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Impact of Fiscal Policies in Western Balkan SMEs' Growth: Evidence from Kosovo

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ABSTRACT

This paper analyses the impact of fiscal policies on increasing the capacity of SMEs from the manufacturing sector in the Western Balkans, with particular emphasis on those in Kosovo. To achieve empirical results, the data obtained from the opinions of the 100 analysed SMEs were processed through logistic regression. The SPSS statistical software was also used for these statistics. Based on literature review and empirical results, it has been concluded that fiscal policies have an impact on Kosovo SMEs growth. Also in Kosovo and in other Western Balkan countries, fiscal policies and packages have been adopted to support SMEs and have had a significant effect on their activities. Despite the fact that under normal circumstances fiscal support for SMEs has been provided by the governments of these countries, in the near future there should be greater fiscal support to SMEs by means of fiscal incentives due to the devastating effects of the COVID 19 pandemic on each country's economy.

Keywords: *fiscal policies, Western Balkans, SMEs, capacity growth, logistic regression*

JEL: H20, H30, H32

1 Introduction

The Western Balkans is a geopolitical term and covers six countries which are in the process of accession to the EU (British Council, 2018; Jusufi and Ukaj, 2020). This six countries are: Albania, North Macedonia, Bosnia and Herzegovina, Kosovo, Montenegro and Serbia (Jusufi and Lubeniqi, 2019). Except for Albania, all other countries in this region have been part of Yugoslavia. According to Bartlett and Prica (2016) Western Balkans countries can be referred to as the "Super Periphery" of the European Union (EU). As a result of the bitter past, these countries have suffered greatly. Therefore, The European Union (EU) has contributed to the integration and regional reconciliation of these countries in order to achieve social and economic development through different programmes (Tošović-Stevanović and Ristanović, 2016; Ajdarpašić and Qorraj, 2019). This multiyear investment of the European Union (EU) has influenced the increase of administrative, human and financial capacities of the countries of this region (Ajdarpašić and Qorraj, 2020). Table 1 presents the economic indicators of the countries of this region.

Table 1: Main economic indicators of Western Balkan countries in 2017

Indicators	ALB	B&H	KOS	NMAC	MNE	SRB
Population (million)	2.87	3.50	1.83	2.08	0.62	7.02
Nominal GDP at current prices (EUR billion)	11.58	15.29	6.41	10.06	4.30	39.18
GDP per capita PPP (constant 2011 international $)	11 802	11 731	9 780	13 132	16 465	14 049
Unemployment (% of total active population)	14.1	20.5	30.5	22.4	16.4	13.5
Services, value added (% of GDP)	47.5	55.7	45.8	54.6	59.1	50.0
Industry (including construction), value added (% of GDP)	20.9	23.9	25.6	24.1	15.9	26.4
Forestry, agriculture and fishing, value added (% of GDP)	19.0	5.6	9.1	7.9	6.8	6.0
Employment in services sector (% of total employment)	41.1	48.7	n/a	53.8	74.3	56.6
Employment in industry (% of total employment)	18.6	32.2	n/a	29.8	18.0	24.4
Employment in agriculture (% of total employment)	40.3	19.1	n/a	16.4	7.6	19.0

Source: OECD et al. (2019)

The market of these countries of this region is small and is largely influenced by developments in global markets (Qorraj, 2018). None of the Western Balkan countries can be considered to have a functioning market economy because it does not have the competitive ability to compete in the world market (Holzner and Schwarzhappel, 2018; Jusufi and Bellaqa, 2019). According to Qorraj and Jusufi (2019) entrepreneurs in these countries have limited access to working capital along with limited managerial and technical expertise. Also the inadequate educational system is one of the causes of economic and social stagnation of region where unemployment rates are very hight (Vidovic et al., 2011; Jusufi and Ajdarpašić, 2020).

The global financial crisis has affected the countries of this region more than other world countries and the European average. The reasons for this are the low level of development of the financial system of these countries (Erić and Stošić, 2012). Whereas, restrictive monetary and fiscal policies have been used to achieve macroeconomic stability (Lorena, 2010) but the results in the reform of the economy and the public sector as well as of public institutions are insufficient. These problems continue to be challenges for this region in the future (Osmani, 2016, p. 6). The process of political and economic transformation in this region is based on the development of the private sector in particular on the development of entrepreneurial activities. Also creating a favorable environment for doing business for SMEs. However, the problems that these SMEs face are: Insufficient financial support, non-supportive tax system for SMEs, inadequate and insufficient institutional support (Džafić et al., 2008).

European Charter for Small Enterprises package has been endorsed also by the Western Balkan countries consist of ten key areas to which these countries are required to focus and harmonize their support for SMEs:

1. Proper education and professional training for entrepreneurs;
2. Faster and cheaper and start-ups;
3. Better system of legislation and regulation;
4. Availability of skills;
5. Improving access to the Internet system;
6. Not just single market but also many markets;
7. Financial and taxation matters;
8. Strengthen the technological capacity of small enterprises;
9. Successful e-models and top-class small business support;
10. Develop stronger, more effective representation of small enterprises' interests at national and EU level (Bartlett et al., 2005).

SMEs in WB are not in the best competitive position especially with regard to the international market, taking into consideration their limited capabilities, such as higher transaction costs, adaption costs, low level of technology, and low level of cooperation with international SMEs (Qorraj and Jusufi, 2018). For a long time SMEs did not have fiscal support from public institutions due to ethnic conflicts fuelled further by expansionary fiscal and monetary policies related to the military conflicts (Uvalić and Cvijanović, 2018). Internal conflicts in the countries of this region have weakened public sector and justice institutions, weakening public confidence in the rule of law (Chapman et al., 2008).

