

# The Role of Customs in Budget Revenues and Economic Development in Kosovo

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*In this paper we address some of the most important issues related to custom: its functioning, its impact on budget revenues in Kosovo, the method of revenue collection, revenue classification, participation of customs revenues in total revenues and other aspects of fiscal character. Also, other customs functions as instruments of accomplishing other political and economic policies are mentioned in this paper. Special attention is given to regulation and its harmonization with EU directives and other customs standards in the region and beyond. CEFTA agreement is especially mentioned, its impact and role in elimination of non-tariff barriers and market liberalization of signatory countries of this agreement as a step forward for connection in regional and EU integration processes.*

*Keywords: Public revenues, excise, customs tax, VAT*

## 1. Introduction

Public revenues are all those financial funds with which the state/government meets the needs of the public and performs its functions. As such they represent all income or funds that are channelled into a state budget. Economic performance and country development depends largely on public revenues. They are a collection of various taxes, fees, contributions and any other financial income. Public revenues and public expenditures together constitute a state budget. In cases when public revenues are higher than public spending, then we are dealing with a budget surplus, while in cases when public revenues are less than public spending, then we are dealing with a budget deficit. For accomplishing state requirements in the implementation of constitution and performing its functions, to cover the expenses that arise during carrying out of these tasks in its competence. Certain revenues are needed that are implemented by the state and are called public revenues. In short we can say that state revenues are revenues (monetary funds) in cash money, annual and serve for financing (completion) of public expenditure (public requirements) and are part of newly created value. Most important forms of revenue/income are: taxes, contributions, customs, fees, state loans, grants, money emission etc. Customs revenues are notable by the importance, role and participation in public revenue in our country as a dominant form of public revenues along with other revenues collected at the border crossings, which currently participate with 65% in Kosovo's

Budget.

This trend of customs revenue has decreased over the years because customs revenue participation since 2000 was higher and that was over 70% of the total budget revenue.<sup>1</sup>

## 2. Revenues from Customs as a Form of Public Revenues

It is still not very clear exactly where and when the concept of customs has begun for the first time. Adam Smith in his famous work “The Wealth of Nations” says that Customs as common payment obligations existed since ancient times. It is believed that customs existed in the kingdom of the ancient Egypt, around 2700-2200 BC. Evidence is found that tell that “ caravan management” a title for one of official administration posts of that time, that was responsible for registration of goods entering and exiting Egypt, would also collect customs duties along with statistics, thus having similar functions to those of a general directorate of customs today. Many books refer to trade and customs of ancient Egypt. Customs are state cash revenue that is paid on the occasion of certain goods crossing through customs border. The nature and role of customs duties has not been the same in all periods of historical development. Starting from the XV century when their role began to take importance to follow until present day and until XVIII century the role of customs duties focused on the regulation of the country’s trade balance, in order to ensure the introduction of gold in the country at that time regarded as the only real/wealth. This was due to the prevalence at the time of mercantilist theories and policies on the economy. Customs revenues are a special type of indirect taxes which are paid to the case and at the time of the passage of goods through the customs border. Although customs duties are actually paid by people who bring or take out the goods from the customs territory (importers or exporters) given that the latter are included in paying customs duties as a cost in commodity prices, in the final analysis it is the Customers who bought imported goods that are paying the customs duties paid on those goods. This is precisely the reason why customs duties are classified in the category of indirect taxes<sup>2</sup>.

The nature and role of customs duties has not been the same in all periods of historical development. Customs revenues are the oldest taxes/fees that are collected historically. They began, as historical facts show, since the time of slave order, but they took the proper development and weight in the second phase of development of feudalism and especially the in first phase of capitalist relations development. Throughout whole this time have dominated customs duties aimed at protecting domestic production and therefore it may be called the period of protectionism in customs. In the nineteenth century, Adam Smith’s ideas regarding free trade began to settle down more and more, changing the purpose for which customs duties continued to be collected. They began to be considered not as a barrier to the introduction of foreign goods in the domestic market but as a means to raise revenue for public finances, thus profiling fiscal role of customs duties.

