Fair Tax Policies In The Western Balkans

Challenges and recommendations for a trade union agenda

CLIMATE-FRIENDLY JOBS
WAGES
RIGHTS
SOCIAL PROTECTION
EQUALITY
INCLUSION

A New Social Contract

ITUC CSI IGB

Progressive Policies

Séverine PICARD
30/08/2022

Table of content

Introduction

The objective of this report is to examine the challenges of current tax policies in the Western Balkans and, on this basis, to issue recommendations for a trade union agenda for progressive tax reform. Our main finding is that tax policies in the Western Balkans present several characteristics of regressive tax systems, where the tax burden is borne disproportionately by the lowest incomes of the population. This has an impact on inequalities and poverty, which in turn feed into political and social instability. Thus, a central recommendation of this report is to increase the shares of the top personal income and capital tax revenues in the overall tax distribution.

This report is based on desktop research as well as in-depth exchanges with trade unions in four Western Balkans countries. These unions highlighted their priority concerns during a workshop organized by PERC in November 2021 and subsequently responded to a detailed questionnaire identifying domestic key features. The organisations involved in this study are: Confederation of Free Trade Unions KSS and Federation of Trade Unions of Macedonia CCM (North Macedonia); the Confederation of Autonomous Trade Unions in Serbia CATUS and the Independence Trade Union Confederation Nezavisnost (Serbia); the Confederation of Trade Unions of Republika Srpska (Bosnia and Herzegovina); CTUM and UFTUM (Montenegro).

The following Section I provides an overview of labour key demands for fair tax policies. Section II analyses country situations in the light of these general demands. Section III sketches a trade union agenda for tax reform. The conclusion suggests that a major obstacle to tax reform is powerful private lobbies, which need to be counterbalanced by a more active tax justice movement in the region.

Further, beyond a seeming failure to stimulate economies in the way advocates hoped, the reforms are also likely to have generated net social harms. In a reality of uneven disposable incomes, 'levelling out' the proportion of tax paid by all income-earners in a society implies in tax cuts for the wealthy and a higher proportion of income taxes paid by lower income earners. As such, in practice, the tax burden effectively shifts from the wealthy and onto those on low or middle incomes.

Further, if pension systems deteriorate and workers are expected to shoulder the majority-share of contributions directly from their own salaries, those with lower savings, who rely on the basic income that should be guaranteed by a pension floor, are harmed disproportionately.

Because decisions to introduce flat-rate taxes, reform social contributions and/or privatise pensions are not backed by strong evidence of a positive impact on economic growth, and given that these policies disproportionately favour the wealthy within a society, this paper argues that they are largely political and ideological decisions.

The paper investigates the impacts of these types of reforms to taxation and social contributions in the four case study countries, using a desk-based review of literature and some supplementary secondary data analysis. An initial section will describe the tax and social security contribution reforms that have taken place in the region, situating the trend in broader historical context and identifying the apparent objectives of the reforms. Then, for each country, the analysis will examine whether the reforms have achieved their apparent objectives and consider the broader impacts of the reforms on the welfare and living standards of the population. After initial analysis of the case study countries is presented, a final section will briefly discuss the impact of the reforms on trust in governments and national social contracts.

Section I : The labour agenda for fair tax policies

This section first reviews the reasons why trade unions should develop demands for fair and efficient tax policies. It then provides an overview of the main demands developed by the global labour organisations.

1.1 Why a tax agenda for trade unions

1.1.1 Increased fiscal space

Fiscal space is understood as a government's room of manoeuvre to support its public spending choices. In general, governments need revenues to finance social welfare, public services and public investment for a sustainable and inclusive growth. In the wake of the pandemic, the need for increased fiscal space has never been so pressing. In December 2020, governments around the world spent over USD 12 trillion, equivalent to 12% of global GDP. That spending was significantly more pronounced in rich countries with more fiscal firepower than emerging economies. In the current context of increased cost of living and energy crisis, the need for expanded fiscal space continues to be extremely important. In particular, public investment in social protection to provide support to people incomes and livelihoods is a strong ITUC priority (ITUC, 2022 a).

Fiscal space can be created by raising revenues, through taxes in particular, or by cutting on public expenditure. In many cases, the International Monetary Fund ('the IMF') has advised countries to reduce "non-priority expenditures". An ILO Working Paper from December 2021 found that while the IMF generally supported increased health care expenditure and cash transfers, it also called for fiscal consolidation and the reduction of public debt in in a great number of cases. In 40% of the countries investigated, IMF austerity proposals were actually larger than the size of the response to the virus. (ILO, 2021)

Austerity measures are generally understood as a reduction of social spending, with an adverse impact on workers and their households, in particular those on lower incomes. It is for this reason that the labour movement calls for a harmonization of fiscal and tax rules. Trade unions are stepping up their activities in favour of tax policies that raise more and more progressive revenues.

1.1.2 Progressive tax policies

Beyond revenue raising, tax also has societal role to play to ensure fairness, inclusiveness and positive impact on employment. Inequalities can result both from an inequal distribution of wages and from a growing gap between capital and labour shares of global income. Progressive taxes play a key role in reducing these inequalities by increasing tax liability on the wealthy and capital owners. As listed in table 1, progressive forms of taxation include personal income tax (to the extent that policies apply progressive rates and not flat taxes), corporate income tax and other taxes on capital and wealth. Regressive forms of taxation include in particular value added taxes ('VAT'). VAT is an indirect and unequal tax as lower incomes pay a higher share than higher incomes. In addition, those who save pay a smaller share of VAT.

Another issue with VAT is its cyclicality: in times of economic downturn, revenue collection is lower due to lower consumption but also due to firms postponing their VAT payments.

Workers pay a double price for regressive policies. First, the tax burden is being shifted away from the wealthiest incomes towards households and employees. Second, where the tax base is narrow public budgets are shrinking, leading to insufficient investment in public services and social welfare.

In a 2022 report, the ITUC has exposed its arguments in favour of stronger social protection regime in times of downturn.

The ITUC also looked at various scenarios to finance social protection. A key finding is that financing through progressive direct taxes performs better than more regressive types of indirect taxes. The study concluded that "while financing social protection through progressive income tax, corporate tax and capital tax can provide some positive small changes in GDP depending on the structure of the economy, financing social protection through indirect taxes generally perform poorly as they raise consumer prices, reduce real income and result in large crowding out of investments" (ITUC, 2022a).