The institutions of these countries, like those of the EU, constantly reformed their tax system by reducing tariffs, redefining tax bases and making changes and clarifications in the interpretation of existing laws. Simultaneously with the reduction of tax levels, the level of deductions and exemptions from taxes was reduced, as a counter-refund for the reduction of tax rates (Krešić et al., 2017, p. 8; Peci, 2013, p. 75; Syka and Kaduku, 2013, p. 150). Value added tax (VAT) is the main source of tax revenue for WB governments. One of the reasons for this is that corporate income tax rates and personal income tax rates are relatively low following widespread adoption of flat tax reforms. Governments of these countries implement policies for the development and growth of SMEs such as reduction of taxes by 65% if 1-10 new jobs are created; 70% if 10-99 new jobs are created; 75% if at least 100 new jobs are created (Bartlett et al., 2017). Also some of the countries of this region have created special economic zones to attract foreign investors (Krasniqi et al., 2019). In these areas international companies will not pay any taxes. These zones are particularly pronounced in Serbia, North Macedonia and Bosnia and Herzegovina. Details regarding the type of taxes applied in the Western Balkan countries are presented in Table 2. Table 2 presents basic data on the type and level of taxes in the 6 countries of the Western Balkans. It should be noted that no country applies anymore the only standard VAT rate, except the Bosnia and Herzegovina, where the tax policy has not changed so much in the last five years. So as can be seen, all of these countries have applied different tax levels in most cases.

Table 2: Tax levels and reduced VAT rates in Western Balkan countries

Countries	VAT	Corporate/ company (income) tax	Personal income tax	Withholding tax on:			Social and health contributions			Inheritance tax	Property tax
				Divident	Interest	Capital, gains	Total	Employer	Employee		
North Macedonia	5;18	10	10;18	0;10	0;10	0;10;15	27	27	0	2-5	0.1-0.2
Kosovo	8;18	3;9;10	0;4;8;10	0	10	5;10	10	5	5	0	0.05-1
Montenegro	7;21	9-11-15	9-11-15	9	0;9	0;9	32.3	8.3	24	3	0.25-1
Albania	6;20	0-13-23	0-13-23	8	15	15	27.9	16.7	11.2	15	1-8
B&H	17	10	10	0;5	0;10	0;10	41.5	10.5	31	2;10	0.05-0.5
Republika Srpska				0;10	0;10	0;10	33	0	33		
Serbia	10;20	15	10-25	15;20	15;20;25	15;20;25	37.05	17.15	19.9	1.5-2.5	0.3-2

Source: AL TAX, 2020

Meanwhile Table 3 presents the data related to the economic freedom of the Western Balkan countries. From the following figures it can be understood that these countries are approximately similar in terms of economic freedom.

Table 3: Index of economic freedom in Western Balkan countries

WB Countries	Tax Burden	Government spending	Fiscal health
Albania	85.9	74.6	86.3
Bosnia and Herzegovina	83.6	49.3	97.3
Kosovo	92.6	76.5	94.0
Montenegro	85.4	32.1	23.4
North Macedonia	91.5	71.0	87.7
Serbia	83.7	49.7	94.1

Source: 2020 index of economic freedom

Recently some WB countries have improved their fiscal sustainability by creating fiscal buffers. This enabled these countries to fund larger support programs. But the region entered the COVID-19 pandemic crisis with more debt than before the 2009 financial crisis. Borrowing needs to increase interest payments across the region as fiscal deficits and rising public debt and tightening financial markets. After overcoming the pandemic, fiscal policy must ensure a balance between supporting the economic recovery and ensuring the fiscal sustainability of these countries (World Bank Group, 2020, p. 1).

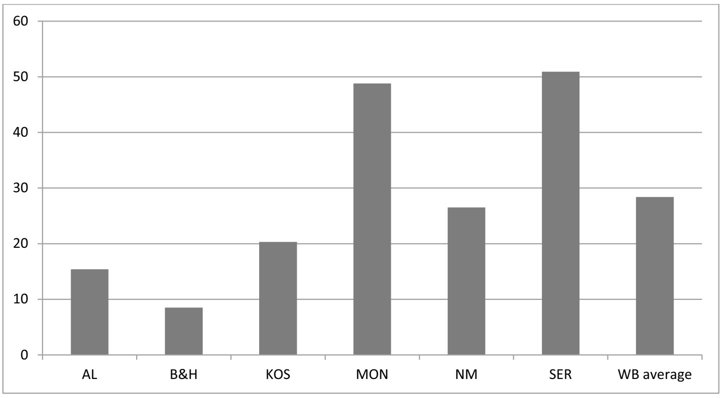
In the following sections the literature review will be done. The literature review will include the characteristics of WB SMEs, a summary of fiscal policies, and the impact of fiscal policies on various economic indicators of developing countries. Then the empirical analysis will be presented, specifically the results of the logistic regression. At the end will be presented the conclusions reached and the confirmation of the raised hypotheses.

2 Literature review

2.1 SMEs sector in Western Balkans

SMEs as economic entities act as catalysts for rapid change and restructuring of the economy in response to changing economic and social conditions (Giurcă and Popa, 2010, p. 1; Ruchkina et al. 2017, p. 260). Over the last decade in the Western Balkans region it has been realized that SMEs have an important role to play in the transition process. Of all the types of businesses, SMEs dominate the economies of the Western Balkan region (Džafić et al., 2007, p. 2). The graph 1 shows the number of SMEs per 1000 inhabitants in this region.

