>
<th>International Trade Taxes</th>
<th>Wealth &amp; Property Taxes</th>
<th>Other Tax Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total Individual</td>
<td>Corporate</td>
<td></td>
<td>Total Individual Corporate</td>
<td>General Sales, turnover</td>
<td>Of which Import duties Export duties</td>
<td>Total Import duties Export duties</td>
<td></td>
<td></td>
</tr>
<tr>
<td>High income OECD</td>
<td>117.4</td>
<td>100.0</td>
<td>17.4</td>
<td>39.6</td>
<td>28.2</td>
<td>7.6</td>
<td>21.3</td>
<td>16.8</td>
<td>8.9</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>European Union(^2)</td>
<td>114.9</td>
<td>100.0</td>
<td>14.9</td>
<td>36.0</td>
<td>24.2</td>
<td>7.0</td>
<td>26.6</td>
<td>17.8</td>
<td>10.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEE (early transition)</td>
<td>117.7</td>
<td>100.0</td>
<td>17.7</td>
<td>27.3</td>
<td>14.7</td>
<td>12.6</td>
<td>31.3</td>
<td>25.0</td>
<td>6.5</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEE (late transition)</td>
<td>114.9</td>
<td>100.0</td>
<td>14.9</td>
<td>22.5</td>
<td>15.6</td>
<td>8.5</td>
<td>31.6</td>
<td>26.6</td>
<td>10.3</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEE (early transition)</td>
<td>126.8</td>
<td>100.0</td>
<td>26.8</td>
<td>32.1</td>
<td>7.1</td>
<td>24.6</td>
<td>23.9</td>
<td>28.1</td>
<td>9.7</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEE (late transition)</td>
<td>115.3</td>
<td>100.0</td>
<td>15.3</td>
<td>23.9</td>
<td>9.8</td>
<td>13.6</td>
<td>19.4</td>
<td>31.0</td>
<td>11.6</td>
</tr>
</tbody>
</table>

\(^1\) Consolidated General Government unless indicated otherwise. For those latter indications, see Appendix Tables 1 to 6

\(^2\) Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom.
Table 4, SME Taxation

Table 4 reports the number of taxes and the average rates that are imposed on businesses.