Table 1:
Main types of taxes and their potential efficiency and equity impact

Tax category	Basic features	Equity (progressive or regressive)	Efficiency	Administrative and compliance costs
Personal income tax	Taxes all income or profit	Progressive: people with higher income pay proportionately more	May reduce incentive to save	State should have a good system to fight tax evasion
Corporate tax	Tax on company profit. Affects owner of capital; but can be transferred to consumers via increased price	Progessive; irrespective of whether it ultimately falls on wage earners or capital owners or a combination of both, it falls disproportionately on wealthy households	Efficient means of collecting revenues particularly on personal income where the system of domestic personal income taxation is weak and easily evaded	Relatively low administrative and compliance costs, especially in comparison to personal income tax
VAT	Appliceble to all market consumers. Affects consumers final price, but not production cost	Regressive; but can be made less regressive through a higher thresh-old, zero rating essential consumer products and higher rating for luxury items	Moderately efficient; a uniform rate makes no distintion between sectors; does not differentiate between domestic and imported goods	High administrative and compliance cost; both companies and state require a good accounting system; proportionately more expensice for small bussiness
International trade tax	Import and export tariffs; charged at customs at the time transactions are made	Can be progressive; different rates for essential and luxury imports	Not very efficient; while can promote domestic production/industries and exports; but these may be less efficient than highly developed industries and prone to rent seeking	Relatively low administrative and compliance costs, easy to implement/collect
Excise tax	Levied on specific goods; principally borne by consumers	Generally progressive; allows for differential rates for essentials and luxury goods	Relatively efficient; creates differences between products, but only for few goods; can also correct market flaws and attain social and environmental objectives	Relatively low administrative and compliance costs, but total revenue must be more than the cost
Property tax (land, wealth etc.)	A fixed rate for a certain amount of land, based on value, paid by the owner	Progessive; paid more by those who own more or valuable land/properties	Efficient; does not distort prices; prevents speculative real estate investment; encourages productive use of land	Relatively low administrative and compliance costs but, requires a good system to assess value; can be susceptible to undervaluation

(Source: Ortiz et al 2019)

1.1.3 The role of corporate income tax

The reform of corporate income tax is an important labour demand considering its significant revenue raising prospects as well as impact on employment and workers' rights.

According to estimations, USD 245 bn are lost every year due to corporate tax abuse (Tax Justice Network, 2021). Aggressive tax avoidance is also affecting workers in other ways. Corporate profits are extracted from work places and sent, through complex mechanisms, to tax havens. When a multinational relies on aggressive tax avoidance schemes, financial accounts are plundered and there is little for trade unions to bargain on. Wages are kept artificially low and working conditions precarious. Effective management is also hidden behind a multitude of shell companies and other letter-box practices. (Picard, 2020)

1.2 Main demands

Global labour organizations have developed the following set of recommendations for tax reforms:

- **An effective corporate income tax rate of at least 25%**

  Taking into account that the average effective tax rate in the EU and OECD countries ranges between 20-25%, the labour movement is calling for a 25% minimum effective tax rate. This floor is necessary to stop tax competition between countries. According to estimations, a 25% effective tax rate implemented globally could raise, depending on design, between US$580 billion and 650 billion each year. (ITUC, 2021a)

  The introduction of a global minimum tax rate has been actively discussed in the context of G20/OECD negotiations that concluded with a statement published in October 2021. According to that statement, OECD countries will soon implement a "top-up tax": where the entities of a multinational corporation (e.g.: subsidiaries, establishments) are paying corporate income tax below a minimum level, fixed at 15%, other countries will "tax back" the undertaxed overseas profits up to that minimum.

  For the labour movement, this statement can only be considered as a first step and greater ambition is needed as only a 25% minimum with a broad tax base would effectively curb tax competition and substantially increase revenues.

- **Unitary taxation**

  The taxation of multinational enterprises is very much influenced by the OECD BEPS Action Plan, enacted in 2015 and laying down 15 action items for countries to combat base erosion and profit shifting. A key area of concern for the labour movement is that Actions 8-11 of the BEPS Action Plan rely heavily on transfer pricing rules. According to these rules, a multinational corporation has no existence of its own. Each of its subsidiaries and establishments is taxed as if it were an independent and autonomous company. They can trade with each other, and thus transfer capital, as long as they do so by respecting market price ('the arm's length principle'). This is a fiction. A multinational enterprise is a coherent unit, with a consistent tax and business strategy implemented

throughout the company group, under the global oversight of the parent company.

The current transfer pricing rules therefore constitute an encouragement for multinationals to set up complex group structures with conduit entities for the purpose of shifting profits from where they have been created to low tax countries.

The trade union movement has long been taking position in favour of a unitary taxation principle, whereby the profits of a multinational enterprise would be determined at global level, and apportioned among countries according to a set of balanced factors. Only then would multinationals be treated as the global companies that they are, and have a real go at curbing profit shifting (Picard, 2020).

Unitary taxation is also the most effective way to tax digital companies, which can be highly profitable but pay on average twice less taxes than their brick & mortar counterparts. The weaknesses of transfer pricing rules are indeed particularly exacerbated for multinationals with unique and highly mobile assets. Further, in a world of digital transactions taxing rights should no longer be dependent on the existence physical establishment but should kick in whenever a series of indicia point at significant economic presence[1].

- **Tax transparency**

Country-by-country reporting is a vital element of the fight against tax avoidance. Where countries have put in place such frameworks, multinationals are required to report annually and for each jurisdiction in which they do business essential information on their activities, their structure, their profits and the income tax paid and accrued. Without such reporting, potential risks of profit shifting would be impossible to assess.

Tax transparency is also an essential element of trade union work. Country-by-country reporting contains crucial data on the financial and economic situation of the company and the scale of investments into low-tax jurisdictions. This information is precious for workers to collectively bargain their fair share of corporate wealth.

- **Higher taxes on capital and wealth**

Both corporate income tax rates and top personal income tax rates have been declining in the past decades. In a context of an explosion in the asset values of the wealthy, global labour organisatons have called for wealth taxation as well as extra taxes on excess profits. the objective is for individuals and businesses that have gained from the pandemic and now the energy crisis also contribute more to the recovery.

The ETUC issued demands for a net wealth tax, which could initially be implemented as a crisis-fighting tool, with a high threshold tackling very wealthy households with the ambition to decrease the threshold to reach a satisfactory level to enhance tax justice (ETUC, 2021).

The ITUC calls for the introduction of extra taxes on profits that exceed a normal return (“economic rents”). (ITUC, 2021a)

1 A proposal to that effect was, unsuccessfully, presented in 2019 by the G24 countries to the G20/ OECD Inclusive Framework

- **Taxing financial transactions**

  Since the 2008 financial crisis, the labour movement has been campaigning for financial transactions taxes, which are small levies on the financial sector transactions. The objective is to reduce the volume of speculative transactions by making them more costly. (ITUC, 2021a)

Section II : Tax policies in western balkans

The EU accession process has been opened for North Macedonia (2005), Montenegro (2012), Serbia (2014) and Albania (2014). Bosnia and Herzegovina, and Kosovo are potential candidate countries. This process implies the implementation of complex reforms, and in particular fiscal reforms in order to comply with EU debt and deficit rules but also to level up with EU Member States on welfare and social protection regimes. Tax policies are at the heart of these discussions.

Although the speed and the focus of reforms vary from one country to another, common features are notable throughout the region. Section 2.1 will review shared challenges in particular with regard to inequalities and insufficient raising capacities. A country analysis is provided in section 2.2.