Graph 1: SMEs per 1000 inhabitants in WB region



Source: OECD et al. (2019)

According to Sanfey and Milatovic (2018), SMEs make up about 99% of businesses in this region. SMEs offer jobs for three quarters of the total number of employees, ranging from just under 70% in Bosnia and Herzegovina to more than 80% in Albania. On average, SMEs add one third of the annual value added of countries. This proportion is similar to the EU average, ranging from just over 50% in Serbia to just under 70% in Albania. Therefore, successful SMEs are of great importance to the economies of developing countries or transition economies. Krasniqi and Tullumi (2013) concentrated on a few sets of variables which influence the success of SMEs: Psychological traits, personality, managerial skills and training of entrepreneurs and the external environment. Instinct for independence, innovative orientation, risk attitude, competitive nature, mastery of business skills, availability of capital, previous experience and family support all have an impact on success (Kadriu et al., 2019, p. 401). The total number of SMEs in this region can be seen from the data in the Table 4.

Table 4: Number of SMEs and their share in Western Balkans total firms number

Country	Number of SMEs	Share
Albania	44,173	99.66%
Bosnia and Herzegovina	29,743	99.12%
Kosovo	37,115	99.86%
Montenegro	30,238	99.84%
North Macedonia	55,055	99.73%
Serbia	357,234	99.85%

Source: OECD et al. (2019)

Rehman et al. (2019) analyzed barriers to growth of WB SMEs. The region has great potential for growth and development of SMEs, especially those in the service sector. Within the services sector, retail and wholesale have the highest percentage of SMEs. Public institutions must play a crucial role in improving the conditions that promote better performance for SMEs. The tax system and the improvement of the regulatory environment should also be simplified. Access to finance is a significant factor that determines the growth of SMEs. Therefore, there must be adequate access to finance.

Properly educated workforce is a problem. This workforce must be trained. The most important role of government in this regard is to educate society at all levels of education to practice entrepreneurship. There should be a general policy coordination in this region, so that all measures taken result in a better performance of SMEs. Also according to Nizaeva and Coşkun (2018) there should be effective government policies aimed at increasing SMEs' access to external financing. SMEs need to rely on the following areas to combat slow growth: Credit facilitation, business support services, technology services, entrepreneurship skills and development, and specific initiatives (Bekefi, 2006, p. 13; Leitner, 2015).

From this sub-section it can be concluded that SMEs are of great importance for the economic development of many countries, especially the Western Balkans. Despite this, the number of SMEs in this region is still small and there is no capacity to alleviate unemployment and ensure overall well-being for this region. Also, the SME sector faces many different challenges and problems that hinder the normal development of this sector, which is so vital for the economy of region.

2.2 Fiscal policy and SMEs growth

There is a lot of research on the impact of fiscal policies on economic growth and SME growth of developing countries. However, there is a lack of literature on the impact of fiscal policies on SMEs of the Western Balkans, especially those of Kosovo. According to Korkmaz et al. (2019) there is a positive and significant impact of indirect taxes on economic growth of developing countries, and a negative and significant impact of direct taxes both in the short run and the long run. Taxation is also one of the main tools of governments to influence the enterprise with the aim of increasing its profit (European Commission, 2017, p. 5). Osmani (2014) analyzed fiscal decentralization as a way to achieve effectiveness in the economic system. In Western Balkans, the process of political and financial decentralization has had many shortcomings because this decentralization has not been analyzed from a functional point of view, but from an ethnic point of view. Examples are Bosnia and Herzegovina, North Macedonia and Kosovo. Easterly and Rebelo (1993) analyzed empirically the effect of fiscal policy on economic growth and evidences support a strong association between the development level of the country and the fiscal structure. In developing countries, international trade taxes are important, while in developed economies, income taxes are a priority. Fiscal policy is influenced by the scale of the economy, measured by its population, investment in transport and communication is consistently correlated with growth. Therefore, the effects of the tax are difficult to assess empirically.

According to Alves (2019) different fiscal policies can have a decided impact on investment decisions of different SMEs. If the government imposes lower taxes on individual income, this could lead to increased aggregate demand for durable and non-durable goods. This brings higher profits and offers new investment opportunities. When the government decides to change corporate tax rates, this affects several sectors. In particular, tax benefits may lead to specialization in higher value-added economic activities for the economy. Moreover, tax raises in property and social security contributions reduce consumption. These tax policies affect the movement of interest rates. This promotes companies' investment decisions. Beca and Nişulescu-Ashrafzadeh (2014) has achieved similar results. Meanwhile Zhllima et al. (2013) emphasize that VAT reduction and excise exemption is very important for agricultural products such as greenhouses. Also Lešnik et al. (2018) confirms that the tax gap is reduced in conditions of economic growth.

The role that fiscal policy should play in promoting economic stabilization has changed in the last decade as a result of conditions and advances in economic research. Auerbach (2017) using a variety of valuation strategies for different countries and different time periods, has suggested that multipliers can be large for both tax and cost changes, and that the effects can be improved during periods of economic slowdown. Taxation in general deals with transferring a part of profits earned in one jurisdiction to the state budget of that jurisdiction (Grubišić and Ćevizović, 2008, p. 115). Balseven and Tugcu (2017) analyzed the impact and role of fiscal policy on the welfare and income of certain countries. Tax revenues alleviate income inequality in developing countries while social benefits alleviate income inequality in developed countries. Also, economic growth has a negative impact on income distribution in developing countries, while economic growth and inflation have a positive impact on income distribution in developed countries.