Customs revenues and quantitative restrictions on the import or export constitute what is often called trade policy instruments. Customs represent one of the fundamental instruments for the protection of national economies from foreign competition.<sup>3</sup>

The role of customs in tax systems and the overall economic system of a country is of great importance. In Kosovo, customs play a role of great importance in an economic aspect, but also for defence and health reasons. Like we said above, the greatest part of the budget consists of customs revenues, and based on the available data similar to previous years this year also Kosovo Customs continued with positive trend of growth in revenues, a trend following customs throughout years.

<sup>1</sup> Kosovo Customs, Annual Reports 2013.

<sup>2</sup> Adam Smith, *The Wealth of Nations*, London, 1998.

<sup>3</sup> Jelçiç B., *Shkenca mbi financat dhe e drejta financiare*, Prishtina 1985, p. 278.

Despite numerous difficulties in the north of Kosovo, as well as losses in taxes during the first quarter resulting from the non-functioning of two customs points in Jarinja and Bernjak, the plan of forecasted revenues according to projections provided by the Ministry of Finances has been achieved.

### 3. Kosovo Customs Accomplishment: Performance of Customs Revenues (2014)

Customs is an institution that consistently provides the Kosovo budget with revenues that are increasing from year to year. This fact results after a comparison of the respective data corresponding to 11 months of each year. Thus, referring to the data released by the Customs, during January-August period of the year 2015 budget of the country a total a sum of € 542,151.444, 00 were brought by customs revenues, i.e. 59.2% of the plan provided, this includes customs duty, Value Added Tax (VAT) and excise duties. This was a good performance not only as regards Kosovo's Customs but also regarding the Kosovo economy in general, also fiscal policies that the government follows in reducing the fiscal burden. An important step that was taken during 2016 was the continuation of the removal and reduction of minimum tax for agricultural and manufacturing equipment which will have a major impact in stimulating production and agriculture. Overcoming revenues received this year compared to last year's and continuing change of structure of imports and orientation on imported raw materials and semi-finished products, is key indicator that shows a work in progress and a performance which is continuously increasing.<sup>4</sup> This success is primarily the result of increasing the efficiency of the entire administration of Customs control located at the border in the north of the country, applying simplified procedures and cooperation and awareness among businesses, preventing and combatting smuggling and corruption and other negative occurrences. Work on implementing the new electronic customs system for processing customs declarations called ASYCUDA system has also begun which has replaced the last TIMS system.<sup>5</sup> The newly applied ASYCUDA system has provided much greater opportunities for the work of customs officials but also for the business community, since it enables access to system from anywhere where there is an Internet connection, it is a centralized electronic system that will enable the standard application procedures and customs control, also it enables easier supervision of transit goods etc. All these elements will undoubtedly affect continuous increase of customs revenue in the future, from which a greater fiscal consistency will be created from where a financing of public expenditure of the state administration in general will be done without any problem (Asycuda World Program Kosovo-UNCTAD).

In achieving better performance of customs -in particular in terms of filling the budget- various factors have contributed and it is important to reckon:

- Good management and increased control and surveillance of the customs authorities at the border and inside the country
- Changing policies and fiscal rates during 2010 and onwards by the Act 03/L-220 for excise on fuel and cigarettes
- Increasing imports in the main categories of goods such as fuel, cigarettes, vehicles, etc.
- Risk management - application of selective controls and focus on high-risk shipments/hazardous shipments.
- Return of control at border crossings in northern Kosovo.

<sup>4</sup> Asllani G. & Imeri V., *E drejta fiskale dhe ndertimi I sistemit tatimor*, Prishtina 2016 p. 64.

<sup>5</sup> <https://dogana.rks-gov.net> (20 October 2019).

- Allowing import of vehicles older than 8 years and raising the excise rate.
- The application of excise tax on gambling and other games of chance.
- Exchange of information with countries in the region, also awareness of importing companies about their obligations, etc.