2.1 Overview of Western Balkans tax policies

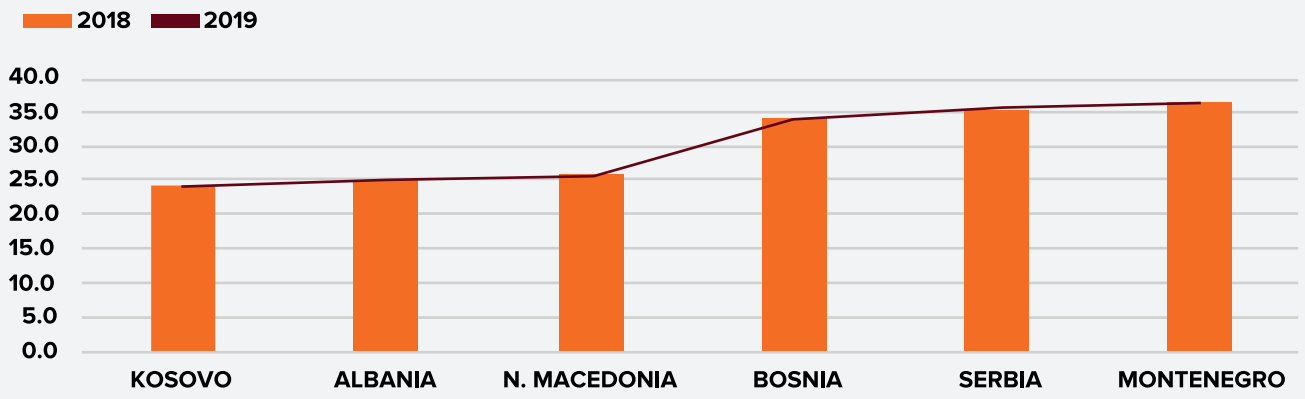
Whilst public budgets in the Western Balkans are very reliant on taxes, the revenue raising potential is relatively low.

The share of tax revenues in the Western Balkan budgets is higher than the OECD and EU average. In 2018, on average 64.5% of government revenues came from direct taxes. This compares to 59.4% for OECD countries, and 59.6% for EU Member States (OECD, 2020). At the same time, the tax burden in the Western Balkans (which includes all forms of direct and indirect taxation as a percentage of GDP) is significantly lower than EU and OECD average.

The total tax revenues account for 30.4% of GDP in the Western Balkans. This is at least 11 percentage points lower than in the EU (41.5%) (see tables 2 and 3).

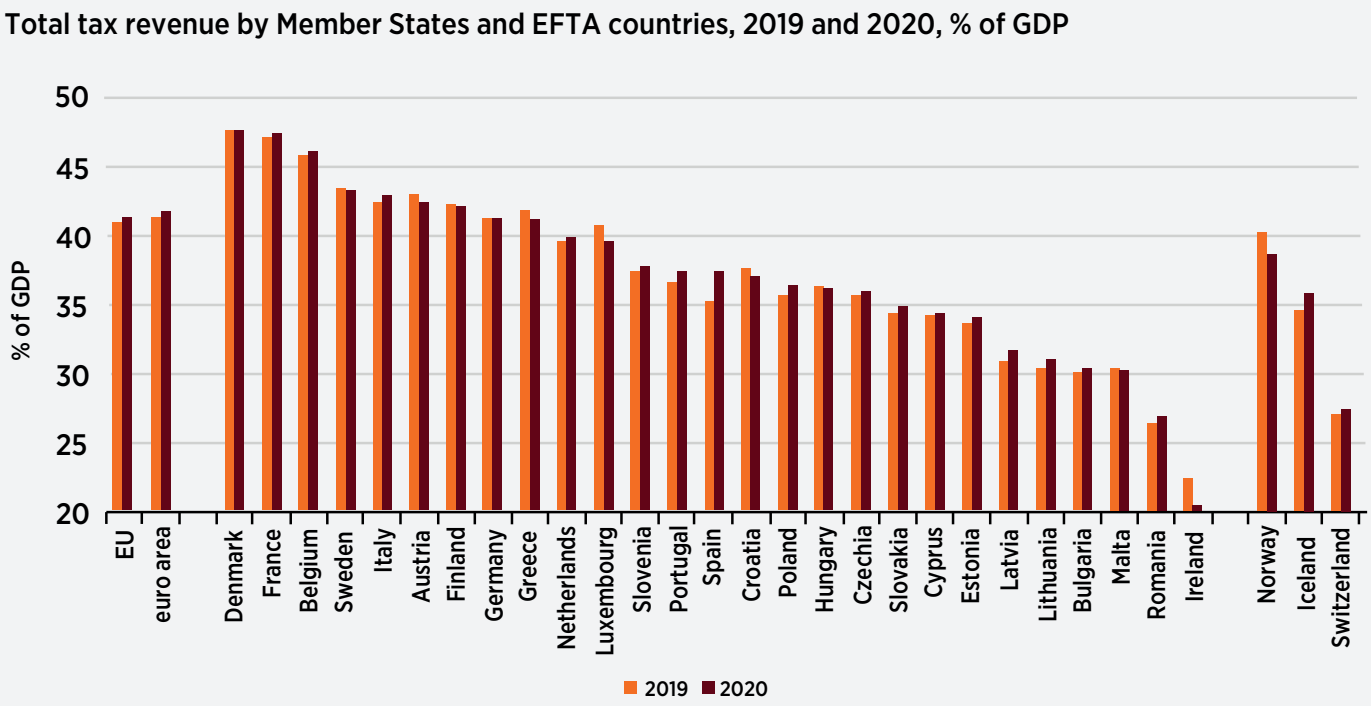
This comparatively low tax burden is explained by low tax policies. The whole region is marked by the low taxation of capital, in particular through the use of tax incentives and low corporate income tax rates, as well as flat taxes or personal income tax rates with little progressivity. As illustrated by figures 2a to 2d (see section 2.1.4), these low levels of taxation are compensated by high social security contributions and an extreme dependence on consumptions taxes.

Table 2:
Tax burden in Western Balkans, 2018-2019



Source: Gjokutaj (2020a p.42)

Table 3:
Tax burden in the EU, 2019-2020



Source: Eurostat 2020

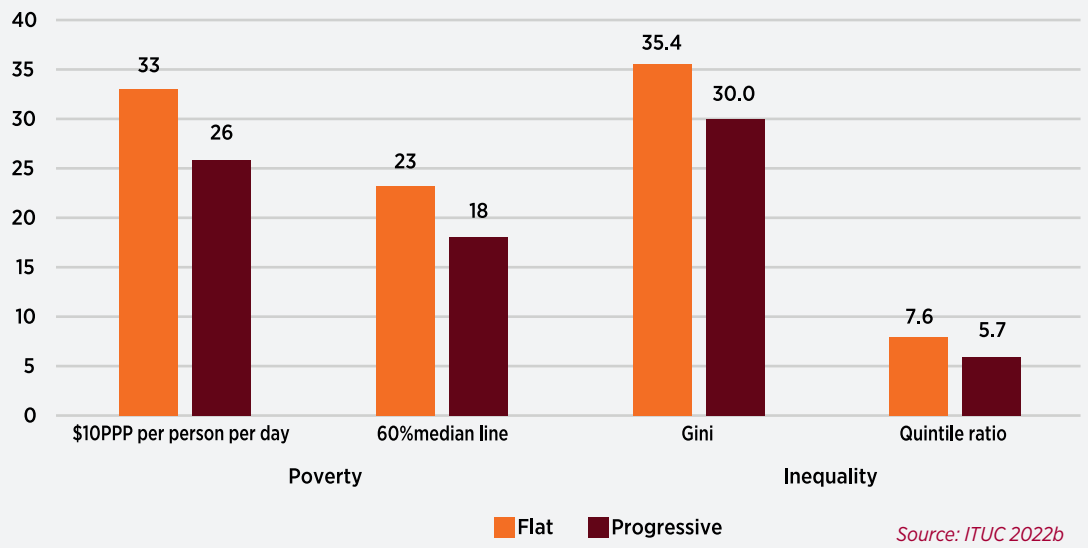
2.1.1 Personal income tax: flat taxes and low progressivity

A "flat tax revolution" was widely implemented in the Western Balkans in the early 2000s. The flat tax consists in a uniform tax rate on personal and/or corporate incomes, that applies once a threshold or basic allowance is reached (ECB, 2007). Flat taxes must be contrasted with progressive income tax rates, that increase proportionally to the size of the income.