When public debt does not exceed the present value of the expected primary budget surpluses we have fiscal sustainability. Shevchuk and Kopych (2018) support fiscal policy aimed at increasing government revenues combined with cuts in public sector spending, in case the current policies are not sufficient to achieve fiscal sustainability. Any attempt to lower the interest rate and stimulate output growth from an expansionary monetary stance is likely to be counterproductive in the presence of significant public external debt at risk of exchange rate misuse. Ćorić et al. (2015) asserted that only coordinated monetary and fiscal expansion can stimulate economic growth in developing countries without compromising exchange rate stability. Both expansionary policies have positive effects on economic activity while the effects on the nominal exchange rate are in the opposite direction. In volatile conditions, public institutions need to implement more prudent fiscal policies in the expansive phase of the business cycle, to stimulate growth in future economic slowdowns. The budget is a framework for expenditures on income and expenditures for one year. It defines policies and programs aimed at achieving government development objectives. Oke (2013) states that government should try to include more capital expenditures in that budget to accelerate the recording of an annual increase in the value of the growth process brought about by the future effect of capital investments.

Fiscal deficit is a problem that many countries face. As a result of expansionary fiscal policies, the fiscal deficit has increased significantly in developing economies. Tung (2018) showed that in all periods the fiscal deficit had a negative effect on the economic growth of developing countries. Policymakers need to make greater efforts to reduce spending. The public budget is not spent to maintain a large state-owned sector because government spending on this sector causes a prolonged budget deficit. The government should generate more revenue from domestic tariffs and taxes, which are obtained from luxury products and services from foreign countries. Similar results have been achieved by Velnampy and Achchuthan (2013). If government institutions aim to implement more effective fiscal policies that would be a useful part of investment policy, it is essential to provide tax law entrepreneurs with the security of using tax incentives that they can understand without much effort and extra risk. in their interpretation and implementation of the business. Thus, the sustainability of the implemented fiscal policy is ensured (Bogovac and Hodžić, 2014, p. 68).

Ezejiofor et al. (2015) concluded that taxation as an element of fiscal policy has a significant impact on the performance of SMEs. The performance of SMEs determines the amount of tax to be paid. Governments should be sensitive to changes in taxes and other macro-environmental elements, enabling productive sectors to adapt to the dynamic environment. Another study conducted by Eze and Ogiji (2013) claims that government expenditure have positive and significant effect on manufacturing sector output, while government revenue have negative and significant impact on manufacturing sector. The result also reveals that there is longrun relationship between fiscal policy and manufacturing sector output, as evidenced by the co-integration. Augustine and Asiedu (2017) reached a significant impact of monetary policy on the performance of SMEs in terms of employment growth. Despite the high interest rates, SMEs that manage to reduce lending rates have a higher growth in terms of employment. Fiscal policy in terms of tax perceptions is less related to the performance of SMEs. To empower SMEs, relevant institutions need to constantly monitor the financial system in order to minimize the large spread of lending in an environment with high rates. Atawodi and Ojeka (2012) studied the impact of tax policy on SME growth. Tax regulations should be simplified in order to facilitate the activity of SMEs. Tax administrators need to perform their duties more efficiently with integrity. This solves the problem of multiple taxes. SME owners should also be educated on tax payment issues.

Kukanja and Planinc (2018) analyzed the efficiency of SMEs in Slovenia after the government's implementation of fiscal cash registers. Revenue growth was achieved as a result of fiscal cash registers. This increased the efficiency of financial data. Tee et al. (2016) asserted that changes in tax rates lead to changes in the prices of goods and services. Increasing tax rates cause higher costs of production, distribution and sales. These increase prices and with rising prices change consumer behaviors. People buy fewer products as a result of high prices. Whenever prices rise due to rising tax levels, the level of consumption falls and this affects the development of SMEs. Paying taxes reduces the purchasing power of an SME because a large amount of money raised is used to pay taxes instead of SME growth.

The results of Gbande et al. (2018) show that major determinants of SMEs growth are policies directed on tax rate reduction and stability, and government expenditure on infrastructure targeting. The policy insinuation therefore, is that fiscal policy should be set in such a way that the objective it wants to achieve is clearly and transparently defined in response to the dynamics of the domestic and global economic developments. The government should maintain its expenditure on infrastructural developments, as this will have a multiplier effect on the growth of SMEs activities and enhance the overall economic growth. Gupta et al. (2013) claim that among economic environment factors fiscal policies affect SMEs growth. Meanwhile Yusuph and Youze (2014) emphasize that the government should provide basic fiscal and monetary conditions for SME development, such as political stability, favorable macroeconomic conditions in terms of low inflation and a real exchange of interest and interest rates, low levels of import protection in the sense of the absence of quantitative restrictions and relatively low uniform tariffs and an efficient legal system. Policy instruments and support measures at the national sector and at the SME level should be well addressed and classified into three types: Enticement Policies, Supply-side policies and Bunch Policies.

According to Sivalingam and Bhaskaran (2005) VAT could lead to new investment opportunities for SMEs because in case many products inclusive of VAT costs is more to consumers in a location far away from the place of manufacturer as a result of value added by transportation, storage and trade chain margins, this would make it attractive for entrepreneurs to start a production facility near the last point of consumption and gain a share of the existing market. Mach (2018) analyzed VAT rates and their impact on business and tax revenue and he emphasizes that reducing a tax rate which is higher than the revenue maximizing rate would be good for everybody.

Manzo (2011) claims that the productivity growth of SMEs is more sensitive to changes in the corporate tax rate than that of larger and older firms. The reasons for this are not immediately clear although they suggest that this could be due to the difficulties that SMEs have in accessing debt finance. According to Wadesango et al. (2018) the self-assessment system requires constant education of taxpayers, as there are always new emerging laws and revision of tax legislation. Other factors that affect SMEs in compliance are the speculations of corruption within those charged with governance on the use of tax monies, the lack of transparency on public sector funds raises a negative attitude towards tax.