#### **4. Customs Revenues in the Overall Structure of Public Revenues**

Revenues collected by customs as the main source of total budget revenues participate in total revenues on average with 65 %. In 2013 total revenues from border crossings are planned to be 906 million euro as main source of Kosovo's total budget revenues. Based on planning by the end of 2015, revenues from the border are planned to reach 991 million euros, a figure which represents an increase of 13.3 % compared to the planned revenues from the border for this year. This projected growth of border revenues for this period mainly comes as a result of the assumption of import level growth, while import growth is estimated to come from the increase in consumption and growth of overall investments. Increased border revenues followed the same trend of import growth, which means that over the years, in general, import growth was accompanied by increased customs revenues. Positive contribution to the growth of revenues is expected to give the continuous increase of the Kosovo Customs performance through increasing cooperation with customs in the region and beyond, customs evaluation basis, enhancing risk analysis, upgrading information systems and combating informality, and also an important role in the growth of revenues is expected to give the control introduction of border points 1 and 31 in the north. In total revenues from border crossings, the main contributor to the revenues from the tax are revenues from VAT with a share of approximately 49 %, followed by excise tax (36 % on average) whereas the share of customs duties/fees in total revenues from the border crossings is 14%. In this regard that customs revenues respectively customs duties/fees occupy a smaller part is influenced a lot by regional agreements on free trade CEFTA (part of which is Kosovo) an agreement that provides the elimination of customs duties/fees on Member States and where the vast majority of products only pay VAT.

On the other hand, the total costs over the projected period of 2013 were expected to show a continuous increase by an annual average of about 2 %, reaching a value of € 1.548 million in 2013. Forecasts suggested that in 2013 total spending budget will mark a slight increase compared with their growth during 2012. This slight increase comes as a result of a more prudent fiscal planning in order to maintain fiscal sustainability in the mid-term. The reduction of public spending, respectively slower increase of spending for this year it has come as a result of the signing of the letter of good Intent (short LOI), between the Ministry of Finance and the IMF in December 2012. The main purpose of these recommendations was that through fiscal rules put certain limitations on one of the specific fiscal indicators as a policy for controlled oversight of macro fiscal stability; as such the restriction can be placed at the level of the budget deficit, debt level, general expenses and similar indicators. As Kosovo moves towards the integration process and one day hopes to be part of the European family and once the SAA-agreement (Stabilization and Association Agreement) is signed then the revenues from customs duties for goods and products coming from the European Union will gradually be eliminated, which will significantly contribute to the collection of customs duty which is currently applied to these countries. Filling the budget from custom tax revenues is not an ideal option for a sustainable budget within a country. Usually, a distinction should be made, as it is known that not only customs tax is collected at customs points, but also is collected VAT on imports and excise; regarding VAT on imports and excise they are more stable revenues for a stable economy, but regarding relying on customs duties, then this is not sustainable in financial terms. Gross domestic product in Kosovo depends on the import of products, goods and services,

then basically, revenues will come from customs and long-term budget stability will not be safe and the best way to succeed in increasing revenues is to increase interior revenues through the Tax Administration where domestic VAT, income from wages, from rents, income from profit, etc. are included. However, the increase of budget revenues within state borders is made possible only through economic growth and economic development, while another option that is very important is combatting the informal economy in Kosovo which is unfortunately a significant issue.

## **5. Customs Revenues and their Impact on Economic Development**

Customs, in addition to the fiscal aspect which is directly related to the collection of revenues and filling the budget, furthermore have their own economic character and an significant role in preserving and developing the economy. Revenues from customs considering their characteristics represent a special kind of indirect taxes.