The key argument in favour of flat taxes lies in their simplicity: a simpler tax policy would be easier to understand, to administer and thus reduce tax avoidance. In addition, flat taxes were believed to boost growth as a reduction of tax burden is seen as contributing to higher investment and ultimately reinforcing incentives to work.

The reality is very different. In a 2022 report, the ITUC collected evidence on the social harm of flat taxes, which it considers reflects "more a broader ideological signaling towards neoliberal market-led model than a rational economic choice". Case studies provide little evidence of flat taxes having achieved labour market objectives. On the other hand, simulations show that they have significant implications for poverty and inequality as more people are likely to be living in poverty or vulnerable to poverty (see figure 1). The report also quotes substantial literature pointing at negative distributional effects at the expense of low or middle incomes. In other words, lower incomes pay a higher proportion of taxes than higher incomes and this exacerbates inequalities. (ITUC, 2022b p.23)

Figure 1:
Simulated poverty and inequality measures after hypothetical flat and progressive tax scenarios



Source: ITUC 2022b

In 2022, out of the four countries covered by this study two continue to implement flat taxes: Boznia and Herzegovina, and North Macedonia. Montenegro and Serbia have finally abandoned flat tax rates in favour of progressive personal income taxes.

Even so, progressivity in the personal income tax rates in these two countries remains low in comparison to the EU average. The top personal income tax rate in the Western Balkans is 20% (table 4), comparing to an average of 35.3% in the EU (see table 5).

Table 4:
Personal income tax rates in the Western Balkans, 2019

Country	Rate
Bosnia and Herzegovina	10%
Croatia	Progressive rates at 24% and 36%, depending on income.
Serbia	10% - employment income and business income 15% - income from capital 20% - income from royalties and other income.
Montenegro	9% - gross monthly salary up to the amount equivalent to the average salary in the previous year (EUR 766). 11% - portion of monthly gross salary exceeding the amount above.
Slovenia	16% - income up to EUR 8,021.34 27% - income up to EUR 20,400 34% - income up to EUR 48,000.00 39% - income up to EUR 70,907.20 50% - income exceeding EUR 70,907.20 20% - income from business activities.
North Macedonia	10% Flat rate
Albania	Exempt - employment income up to ALL 30,000 13% - from ALL 30,001 to ALL 150,000 is taxed at a rate of 13% on the amount exceeding ALL 30,000 tax of ALL 15,600 - income exceeding ALL 150,000 + 23% -income in excess of AL 150,000 15% - all other income except dividends (8%).
Kosovo	0% - income between 0 and EUR 960 4% - income between EUR 960.01 and EUR 3,000 8% - income between EUR 3,000.01 and EUR 5,400 10% - income exceeding EUR 5,400.

Source: Deloitte, 2019

Table 5:
Top personal income tax rates in Europe, 2022

Country	Top Statutory Personal Income Tax Rate
Austria (AT)	55.0%
Belgium (BE)	53.5%
Czech Republic (CZ)	23.0%
Denmark (DK)	55.9%
Estonia (EE)	20.0%
Finland (FI)	51.2%
France (FR)	55.4%
Germany (DE)	47.5%
Greece (GR)	54.0%
Hungary (HU)	15.0%
Iceland (IS)	46.2%
Ireland (IE)	48.0%
Italy (IT)	47.2%
Latvia (LV)	31.0%
Lithuania (LT)	32.0%
Luxembourg (LU)	45.8%
Netherlands (NL)	49.5%
Norway (NO)	39.4%
Poland (PL)	36.0%
Portugal (PT)	53.0%
Slovakia (SK)	25.0%
Slovenia (SI)	50.0%
Spain (ES), Valencia	54.0%
Sweden (SE)	52.3%
Switzerland (CH)	44.8%
Turkey (TR)	40.8%
United Kingdom (GB)	45.0%

Source: PwC "Worldwide Tax Summaries

Another legacy of flat taxes is reduced revenues for public budgets. In a bid to compensate for those diminishing revenues, the governments that rely on flat taxes tend to turn to other forms of taxation such as labour taxes and VAT.

2.1.2 High taxation of labour: impact on low wages

A central concern for trade unions in the four countries covered by this report is the heavy tax burden borne by employees. Unions unanimously consider that the current labour taxation policies are unfair on lower wages and constitute a strong driver for undeclared work, which in turn feeds into precarious employment conditions and insufficiently funded social protection regimes.

A report issued by the World Bank in 2019 singles out the taxation of labour as one of the most problematic features of labour markets in the region. This is due to the high regressivity of the system, which incentivizes informal economy and reduces competitiveness.

The personal income tax components of labour taxation are marginal or modest. Consequently, whilst in most countries social security contributions represent a larger portion of non-wage labour costs than personal income tax this feature is more pronounced in the Western Balkans (World Bank, 2019 p.75). In addition, social security contributions are more heavily borne by employees than employers. In North Macedonia, all social security contributions are paid by the employees.

In Boznia and Herzegovina, employees contribute three times more than employers. In Serbia, the contribution is almost equal (see table 6).

As a result, the labour tax progressivity is lower in the Western Balkans than in most EU or OECD countries and the tax burden on workers earning minimum wage is significantly high. As lower income workers make for two third of employment, the majority of the population brings home poor net wages.

The World Bank report underlines two further aggravating factors. One is that the high labour tax burden is not usually compensated by separate tax credits for workers with dependents. Secondly, as labour taxes are high in Montenegro, Bosnia and Herzegovina, and Serbia there is a proportionally higher cost to the employer for minimum wage workers than for average or higher wage workers. Thus, the labour intensive industries in these three countries are less competitive than their counterparts in the European Union.

As the country analysis below will describe there is as a result a worryingly high level of undeclared employment in the region.

Table 6:
Social Security contributions

Country	BiH	CRO	SRBM	MNG	SLOM	MKD	ALBK	KOS
From gross salary (employee cost)	FBiH 31% RS 33% BD 30.5 or 32%	20%	19.9%	24%	22.1%	27%	11.2%5	%
On top of gross salary (cost of employer)	FBiH 10.5% RS - BD 0% or 6%	16.5%1	7.9%	10.3%1	6.1%	0%	16.7%5	%

Source: Deloitte, 2019 p.51

2.1.3 Low taxation of capital: the corporate tax incentives

Corporate income tax rates in the Western Balkans are lower than anywhere else in the EU and OECD average. They range between 9% and 15% statutory rate (see table 7). These are statutory corporate income tax rates, meaning that effective rates (corresponding to the payments actually made by companies) may be considerably lower. This research has not been able to find estimations of effective tax rates, which points at a problem of transparency and lacking accountability of Western Balkans tax authorities. In the EU, the average statutory rate is 23.5%, whilst in OECD countries the average ranges between 20%-25%.

As described in the Section I of this report, a 25% effective tax rate is a strong priority for the labour movement across the globe. This is a necessary reform to increase revenues, to stop tax competition and to reestablish some fairness in the capital and labour respective shares of income.