Other issues that affect SMEs on complying through Self-assessment system are complexity of the tax legislation and as previously stated the economic environment is a probable cause for tax evasion. The complexity of tax legislation has caused SMEs to fail in the application of exemptions and other benefits such as capital allowances, wear and tear and allowable deductions. A tax incentive grant to SMEs encourages a positive attitude towards tax and encourages SME growth and public funds transparency is also to be considered. Matarirano et al. (2019) studied impact of tax compliance costs on business performance. According to their findings internal tax compliance costs were found to have the heaviest burden on small businesses, and thus had the strongest impact on performance. External tax compliance costs were found to have a negative effect on business performance. These authors recommend proper tax planning for small businesses to enjoy the benefits associated with tax compliance costs. To improve on their performance, small businesses are advised to undertake tax tasks in-house.

The study of Pope and Abdul-Jabbar (2008) has shown that the most important policy area that should be addressed is to recognize fully the compliance burden of the SMEs at the national level. Accordingly, establishment of relevant committees, similar to the Beddall Committee and the Small Business Deregulation Task Force in Australia, involving all relevant parties, relevant SMEs organizations, tax professionals and academics, is recommended. Feyitimi et al (2016) claim that tax incentives are germane to the growth, development and continued sustenance of SMEs. Tax incentives play a vital role in ensuring that SMEs thrive. There was a significant correlation between taxation and SMEs' growth. The study recommends that there should be a friendly tax policy for all startup businesses preferably a tax holiday, or an introduction of a growth limit which can be said to be a level stable enough to sustain tax payment. Also Twesige and Gasheja (2019) in their study emphasize that there was a strong positive and significant relationship between tax incentives and the growth of SMEs. The study concluded that tax incentives are the key to the sustainable growth of SMEs. The government should design policies that specifically address issues related to the sustainable growth of SMEs.

Mungaya et al. (2012) studied the effect of tax incentives on SMEs growth and SMEs which are not registered cannot benefit from the tax incentives. The many SMEs that operate in the informal sectors cannot benefit from growth incentives. The findings of the study also show that SMEs that have not prepared books of accounts and payroll summaries as they have a small number of employees cannot benefit from tax incentives. The same applies to SMEs whose owners are business employees, who do not take into account the principle of business as a separate entity from the owner and employment status. Due to this fact the tax imposed on them is based on approximations which may not reflect the true picture of business' turnover. As a result, the business may be charged a huge amount of tax compared to what it would probably pay if books of accounts and payroll summaries were maintained.

3. Tax policy and system in Kosovo

Having in mind that Kosovo is transitioning from a socialist, centrally-planned economy to a capitalist, market economy, with a decade of existence as a parallel ineffective state, a devastating conflict in between the transition, and a half-decade rule of international community where the primary concern were human rights, it is not surprising that tax policies and their effect have not been a priority for researchers. In terms of tax incentives, it can be argued that other than basic tax incentives import tax exemptions and VAT exemptions for a few goods and services, there are no major tax incentives foreseen in the Kosovo laws. Recent developments regarding free economic zones are preceding changes in tax incentives. Tax rates in Kosovo are low compared to other countries in the region or in Europe but Kosovar manufacturers still find them to be high, mainly because they operate in an environment where the cost of doing business is already high. They are thus driven to informality, which among other adverse effects, such as lower opportunities to get credit, also makes them vulnerable to tax officials' arbitrariness and extortion, creates conditions that are conducive for unfair competition, and further increases their cost of doing business (Ministry for Foreign Affairs of Finland & UNDP, 2014).

In Kosovo creators of tax policy in 2009 did a reduction of tax norms in two main forms of direct taxes, Corporate Income Tax (CIT) from 20% to 10% and Personal Income Tax (PIT) from 0%, 5%, 10% and 20% to 0%, 4%, 8% and 10%. At CIT, the aim was through reduction of tax norm, to increase the competition capacity of Kosovo vis-à-vis Foreign Direct Investments, respectively CIT norm to be harmonized in the level of existing norms of CIT that were already existing in Western Balkan countries. At the case of PIT creator's aim was to achieve another objective, that of fighting fiscal evasion, respectively attracting tax subjects so that by stimulating with tax burden they move from subjects of gray economy to subjects that manage to carry out their tax obligations. At the increase of VAT norm from 15% to 16% designers had fiscal intentions, respectively the aim was to be done the compensation of public incomes that would be lacking along with decreasing of tax norms of CIT and PIT.

On September 2015, the amendments to the Law No. 05/L-037 on Value Added Tax (VAT) entered into force. The standard rate is 18% (previously 16%). This represents a 50% decrease from the initial standard rate of 16%. Considering the importance of VAT on budget revenues, in order to make up for the lost revenues with the introduction of the reduced rate, the Draft Law on VAT foresees an increase of the standard rate from 16 to 18% for all other remaining categories. In the meantime, the rate of 0% is applied to exports with the aim of stimulating export-oriented firms. At VAT, creator's aim was that through reduced rate of 8% tax policy to be more in realizing social equality. Except decreasing of tax norms, Kosovo has applied few numbers of tax incentives to CIT in order to simulate foreign investors. Tax incentives mainly are related to CIT. Therefore, Kosovo in comparison to the compared countries, it very little applies tax incentives, by making tax policy and tax system in this segment not being in function of economic development (Peci 2016).