### **5.1. The Impact of Customs Revenues in the Economic and Social Trends**

Kosovo emerged as a new state from a long process of wars (and later a political and economic transition) is faced with economic and social problems, and is currently trying to mitigate these problems through customs policies and the application of custom tariffs.<sup>6</sup>

Customs duty as an instrument of fiscal policy in general and in particular of the customs policy has great importance not only in providing state revenues, but also in economic and social trends in the country. It may be noted that customs duty has significant impact on the volume of imports of goods, increasing productivity of production capacities, in the formation of prices of the imported goods, in reports of offer/supply and demand in the market, employing people etc...how much these effects will achieve depends on customs policy settings respectively defining of customs duty rates. Currently in our country customs duty rate is fixed in value tax of 10% for all goods which are imported from abroad, except for countries of CEFTA (Central European Free Trade Agreement) where customs duties do not apply for products originating from these countries. This rate of taxation was for the first time applied by UNMIK Regulation 1999/3 and is still currently effective and represents a fundamental flaw in terms of design and application of a genuine customs policy. According to reports from the WTO (World Trade Organization) approximately 9 % of all EU tariffs exceed the rate of 15 %, and a number of them exceed the rate of 100 %. It seems Albania currently has the most liberal tariff regime in the Western Balkans. Its fees consist of six rates: 0 %, 2 %, 5 %, 6 %, 10 % and 15 %. Kosovo has only two, the rate of 10 % and 0%. In order to promote domestic production, the New Kosovo Custom Code implements the reduced tariff rate of 0% of customs duties for the following goods: majority of the raw material, most of the equipment used for production and all raw agriculture materials (such as seeds, fertilizers, etc.) and equipment. For this reason there should be a designation of linear norms of customs duties and trends of further development depend on the setting of these rates, so the adoption of national customs tariff law is most necessary in which case throughout professional analysis that would be provided by law, the appointment of customs duty rates fairly and right, obviously that would ensure the achievement of the clearly defined objectives of customs policy.

### **5.2. The Impact of Customs Revenue in Supporting the Country Budget**

As regards fiscal issues, in developed countries' economies customs revenues participate with a

<sup>6</sup> Kadriu S., *Financimi i shpenzimeve të përgjithshme e të përbashkëta me vështrim të posaçëm në Republikën e Kosovës*, Prishtina 2003, p. 135.

small percentage in supporting or increasing the country budget, but this doesn't apply to the developing economies, including Kosovo's economy where revenues from customs have the biggest influence on raising the state budget. In countries which are in a transition phase, revenue from customs has even greater impact/influence in raising and stabilizing the country budget. In these countries customs revenue are very high and intend to provide funds for financing domestic activities, services and properties, since the state budget can be sustained only if raised by a fiscal system with a comprehensive basis of the non-producing payers –taxpayers and customs payers, respectively financing public spending. For proper functioning of the government organs means must be provided, which after collection on the occasion of the approval of the budget are allocated for financing social activities. In Kosovo, due to the low level of economic development revenues from customs have an important fiscal character, except that at the time of collection of revenues apart from applying regular taxes special taxes are also collected such as various types of excise, since the revenues collected have a dominant role in the establishment of the state budget; the same thing happens in most countries of the Balkans where in war-torn economies like in Croatia, Bosnia-Herzegovina as well as those arising from political transition, such as Albania and Macedonia revenues from customs have got a fiscal character and play a dominant role in raising and stabilizing the respective national budgets in these states.

### **5.3. The Impact of Customs Revenue on Domestic Productivity and Employment**

Custom revenues have an impact and influence also on domestic productivity and economic development, therefore customs application should be regulated by the national law for customs fees and taxes. A greater caution should be exercised in this context regarding eliminating taxes for reproductive materials, raw materials, production equipment and spare parts, since through such measures the cost of domestic production would be reduced; while in an opposite case (i.e. with increased financial duties being applied to these products) there would be some perceivable negative impacts in the process of domestic production. However for widespread consumer goods customs tax should be higher since it reduces their import and stimulates the placing on the market of domestic/local products increasing market competition which is a prerequisite for stable economic development. The application of customs tax rates should be regulated by the law on tariffs, and should be set to a level that would not prevent the import of goods that impact the technological process and should be higher for the goods that are in the market (commercial goods) because this way the aggregate market situation can be adjusted.