In addition to low statutory rates, a characteristic of the Western Balkans is the presence of special economic zones. These are geographical areas where business activity is subject to different rules than those prevailing in the rest of the economy.

The objective is to have incentives to attract foreign direct investment ('FDI'), for instance to compensate for a risky investment. By increasing FDI, countries expect to foster economic growth through job creation, increased exports and positive spillover into domestic economy. Of interest for this research are the tax incentives that are deployed in those special economic zones. They broadly consist in tax relief in the form of tax holiday (exempting firms from corporate income taxation during the initial stage of the investment), reduced tax rates and tax credits.

Special economic zones are a substantial part of investment strategies in the Western Balkans. According to the OECD, their number has quadrupled between 2009 and 2017 and they have become a critical driver in the intensifying regional competition for FDI. Special economic zones in Bosnia and Herzegovina, Macedonia, Montenegro and Serbia have attracted almost 400 foreign companies, mostly manufacturing investment in the car components industry, for a cumulative investment of EUR 2.5 bn. In terms of job creation, the report estimates that companies active in the special economic zones have generated over 30 000 jobs in the region. Serbia is by far the largest recipient of FDI. (OECD, 2017)

Table 7:
CIT rates in the EU and Western Balkans, 2022

Country	Corporate income tax rate
Austria	25,0
Belgium	25,0
Czech Republic	19,0
Denmark	22,0
Estonia	20,0
Finland	20,0
France	28,4
Germany	15,8
Greece	24,0
Hungary	9,0
Ireland	12,5
Italy	24,0
Latvia	20,0
Lithuania	15,0
Luxembourg	18,2
Netherlands	25,0
Poland	19,0
Portugal	30,0
Slovak Republic	21,0
Slovenia	19,0
Spain	25,0
Sweden	20,6
Albania	15,0
Bosnia and Herzegovina	10,0
Bulgaria	10,0
Malta	35,0
North Macedonia	10,0
Romania	16,0
Serbia	15,0

Data extracted on 20 Jul from OECD.Stat

Table 8:
Key indicators for the special economic zones in the Western Balkans

Economy	Total number of zones	Number of active zones[1]	Size(ha)	Number of enterprises	Cumulative zone investment (EUR million)	Number of employees	Total turnover 2015 (EUR million)	Zone exports as % of total exports
Albania	3	0	494 (planned)	0	0	0	0	0
Bosnia and Herzegovina	4	4	79.5	95	n/a	1 700	303	6.4
Former Yugoslav Republic of Macedonia	15	6	893	23	207	6 800	1 475	36.4
Kosovo	3	0	530	0	0	0	0	0
Montenegro	1	1	130	36	5	398	7.6	n/a
Serbia	14	10	1 615	241	2 240	2 2242	2 431	17.6

[1] Active zones are zones with a fully establishe legal, institutional and management structure and which are broadly investment-ready (basic infrastructure and main services to be offered are in place, etc.), with active entrerprises operating in them.

[2] Cumulative investments is calculated as the simple sum of investments since the zones' establishment (with the exception of the Former Yugoslav Republic of Macedonia which covers the period from 2011 to 2015), and does not account for capital depreciation.

[3] Data for Bosnia and Hezegovina refer to 2014, whereas total turnover for the Former Yugoslav Republic of Macedonia is estimated from the share of total exports for 2015.

Source: OECD, 2017

However, the reality behind special economic zones is far from ideal. Trade unions have long denounced the adverse effect of investment deregulation on workers' rights and overall insufficient contribution to domestic economy. Foregone revenues through tax holidays and tax credits are a key driver for the unequal taxation between labour and capital.

Overall employment levels have to be compared with the quality of the jobs created. As companies operate in a legal vacuum, the trade union experience with special economic zones is that jobs often consist in precarious employment, poor wages, insufficient health & safety protection and no access to trade unions nor judicial redress.

Several studies have now demonstrated that there is no evidence that reducing corporate income tax has an impact on growth (Gechert, Heimberger 2022). There is indeed no guarantee that investment would not have been made without the tax incentives. Other factors such as political and economic stability, geographical location, existing infrastructures, and workforce may be more influential factors on the choice of location of real investment.

Further, FDI in special economic zones does not always create positive spill over into the domestic economy. The lack of spillover is particularly obvious when foreign multinational companies source their products and services through their own networks rather than through domestic enterprises. On this, the OECD raises some questions as to whether the special economic zones in the Western Balkans do contribute to higher added value activity in global value chains. The foreign investment tends to be in labour intensive industries, with limited added value activity and insufficient technological upgrading (OECD, 2017).

Lastly, tax incentives constitute a clear encouragement for corporate tax avoidance: i.e. multinationals shifting their profits from high tax countries to the low tax areas. In case of profit shifting, FDI does not translate into real investment into the local economy and the benefits of reduced taxes are mainly enjoyed by the shareholders.

In addition to low corporate tax rates, the Western Balkans rely on transfer pricing rules, which the labour movement criticizes as inadequate to tackle corporate tax avoidance by multinational enterprises (see above Section 1.2).

In parallel, the unions interviewed for this report have underlined the lack of capacity of tax administrations to fight against tax avoidance and tax evasion. In a catch-22 situation, poor enforcement further feeds into insufficient resources for stronger tax administration.

Revenues are lost as a result of these structural weaknesses. Table 8 shows estimated revenue losses in absolute numbers and equivalent of share of vaccinations during the pandemic. These estimations are based on the current low tax rates.

Table 9:
Estimated revenue losses through corporate tax avoidance

Country	Total annual tax loss (USD million)	Total annual tax loss (% of GDP)	Of which corporate tax abuse (USD million)	Of which offshore wealth (USD million)	Full vacci-nations possible (millions)	Full vacci-nations possible: Share of population
Serbia	239.6	0.5%	234.8	4.8	13.9	197.4%
Montenegro	17.2	0.4%	16.3	0.9	1.0	161.0%
North Macedonia	38.9	0.3%	37.1	1.8	2.3	108.7%
Bosnia and Herzegovina	27.1	0.1%	25.6	1.5	1.6	46.2%

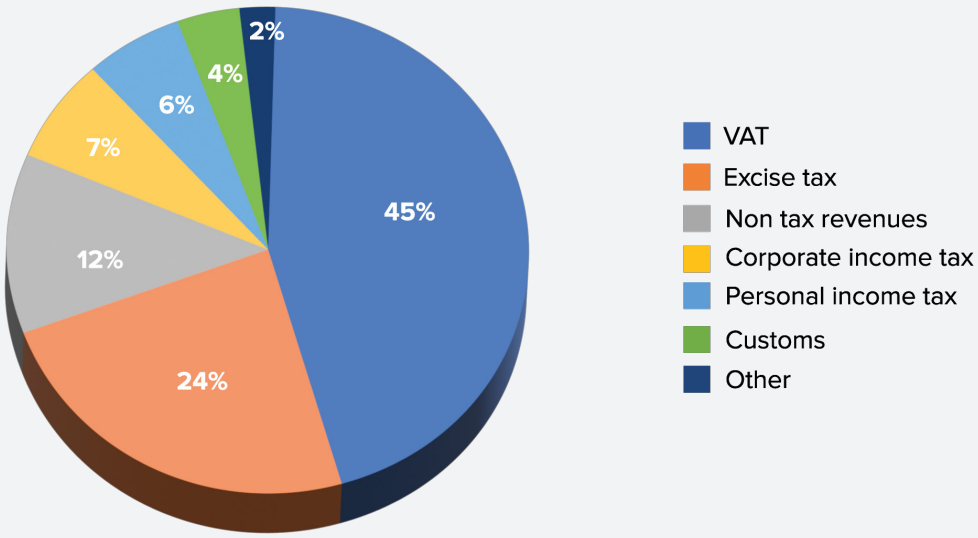
Source: Tax Justice Network 2021

2.1.4 Consequences: regressive tax policies, risks of poverty and depleted budgets

Tax policies in the Western Balkans present several characteristics of regressive tax systems, where the tax burden is borne disproportionately by the lowest incomes of the population. This has an impact on inequalities and poverty, which in turn feed into political and social instability.

