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# **Building Systems for Revenue Mobilization and Tax Administration The Case of Kosovo**

**Handout 2 for Post Conflict Course USAID Oct. 16 2007**

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**In this presentation we discuss:**

1. Nature of the conflict
2. Post war situation and tax challenges
3. Immediate, intermediate and recent focus of tax policy and tax administration
4. Major Results
5. Where are we today relative to the Region
6. Lessons Learned

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## Nature of the conflict

- International intervention to end violence
- Ethnic conflict/cleansing
- Destruction throughout the country
- Massive numbers affected
- Establishment of a UN authority

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## Immediate post war situation

- High demands for spending
- Loss/lack of human capital; need to create institutions from scratch
- Collapsed or misaligned institutions
- Little international consensus that Kosovo needed a modern tax system rather than indefinite donor support
- Legacy of informality and non-cooperation with authorities
- Little tax base other than international presence, which is mostly exempt

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## Post-conflict tax challenges

- Create a tax administration from scratch.
- Tax policy for market economy, in parallel with analytical capacity.
- Create Customs operations.
- Replace payments system for both private and public sectors.
- Popular demand for reinstatement of a pension system.

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## Immediate focus

- USAID focus on creating basic, simple taxes first (first presumptive; then VAT, wage withholding, pensions)
- Creation of a tax policy unit (internationally led but with junior local professional staff) from very early on
- Little capacity building initially in policy; lots of attempts at capacity building in administration

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## Intermediate focus

- USAID provided assistance in tax administration, tax policy, macroeconomic analysis, and pension reform
- UN mostly implemented customs
- Tax revenues grew as donor contributions declined
- Most revenues were collected at the border

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## Most Recent Developments

- Wage withholding tax was replaced with a modern personal income tax. Difficulty in implementation.
- No substantial digressions in tax policy. The general trend of introducing simpler taxes, and then more modern taxes, continued.
- Is the glass half full or half empty? Remarkable progress has been achieved in creating a modern tax system that now fully funds the current budget, compared to total donor financing several years ago. Still, tax administration capacity remains weak, to some extent corrupt, and heavily reliant on border taxation.

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## Major Results

- Rapid shift from total donor funding of the current budget to total tax funding.
- New modern tax laws adopted and implemented – personal income tax, profits tax, customs, VAT, and pensions.
- Somewhat greater tax analysis capacity; certainly more ownership

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# USAID Where are we today relative to the Region

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Rates (%)	Kosovo	Serbia	Montenegro	Albania	Macedonia
<b>Income Tax Rates</b>	5 (> E200/mo) 10 (> E2,000/mo) 20 (> E5,000/mo)	14	15	10 (by July 1, 2007)	12 to 10 by 2008
<b>Corporate Tax Rates</b>	20	10	9	20 to 10 by 2008	12 to 10 by 2008
<b>VAT Rates</b>	15	18	17	10	18

Other countries in the region have learned from Kosovo's low tax rates.

However, nearly all of Kosovo's collections come from VAT at the border  
Inland revenue collection has been a failure over the last 8 years





# USAID Lessons Learned

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- Start with simplest taxes: turnover, hotel and restaurant taxes, other presumptive taxes.
- Then move to value-added tax and wage withholding tax.
- Modern personal income taxes and profit taxes are very complex. The post-conflict period may not be the time to heavily emphasize these.
- Need for tax administration improvement will continue indefinitely.
- A modern pension system can be created in a post-conflict environment.
- It is important to keep overall labor taxes, and indeed all tax rates, low in order to encourage compliance.
- Policy analysis skills are important but harder to teach than admin skills.