Through the variable *Impact of the tax administration* we have tried to analyze the impact of the institution of tax administration on the business activity of SMEs. So how effective are the activities of this institution in increasing the functionality of the analyzed SMEs. From descriptive statistics it can be understood that this institution is often effective in performing its tasks towards SMEs. While this variable does not represent significance in logistic regression. According to World Bank Report (2014) Kosovo institutions need to strengthen the tax administration by developing the quality of tax inspectors, improving risk assessment modules, stepping up efforts to combat tax evasion, and increasing random audits to assess areas for improvement in risk assessments. To better understand Kosovo's tax system we can rely on the data in the Table 5.

Table 5: Tax types in Kosovo

Tax type	Turnover threshold	Tax rate
Value Added Tax- VAT	30000 E	8% and 18%
Corporate Income Tax- CIT Manufacturing, trading and transporting industry, etc Service industry	under 50000 Euro	3% 9%
Personal Income Tax- PIT Manufacturing, trading and transporting industry, etc Service industry	under 50000 Euro	3% 9%
Corporate Income Tax- CIT	over 50000 E	10%
Personal Income Tax- PIT Annual income from 0 to 960 Annual income from 960- 3000 Annual income from 3000- 5400 Annual income from 5400 and over	over 50000 E	0 % 4 % 8 % 10 %
Tax on wages (monthly) Annual income from 0 to 80 Annual income from 80- 250 Annual income from 250- 450 Annual income from 450 and over		0 % 4 % 8 % 10 %
Tax on rents, interests and Royalties.		10%
Tax on special categories		3%
Tax on non-residents		5%

Source: Tax Administration of Kosovo (2020)

The Government of Kosovo made a number of decisions for fiscal adjustment. Among other things, these decisions are related to the approval of new drafts:

a. Value Added Tax (VAT);

b. Corporate Income Tax;

c. Personal Income Tax.

Under Article 6 of the Draft Law on VAT, the threshold of VAT is reduced of 50 000 € as current law is 30 000 €. So any business that performs turnover over 30 000 € per year, will be obliged to register for VAT and pay the portion that exceeds this amount. Budget would benefit from this reduction in the VAT threshold because a greater number of businesses will be obliged to pay VAT. This fiscal policy will burden the new businesses and small businesses, especially those services that have lesser levels of supplies. It is exactly the new businesses that need fiscal incentives and which potentially create new jobs. VAT is charged with the standard rate of 18%. Notwithstanding paragraph 1 of this Article, the reduced VAT rate is calculated and paid 8% for the supply of goods and services, as well as their import (Statovci and Asllani, 2017).

In addition to these decisions, Fiscal package 2.0 has been approved by the government of Kosovo in 2017 and provides tax exemptions for new businesses, from three to seven years, depending on the amount invested and the number of employees. We have tried to get the opinions of Kosovo SMEs regarding the effects of this package through *Impact of fiscal package 2.0* variable. Most of the surveyed SMEs stated that this package has had a positive impact on their business activity. This variable is significant. The last variable is *Fiscal policy functionality* through which we have tried to obtain the opinions of SMEs analyzed on the functionality of fiscal policy. A large number of SMEs analyzed stated that fiscal policies in Kosovo are functional so they are at the service of businesses. Also the results of logistic regression show that this variable has a positive relationship with the dependent variable. So the more functional the fiscal policies in Kosovo, the more the capacities of SMEs will increase.

Asllani (2011), Asllani et al. (2020) claims that Kosovo's budgetary sustainability requires improvements in tax collection and administration processes, an increase in fiscal culture, the establishment of a complete, advanced and enforceable legal framework, better definition and full implementation of policy good government in terms of budget expenditures, elimination of corruptive phenomena, very good control of the movement of goods at the border and within the country and a continuous reduction of the informal economy and tax evasion. All this will enable better quality revenue collection, thus ensuring the growth of SMEs. According to Kryeziu (2019) one of the objectives of the tax policy norms in Kosovo, is to continuously improve and design tax system. Whereas, as far as trade relations between states are concerned, the primary purpose of this policy is to make efforts to harmonize taxes at EU level, as the pronounced difference in tax rates can break down and `regulate market competition at EU level. In addition to the improvements made, the countries of the Western Balkans also face many challenges in terms of fiscal policy. The Table 6 is a summary of the challenges and recommendations to be made by the institutions of the Western Balkan countries.

Table 6: Challenges and policy recommendations of fiscal policies in Western Balkan countries

Country	Challenges	Recommendations
Albania	High debt and financing needs, heavily dependent on banks	Fiscal consolidation largely through revenue measures and phasing out energy subsidies
B&H	Balance the need for further fiscal consolidation with supporting growth; composition of spending	Contain current, non-disaster related spending, notably wages and benefits; improve the quality of public spending; continue ongoing efforts to improve revenue collection and administration
Kosovo	Safeguard fiscal sustainability, arrest the worsening composition of the budget	Wage and benefit moderation; improve tax compliance; shift tax policy gradually towards domestically collected taxes
North Macedonia	Rebuild buffers and safeguard sustainability of public finances and the exchange rate peg	Fiscal consolidation embedded in a comprehensive spending review
Montenegro	High and rising debt, preserving market access	Fundamental expenditure reform on pension system and public sector wages
Serbia	High debt, increasing debt dynamics	Ambitious and sustained fiscal adjustment through wages and pensions, reducing state aid to weak state-owned enterprises