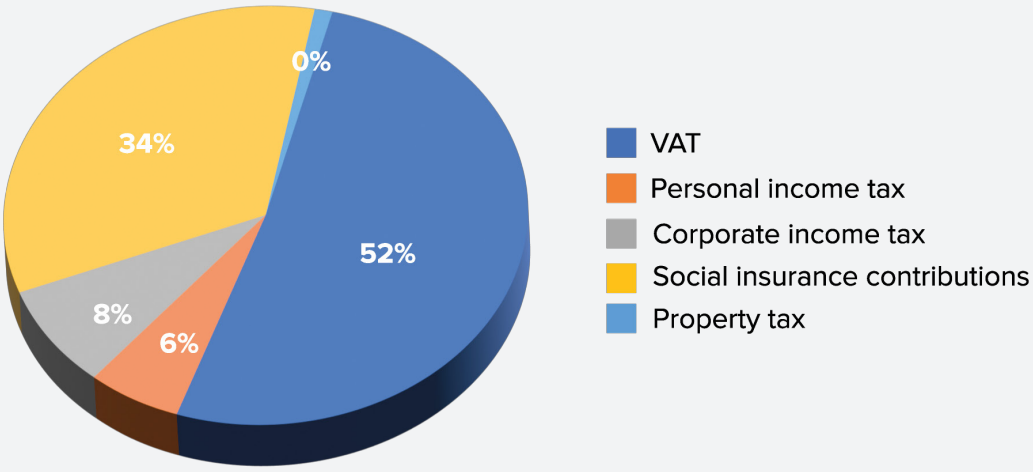
The lack of progressivity in personal income tax as well as foregone corporate revenues have led to a massive report on social security contributions and VAT. As illustrated by the following figures 2a to 2d, Western Balkans countries tend to be extremely dependent on VAT, a lot more than in the EU or OECD average.

Figure 2:
Revenue structure in Serbia, 2022



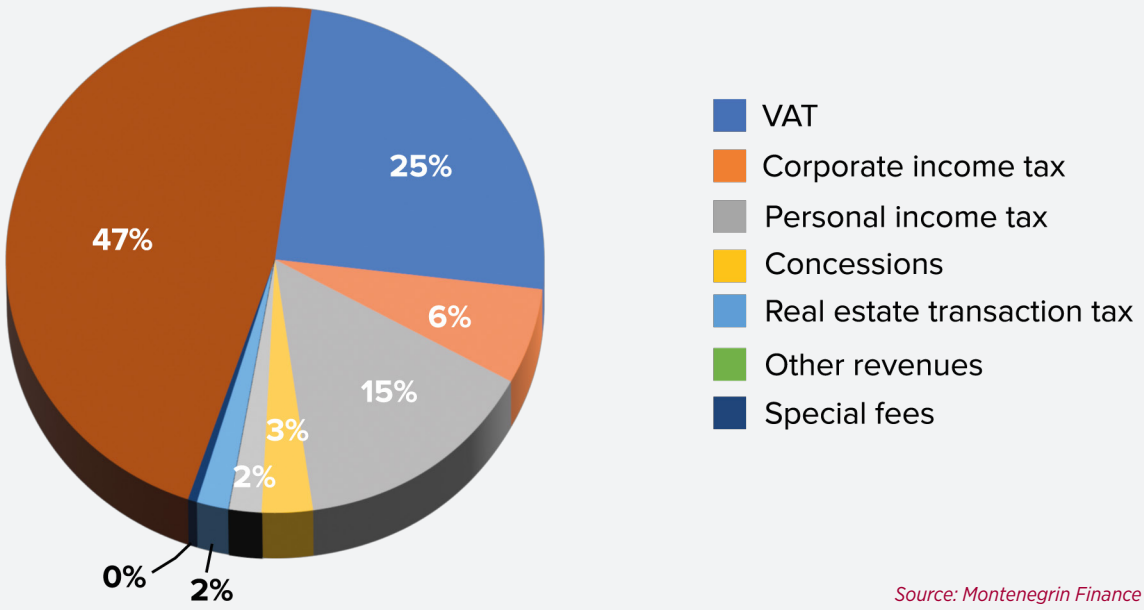
Source: Serbian Finance Ministry website

Figure 3:
Tax distribution in Republicka Srpska, 2022



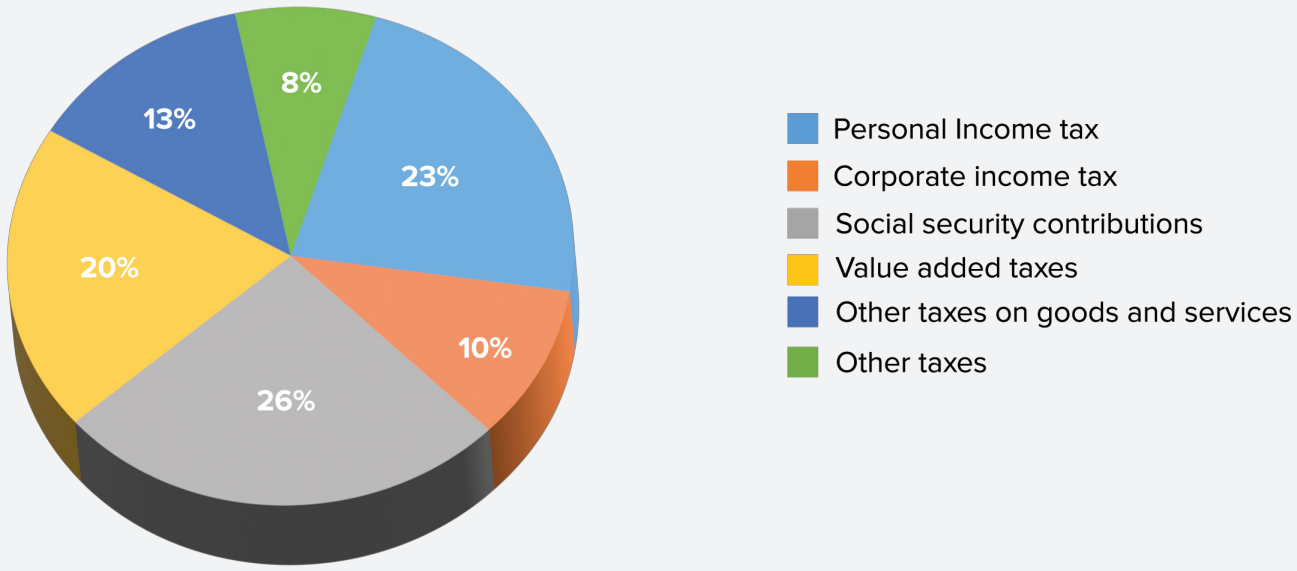
Data compiled by the Confederation of Trade Unions of Repubika Srpska

Figure 4:
Tax collection in Montenegro, 2019



Source: Montenegrin Finance Ministry website

Figure 5:
Tax distribution, OECD average 2018



Source: OECD stats, 2018

The following Section 2.2 will show that for each country covered by this study, there are fiscal challenges linked to a narrow tax base and the need for public investment. Workers and their communities are therefore paying a double price. They carry a heavy tax burden and they do not enjoy strong public services nor effective social protection regimes.