<table>
<thead>
<tr>
<th>Country</th>
<th>Standard profit tax</th>
<th>Standard VAT</th>
<th>Max. personal income tax</th>
<th>Number of national taxes</th>
<th>VAT turnover threshold (US$)</th>
<th>tax incentives for new startups/investments</th>
<th>General SME tax break</th>
<th>Simplified tax for SMEs and sole proprietors (lump sum or presumptive)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>25%</td>
<td>20%</td>
<td>25%</td>
<td>5</td>
<td>57000</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Armenia</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>4</td>
<td>17000</td>
<td>No</td>
<td>Yes***</td>
<td>No</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>22%</td>
<td>15%</td>
<td>25%</td>
<td>4</td>
<td>5400</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Belarus</td>
<td>30%</td>
<td>20%</td>
<td>30%</td>
<td>8</td>
<td>3200</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Bosnia &amp; Herzegovina (Federation)</td>
<td>30%</td>
<td>24% sales tax</td>
<td>50%</td>
<td>No</td>
<td>No</td>
<td>Yes***</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Bosnia &amp; Herzegovina (Rep)</td>
<td>20% - 16% progressive</td>
<td>16% sales tax</td>
<td>25%</td>
<td>5</td>
<td>No</td>
<td>No</td>
<td>Yes***</td>
<td>No</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>23.5%</td>
<td>20%</td>
<td>25%</td>
<td>4</td>
<td>33000</td>
<td>No</td>
<td>No</td>
<td>Yes***</td>
</tr>
<tr>
<td>Croatia</td>
<td>22%</td>
<td>22%</td>
<td>35%</td>
<td>4</td>
<td>6000</td>
<td>Yes***</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>31%</td>
<td>22%</td>
<td>32%</td>
<td>4</td>
<td>91000</td>
<td>No</td>
<td>Yes***</td>
<td>No</td>
</tr>
<tr>
<td>Estonia</td>
<td>26%</td>
<td>18%</td>
<td>26%</td>
<td>4</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Georgia</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>5</td>
<td>11000</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Hungary</td>
<td>16%</td>
<td>25%</td>
<td>42%</td>
<td>4</td>
<td>No</td>
<td>Yes***</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>30%</td>
<td>16%</td>
<td>30%</td>
<td>4</td>
<td>25000</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Kosovo</td>
<td>20%</td>
<td>15%</td>
<td>20%</td>
<td>4</td>
<td>92000</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>6</td>
<td>2100</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Latvia</td>
<td>22%</td>
<td>10%</td>
<td>25%</td>
<td>4</td>
<td>16000</td>
<td>Yes***</td>
<td>No</td>
<td>Yes***</td>
</tr>
<tr>
<td>Lithuania</td>
<td>15%</td>
<td>10%</td>
<td>33%</td>
<td>4</td>
<td>2500</td>
<td>No</td>
<td>No</td>
<td>Yes***</td>
</tr>
<tr>
<td>(FYR) Macedonia</td>
<td>15%</td>
<td>15%</td>
<td>16%</td>
<td>4</td>
<td>75000</td>
<td>No</td>
<td>Yes***</td>
<td>No</td>
</tr>
<tr>
<td>Moldova</td>
<td>25%</td>
<td>25%</td>
<td>35%</td>
<td>4</td>
<td>No</td>
<td>Yes***</td>
<td>No</td>
<td>Yes***</td>
</tr>
<tr>
<td>Poland</td>
<td>30%</td>
<td>23%</td>
<td>40%</td>
<td>4</td>
<td>9000</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Romania</td>
<td>25%</td>
<td>16%</td>
<td>42%</td>
<td>6</td>
<td>15000</td>
<td>Yes***</td>
<td>Yes***</td>
<td>No</td>
</tr>
<tr>
<td>Russia</td>
<td>20-24%</td>
<td>22%</td>
<td>13%</td>
<td>5 (4 from 2003)</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>25%</td>
<td>23%</td>
<td>35%</td>
<td>4</td>
<td>16000</td>
<td>No</td>
<td>Yes***</td>
<td>No</td>
</tr>
<tr>
<td>Slovenia</td>
<td>25%</td>
<td>20%</td>
<td>50%</td>
<td>4</td>
<td>20000</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>30%</td>
<td>20%</td>
<td>20%</td>
<td>N.A.</td>
<td>N.A.</td>
<td>N.A.</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
<td>6</td>
<td>Small scale firms exempt.</td>
<td>No</td>
<td>Yes***</td>
<td>Yes***</td>
</tr>
<tr>
<td>Ukraine</td>
<td>30%</td>
<td>20%</td>
<td>40%</td>
<td>5</td>
<td>11500</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>26%</td>
<td>20%</td>
<td>36%</td>
<td>6</td>
<td>Small firms are exempt.</td>
<td>No</td>
<td>Yes***</td>
<td>No</td>
</tr>
<tr>
<td>FYR Montenegro</td>
<td>20%</td>
<td>8-17% Sales tax</td>
<td>40%</td>
<td>4</td>
<td>No</td>
<td>N.A.</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>FYR Serbia</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>4</td>
<td>No</td>
<td>Yes***</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: Mitra, Pradeep and Stern, Nicholas, Tax systems in transition, 2003
Linnaeus University – a firm focus on quality and competence

On 1 January 2010 Växjö University and the University of Kalmar merged to form Linnaeus University. This new university is the product of a will to improve the quality, enhance the appeal and boost the development potential of teaching and research, at the same time as it plays a prominent role in working closely together with local society. Linnaeus University offers an attractive knowledge environment characterised by high quality and a competitive portfolio of skills.

Linnaeus University is a modern, international university with the emphasis on the desire for knowledge, creative thinking and practical innovations. For us, the focus is on proximity to our students, but also on the world around us and the future ahead.