Source: IMF 2015, 108

Abdixhiku et al. (2018) claim the importance of institutional elements and the tax rate. Slow reforms, high corruption and high tax rates reduce the amount of taxes paid by SMEs to transition economies. In these economies, government reforms are key to combating tax evasion. According to BSC Kosovo (2013), It is assumed that in Kosovo about 50% of turnover is not declared by businesses to the tax authorities. Despite this, tax collection has improved as a result of stricter control by tax administration officials. Therefore, based on these data, it can be said that the tax administration has a tremendous impact on the functionality and effectiveness of fiscal policies and the fiscal system in developing countries. Asllani (2015) claims that Kosovo has a poor collection of the incomes. Mostly dominate border taxes (excise, customs fees, VAT) with tendency to fall down slowly and beside this a symbolic increase of internal taxes. The intention of government policy should be oriented in the collection of the taxes inside the country not to be collected at the border. Certainly to achieve the objective in collection of the incomes within the economy the country, needs time and to build institutional and economic capacities. Also, at the local level should be done more not only in the most incredibly completion in the field of harmonization of legislation but should increase the efficiency even in cases of collection of funds and also should be done the fiscal decentralization. Another important component is the issue of government spending, as those costs burden the budget and where they are oriented.

4 Methodology And Data

Empirical research has involved the collection of data using survey. The process of data collection took place between November 2019 and March 2020. We analyzed 100 Kosovo manufacturing SMEs that currently operate in Kosovo market. The target audience, focus on CEOs, and production managers of manufacturing SMEs in all regions of Kosovo. The interview of the respondents lasted 50 minutes. Due to the nature of the empirical problem, face-to-face interviews were conducted. We selected data for these SMEs from Ministry of Trade and Industry of Kosova. In logistic regression the dependent variable has two categories 1 and 0. Like ordinary regression, logistic regression can include some independent variables, which can be quantitative or qualitative. The logistic regression model can be written as follows:

$$\text{logit}(p) = a + b_1x_1 + b_2x_2 + \ldots + b_ix_i \quad (1)$$

Logistic regression makes it possible to understand the impact of the dependent variable on the independent variables. The suitability of the formulated model can be assessed using several methods (Bewick et al., 2005)

The logistic regression equation is as follow:

$$P(Y_i = 1) = (\beta_0 + \beta_1 \text{Business duration} + \beta_2 \text{ Education background} + \beta_3 \text{ taxes} + \\ + \beta_4 \text{ Impact of the tax administration} + \beta_5 \text{ Impact of fiscal package 2.0} + \\ + \beta_6 \text{ Fiscal policy functionality} + \varepsilon_i \quad (2)$$

Table 7: Variables of logistic regression

Dependent variable	Variables descriptions and measurement
Capacities growth	1- if the capacities increased, 0-otherwise
Independent variables	Variables descriptions and measurement
Business duration	1 to 5 years (reference category), 1. 6 - 10 years, 2. 11 - 15 years, 3. 16 - 20 years, 4. 20+ years
Education background	Low (reference category), 1.Secondary, 2.High, 3. Master of science level employee, 4. PhD level employee.
Impact of taxes on business constrain	Never (reference category), 1.Rarely, 2.Sometimes, 3.Often, 4.Always
Impact of the tax administration	Never (reference category), 1.Rarely, 2.Sometimes, 3.Often, 4.Always
Impact of fiscal package 2.0	1- Yes, 0-otherwise
Fiscal policy functionality	1- Yes, 0-otherwise

Source: own calculations

The model will be tested to determine if there is a relationship between the fiscal package 2.0 and SMEs capacity growth, as well as tax constraint and SMEs capacity growth. Therefore, the hypotheses of this paper will be:

H1: No relationship between tax constraint and SME capacity growth;

H2: Positive relationship between fiscal package 2.0 and SME growth.

H3:Tax administration has a positive impact on the functionality of fiscal policies in developing countries such as Kosovo.

SME capacity growth is the dependent variable. There is a lack of research that has used sales as a dependent variable to measure SME growth. SME growth is associated with strong survival and achievement of organizational goals (Rexhepi Mahmutaj and Krasniqi, 2020, p. 30). The dependent variable is capturing period of 2015–2019. SME representatives were asked if their capacities had increased during this period. 68 of the surveyed SMEs answered that YES have increased their capacities, while the rest answered that NO their capacities have not increased.

5 Results

The Table 8 presents the descriptive statistics for each analyzed variable. So in this table are presented the answers of the representatives of the analyzed SMEs.

Table 8: Descriptive statistics

Variables	Frequency
SME capacities growth	
1- if the capacities increased	68
0-otherwise	32
Business duration	
1 - 5 years	11
6 - 10 years	26
11 - 15 years	28
16 - 20 years	20
20+ years	15
Education background	
Low	6
Secondary	39
High	45
Master of science level employee	8
PhD level employee	2
Impact of taxes as business constrain	
Never	10
Rarely	5
Sometimes	44
Often	36
Always	4
Impact of the tax administration	
Never (reference category)	1
Rarely	13
Sometimes	7
Often	49
Always	30
Impact of fiscal package 2.0	
Yes	61
Otherwise	39
Fiscal policy functionality	
Yes	84
Otherwise	16

Source: own calculations

The Table 9 shows the data or results from the logistic regression. Their comments will show what impact each independent variable has on the dependent variable or on increasing the production capacity of the analyzed SMEs.