Lastly, the current tax policies are having a heavy toll on labour market indicators, with high levels of unemployment and undeclared work. The whole region faces high levels of population at risk of poverty, ranging from 21.9% (North Macedonia) to 30.5% (Montenegro). As a comparison, the EU-27 is of 20.9%.

2.2 Country analysis

2.2.1 North Macedonia

Fiscal challenges

Public finances in North Macedonia have been hit hard by the pandemic. The share of foregone revenues due to low tax rates and insufficient enforcement was further increased by the slowdown in economic activity. In parallel, public spending increased to finance COVID related measures: wage subsidies, financial support to households and companies, reduction of VAT rate, extension of tax deadlines etc. According to the European Commission, the total impact of COVID measures in 2021 amounted to an equivalent of 2.9% of GDP (Commission, 2021).

In parallel, the North Macedonian government pursues an intense program of investment. Until 2025, the government has announced it will focus on the implementation of infrastructure projects in road and railway, energy and utility as well as investments to improve the conditions in the health, education and social system, agriculture, environmental protection. These projects amount to a total of 3.1 billion euros, partly financed with budget funds of 1.16 billion euros[2].

Thus, there are tensions between, on the one hand, foregone revenues and, on the other hand, an acute need for fiscal consolidation. According to the unions, the IMF and the World Bank advise increasing the progressivity and efficiency of tax policies. In 2021, the European Commission also recommended broadening the tax base in order to improve revenue collection. At the same time, the European Commission expressed concerns about public announcements that would translate into an erosion of revenues. For instance, a Tax System Reform Strategy published in 2020 announced further measures to strengthen revenue collection whilst at the same time foreseeing further tax incentives for companies and households (European Commission, 2021b).

Social indicators

According to the 2021 data of the national statistical office, the labour force in the Republic of North Macedonia numbered 937482 persons, of which 795276 were employed, while 142206 were unemployed persons. **The unemployment rate** is 15.2%. Trade unions report that the pandemic has aggravated the unemployment situation with mass dismissals, often in violation of workers' rights.

The European Commission estimates that **undeclared employment** and partially undeclared wages concern almost 44% of employees. A key driver for this situation is the high taxation of wages, in particular those at lower incomes. Workers appear prefer to receive a higher net wage in spite of foregoing their right to pension and social protection (European Commission 2021b).

[2] Figures extracted in March 2022 from North Macedonian Finance Ministry website

The high level of undeclared work is an area of particular concern to North Macedonian trade unions. For instance, the Federation of Trade Unions of Macedonia CCM reports that the formalisation of the grey economy is a high priority. Undeclared workers are not protected by employment law; they earn less than those in formal economy, have unstable earnings and do not have access to any form of social protection.

Poverty figures are also high with 21.9% of people being at risk of poverty in 2019. The Confederation of Free Trade Unions KSS reports higher risks among the lower income earners groups of the population, given that they tend to be employed in vulnerable sectors affected by the pandemic (such as trade and transport).

Concerning **social dialogue**, CMM positively assesses its relation with the current government in in relation to a recent minimum wage reform. At the time of this research, however, both CCM and KSS report serious deterioration of social dialogue. KSS for instance raises concerns about the union lack of influence on the management of the crisis. The general state of social dialogue remains preoccupying for the European Commission which considers that social dialogue in the private sector remains weak and is marked by the absence of private unions engagement.

From the business side, it appears from our questionnaires that the Chamber of Commerce of Macedonia has an active policy advocacy agenda on tax related issues. This agenda appears generally hostile to increase in tax rates, including on personal income tax, and expresses concerns about loss of competitiveness.

Aside from the trade unions, there does not seem to be any civil society movement actively engaged in tax justice activities.

Personal Income Tax and Labour Taxation

The Republic of North Macedonia applied between 2007 and 2018 a flat tax, first at a rate of 12% and then at a rate of 10%. The declared reason for introducing the flat tax was that it would make the business environment more friendly to doing business, while increasing tax revenues due to reducing the effect of tax evasion. Although the flat tax was in force for 12 years, a comprehensive analysis of its effects still has not been conducted.

In 2019, a higher tax rate of 18% has been introduced for income above 90 000 Denar (approx. 1460 EUR). According to the World Bank, this is a symbolic reform affecting only the highest earning 1% of the total population (World Bank, 2019 p.73).

Social security contributions coming from wages are on the other hand much more significant, as evidenced by table 9a. Table 9b provides a calculations of gross and net minimum wages. For a gross wage of 22.146 MKD, the worker will take home 15.194 MKD. Both tables have been compiled by KSS on the basis of official information.

Table 10:
Rates of Social Security Contributions in North Macedonia, 2022

SOCIAL SECURITY CONTRIBUTIONS	
Contribution for pension fund and disability insurance of Macedonia (PFDIM)	18,80%
Health insurance contribution	7,50%
Additional health contribution	0,50%
Employment contribution	18,80%

Table 11:
Calculation of gross and net minimum wages in North Macedonia, 2022

GROSS WAGES	**22.146**
Contribution for PFDIM	4.163
Health insurance contribution	1.661
Additional health contribution	111
Employment contribution	266
Total contributions	**6.201**
Gross salary reduced for contributions	15.944
Tax exemption	**8.438**
Basis for calculation of personal income tax 10%	**7.506**
Accrued personal income tax 10%	751
Net wage	15.194

Source: data compiled by KSS, 2022

Corporate Income Tax and Tax Incentives for Corporations

North Macedonia implements a low corporate income tax rate of 10%. In addition, the country offers foreign investors no less than 15 special economic zones (see table 10).

Table 11 provides a comparison between tax due by foreign investors established in special economic zones and tax due by domestic companies. Foreign investors enjoy considerable tax incentives, including a 0% corporate income tax rate for 10 years and a 0% VAT.

Table 12:
Special economic zones in North Macedonia, 2017

Special economic zone	Area in hectares	Number of enterprises	Main operating industry	Cumulative investment (EUR millions)
Skopje 1	140	12	Automotive	208
Skopje 2	97	1	Automotive	25
Skopje 3	44	n/a		
Stip	206	3		12
Tetovo	95	1		
Prilep	67	2	Automotive/Plastics	20
Struga	30	2		
Strumica	25	1		
Kichevo	30	1	Electronic/Cables	15
Gevgelija	50	n/a	Automotive	15
Berovo	17	n/a		
Delchevo	21	n/a		
Radovis	10	n/a		
Rankovce	40	n/a		
Vinica	21	n/a		

Source: OECD, 2017

Table 13:
Comparative tax advantages in special economic zones

TAX DUTIES		
TAX	**RATE IN THE ZONE**	**RATE OUTSIDE THE ZONE**
Corporate Tax	0% up to 10 years	10%
Personal Income Tax	0% up to 10 years	10%
Value Added Tax	0%	18%
Excise Tax	0%	5% - 62%
CUSTOMS DUTIES		
PRODUCTS	**RATE IN THE ZONE**	**RATE OUTSIDE THE ZONE**
Equipment, machines and spare parts	0%	5% - 20%

Source: data compiled by KSS, 2022

Trade Union priorities

KSS and CCM priorities are on core labour issues, including increase of wages and pension system reforms. Both topics raise questions of public financing and therefore tax policies. In addition, whilst the two organisations have not yet developed detailed policy demands for tax reform, they are acutely aware of the synergies between the current tax policies and income inequalities.