Applying taxes on imports also has an impact on employment, this occurs when applying import taxes for certain types of goods demand increases in the country for such types of goods, which in turn increases the need for national production and requires engaging an increased workforce in the respective technological process. But this measure of reducing unemployment should be short-term since this problem should be solved essentially not via customs policy instruments but by applying economic policy measures throughout capital investments and with absorption of foreign investments in domestic economy.<sup>7</sup>

### **5.4. The Impact of Customs Revenues in Setting the Market Price of Goods**

Customs revenues have got also a direct impact on setting market prices in the country. It is known that the amount of customs duties calculated for the imported goods is paid by the importer and this factors into the calculation of the price that is applied at retail stores and is ultimately paid by the last buyer. Apart from direct impact, an indirect impact of customs duties on setting market price

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<sup>7</sup> Rraci Y., *Bazat e sistemit doganor*, Prishtina 2010, p. 107.

also exists; this happens in case of imports when the rate that determines a high customs tax payment is applied; this will raise the price of imported goods and creates space for raising the price of local goods as well. We can conclude that the impact of the customs taxes may have a positive character in some circumstances because it increases competition in the market and creates motivation for local economic entities (businesses) to place higher quality products on the market with much lower cost and competitive prices in the local market as well as regarding exports.

## 6. Conclusions

While Kosovo is moving towards the European integration process, and in the near future will be part of the European family and has already signed the Stabilization and Association Agreement in 2015<sup>8</sup>, the revenues from customs duties for goods and products coming from the European Union will gradually begin to decrease and later will be almost completely eliminated. Collection of over 65 per cent of revenues to state crate (state budget) by Kosovo Customs has put the country's budget in an unfavorable situation, the fact is that this way is not stable for a country especially when taking into account the increased level of integration into European mechanisms. International agreements reached between Kosovo and several other states, as in the case of CEFTA in some cases restrict the capacity of budget revenues because certain categories of goods are removed from the obligation to pay customs. Kosovo Government concluded agreements with some countries to reduce customs duties, which are expected to be achieved at the beginning of this year, and will result in Kosovo having even lower customs revenues compared to previous years. The agreement with Turkey alone, which had already been concluded will have an impact of 17 million euro less in revenues, since it will provide an agreement where the customs tax/fee will fall from 10 % to 0%. Also, the reduction of customs tariffs for capital and reproductive material from 10 % to 2 %. It would be preferable also to reduce VAT rates on imports of capital equipment and especially for investors meaning to apply incentive fees for investors as with the increased level of integration the importance of borders will be reduced and consequently puts to risk the main source of revenue such as customs. In the meantime, revenues will be needed in the budget to fund the spending / costs and I think real opportunity to compensate this reduction in customs revenues is only by setting excise as a special tax/fee since excise is rarely or almost never included in any agreement. Different excise and fees can be assigned to some categories of goods that will compensate what is lost from agreements.

A positive aspect would probably be for Kosovo to entirely remove customs taxes either for product processing, production or final products from EU countries and other countries. And, while not losing sight of the contours of revenues to the budget, VAT should be increased, increasing also the efficiency of VAT collection, increase income/wage revenue and combating informality as well.

The first thing to do is to minimize the informal economy, coupled with combating tax evasion. Furthermore the budget revenues should primarily be based on sources established within Kosovo's borders because the current method of collecting revenues for the state budget from customs results in financial and fiscal instability. As in most other states that have passed this stage, there are always other elements or additional sources from which Kosovo's budget can be covered, such as VAT, income/wage revenue, rents, profit revenue, etc. But the increase of budget revenues within state borders is made possible only through economic growth, economic development – or increasing VAT which is not very practical as it increases the inflation rate. On the other hand, it would be important that Kosovo government make efforts through domestic economic policies to aid the business community in order to increase production capacity, improve quality of production and be influenced in promoting export thus reducing the huge deficit in the trade balance that currently

<sup>8</sup> <https://www.consilium.europa.eu/en/press/press-releases/2015/10/27/kosovo-eu-stabilisation-association-agreement/> (20 October 2019).

exists.