Table 9: Logistic regression results

Variables	B	Std. Error	Wald	df	Sig.	Exp (B)
Business duration						
1 - 5 years (reference category)						
6 - 10 years	1.167	1.046	1.222	1	0.068	0.954
11 - 15 years	1.230	0.566	1.296	1	0.042**	1.023
16 - 20 years	1.165	0.423	1.185	1	0.091	0.951
20+ years	1.241	0.863	1.327	1	0.085	2.032
Education background						
Low (reference category)						
Secondary	-1.006	0.556	1.185	1	0.062	1.942
High	1.422	0.423	1.369	1	0.058	0.133
Master of science level employee	1.216	0.359	2.066	1	0.126	1.011
PhD level employee	1.365	0.502	2.455	1	0.143	0.627
Impact of taxes as business constrain						
Never (reference category)						
Rarely	1.158	1.006	1.533	1	0.679	1.039
Sometimes	1.237	1.036	1.452	1	0.023**	0.827
Often	1.697	1.569	2.036	1	0.593	0.648
Always	1.324	1.098	1.556	1	0.752	0.863
Impact of the tax administration						
Never (reference category)						
Rarely	1.235	1.023	2.552	1	0.094	0.956
Sometimes	-1.558	0.856	2.435	1	0.103	0.639
Often	1.654	0.795	1.221	1	0.087	1.236
Always	1.698	1.033	1.563	1	0.076	1.498
Impact of fiscal package 2.0	2.356	1.008	2.030	1	0.047**	3.569
Fiscal policy functionality	1.876	0.963	1.783	1	0.075	1.911

Notes: **significant at 5%. Source: Own calculations.

The first category *1 to 5 years* of the first variable *business duration* is reference category. This category will not be included in the logistic regression calculations. While other categories of this variable will be compared with the reference category. Categories *6 to 10 years* and *16 to 20 years* are in negative relation to the reference category because their values are (0.954) and (0.951). With the increase of these values, the production capacities of SMEs decrease. *11 to 15 years'* category is significant category. Gashi (2014) has achieved similar results in terms of business experience or duration of Kosovo SMEs.

As for Education background variable *low education level* category is reference category. *High* and *PhD level employee* categories are in negative relation with reference category. As the values of these categories increase, the influence of the reference category decreases. The more these SMEs hire employees with higher education the more the number of employees with lower level of education will decrease. The average salary in Kosovo ranges from 350 to 450 Euros. The trend of the salaries has been increasing 5 to 10 percent during the last three years, and this trend is being expected to further increase in the coming years. An obstacle regarding employee recruitment is that of low qualified applicants in the field of food engineering. Therefore, in most of the SMEs outsource food-engineering experts from EU countries or from other neighboring countries. Another problem that SMEs face when recruiting and hiring new employees is considered the low willingness and low interest of youth for handicraft work (Riinvest Institute, 2016, p. 49).

Regarding *Impact of taxes as business constrain variable*, most SMEs (44) have declared that taxes sometimes pose a problem for their business activity. This category is also significant. Based on the responses of SMEs and the results of logistic regression, it can be said that taxes do not pose a major problem for the development of business activities in Kosovo. But this only applies to normal conditions, because in the current conditions where COVID 19 has hit the economy of every country hard, it cannot be said that taxes do not pose a major problem for SMEs. In the current conditions, SMEs are not carrying out normal activities and this will affect the payment of taxes. There is lack of research on the impact of tax rates or tax incentives on private sector investments and economic development in Kosovo. The lack of consistent, detailed and reliable data in Kosovo has made any such efforts difficult or even impossible. Kosovo has undergone a process of institution-building only recently and has only now started to accumulate tax records or enterprise surveys that can be used to build longer time series and analyze trends.

6 Conclusion

Fiscal policies are very significant for general development of all countries. Through them, social equality is achieved, the development of enterprises through their support by easing taxes and fees, etc. From the literature review it can be claimed that the countries of the Western Balkans have made considerable efforts to formulate fiscal policies in line with the contemporary needs of business and other stakeholders. Many reforms have been made which have been requested by the EU institutions, with the aim of bringing the fiscal policies of this region closer to those of the EU. All this was done during the process of integration of these countries into the EU. Harmonization of fiscal policies is one of the key elements that enables faster integration of these six countries in the EU.

This region has similar economic indicators. Therefore, the empirical evidence obtained from the analysis of Kosovo SMEs can be applied to other countries, simply a comparison sample can be taken for further studies. Our first hypothesis is *No relationship between tax constraints and SME capacity growth* and based on the results achieved, it can be said that tax-related barriers or tax constraints are not a major barrier to the business activity of these SMEs. So the level of taxes in Kosovo does not hinder SMEs much to carry out their business activities. However, despite this result, it can be said that in the near future as a result of the crisis caused by COVID 19 taxes will be a major barrier to the development of business activities in Kosovo and other Western Balkan countries.

Our second hypothesis is *Positive relationship between fiscal package 2.0 and SME growth*, which can be proved to be accurate because it is significant and has a positive relationship with the dependent variable SME capacity increase. This package has had a positive role on the business activity of SMEs in Kosovo. Similar packages have been adopted in other countries of the Western Balkans, so any initiative taken by public institutions for fiscal relief is very beneficial for businesses in each sector. Despite the positive results, it is recommended that in the near future due to the crisis by COVID 19, the countries of the Western Balkans adopt special fiscal packages aimed at supporting SMEs to overcome the economic and financial consequences of this pandemic. In Western Balkan countries there are many fiscal and public policies aimed at increasing SMEs and expanding their business activity, but so far there have been very few such studies that have researched their effect on SMEs. Therefore, the added value of this paper lies in the research of such an important topic for the financial sustainability of these countries.

As for our last hypothesis Tax administration has a positive impact on the functionality of fiscal policies in developing countries such as Kosovo, it can be said that the tax administration plays an important role in this regard. Therefore, the more organized and legally strong this administration is, the more effective will be the fiscal policy and its instruments in developing countries. This assertion is also supported by the empirically obtained data of our paper.

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