More broadly, the trade unions emphasize the importance of transparent decision-making. For every reform in the tax system, they demand a comprehensive analysis, social dialogue and a thorough implementation.

2.2.2 Serbia

Fiscal challenges

The global slow down which resulted from the pandemic did not really affect Serbia, compared to the majority of European countries. This is due to the previous dynamics in growth, financial stability, and the structure of the economy.

Nonetheless like everywhere in the region, the country took sizeable support measures, with an impact on budget.

The government issued three successive support packages for a total amount of 8 bn euros. The measures included employment subsidies to SMEs and large companies, tax relief and other public subsidies. Already in 2020, the support packages amounted to 6 billion EUR or 12.7% of GDP.

Aside for pandemic related spending, half of the capital expenditure is earmarked for public investment in road and rail transport infrastructures (European Commission 2021c).

Social indicators

The **unemployment rate** in Serbia is 10% of the population. **Informal employment** remains high at 16.7% but significantly less important than in the other 3 countries covered by this study. Like everywhere in the region, high labour taxation is a strong incentive for undeclared work both from an employer and a worker perspective.

In 2019, 31.7% of the population was **at risk of poverty**. The European Commission considers that the further increase of an untaxable wage base for minimum salary would have a significant impact on poverty.

Social dialogue does not appear to be well-functioning, especially in the private sector where few collective agreements are negotiated. In addition, trade unions report a lack of communication with public officials. Although unions have developed a set of clear demands for tax reform, they have mainly been ignored by the government.

From the business side, it appears from our questionnaire that there are several private sector organisations with active policy advocacy on tax reform. These include the Council of foreign investors, the Chamber of commerce, the American Chamber of Commerce, the national alliance for local economic development, USAID and unions of employers of Serbia.

In contrast, there does not seem to be a civil society movement engaged in tax justice.

Personal Income Tax and Labour taxation

Serbia introduced in 2001 a flat personal income tax rate of 14%, gradually lowering it to reach 10% in 2013.

Social security contributions exceed 37.05% of the gross wage, more than half of which is borne by employees. An untaxed allowance is adjusted annually to reflect real wage trends. Furthermore, companies can be completely exempted from labour taxation if they meet one of the following situations:

a) those who employ an unemployed person, registered for at least six month with the Employment Bureau are entitled to a 65% - 75% tax return, depending on the number of newly employed workers.

b) Those who employ a person, who in 2019 did not have the status of insured worker are entitled to a tax return for three years, first in the amount of 70%, then 65% and 60%.

Corporate Income Tax and Tax Incentives

The statutory corporate income tax rate is 15%. In addition, Serbia has 14 special economic zones where foreign investors enjoy considerable tax benefits, including a 0% CIT rate for the first 10 years of investment exceeding 8.5mn euros. Foreign investors also benefit from VAT exemptions.

Table 14:
Comparative tax advantages in special economic zones

Special economic zone	Area in hectares	Number of manufacturing enterprises	Main operating industry	Number of people employed	Total turnover (EUR millions)
Apatin	415	Zone is not fully active	Petroleum	0	0.1
Subotica	44	5	Electrotechnics	3521	622
Zrenjanin	98	5	Plastics	3398	206
Novi Sad	75	6	Petroleum	251	82
Šabac	244	6	Automotive	56	9
Smederevo	143	6	Metal	1363	36
Svilajnac	33	1	Electric works	392	85
Kragujevac	176	7	Automotive	4354	2490
Užice	55	6	Cooper	1950	393
Kruševac	64	1	Rubber/Chemical	1150	15
Pirot	116	16	Rubber/Pneumatics	5808	689
Vranje	123	Zone is not active	Footwear	0	0
Beograd	98	Zone is not active			

Note: The table contains the 12 free economic zones in Serbia except the 2 in Belgrade and Priboj for which relevant data is not available. The data are relevant as of the year 2014.

Source: OECD, 2017

Trade union priorities

The Confederation of Autonomous Trade Unions in Serbia CATUS and the Independence Trade Union Confederation Nezavisnost have developed a detailed set of proposals for tax reforms, which to date are not being considered by the government. These demands are summarised in the following box 1.

Box 1: Trade union demands concerning tax reforms in Serbia

1. **Increase the rates of direct taxes**
   Direct taxes (profit tax, income tax, and property tax) should have priority over the indirect taxes (VAT, excise duties, and customs). A functional state, legal security, low level of corruption etc. are more important attraction factors of FDI than low tax rates and low wages.

2. **Introduce progressive personal income tax**
   The flat tax is unfair as it violates the principle that "those who make more should contribute more". Income tax should be taxed progressively, with the application of tax relief on the lowest wages.

   Contribution rates for social insurance should be maintained or even increased, considering that the applicable rates are low and that the fonds (pension and disability fond, healthcare insurance fond) have difficulties in their operation. Social contributions should be adequately high to guarantee the adequacy and sustainability of mandatory social benefits, being mindful of the ageing society.

3. **Address tax avoidance and tax evasion**
Measures that could help in the improvement of tax collection, stronger discipline and efficient control include:

- improvement and/or capacity building of tax administration;
- Investment in staff, training and modern equipment of tax and social inspectors;
- mandatory payment of wages, compensations and other earning (such as bonus) via a bank account;
- obligation to pay commercial transactions (especially those in higher amounts) via a bank account;
- establishment of a central register of all bank accounts and control of bank accounts in case of indication to a tax fraud;
- control of sensitive goods related transactions, such as antiquities, pieces of art, gold, jewellery, etc.;
- introduction of a fiscal cash register in the areas where they are not yet mandatory;
- inclusion of questions about foreign bank accounts or insurance policies in the annual tax return forms.

4. **Measures aiming at reducing undeclared work**
These measures should include:

- the promotion of declared work by way of tax incentives and public campaigns about the long-term advantages of declared employment. This awareness raising should be conducted jointly with employers' associations;
- simple and transparent tax laws, and simplification of legislation applicable to bookkeeping, accounting, and business records;
- reform of the existing system of social and healthcare insurance and creation of stimulating environment for due respect towards the payment of taxes and contributions (extending the tax base and introduction of progressive taxation);
- more efficient sanctions.

2.2.3 Bosnia and Herzegovina

Fiscal challenges

Bosnia and Herzegovina was hit hard by the COVID crisis, with a contraction of 4% GDP in 2020. The crisis has accelerated a slowdown that was already there before the pandemic. 2020 saw a reduction of exporting activities, a major source of the country's economic activity, and public finances experienced a marked drop in revenues. Nonetheless like everywhere in the region, the country took sizeable support measures, with an impact on budget.

In parallel, public spending is on the increase. COVID packages included wage support measures, tax deferrals, the establishment of a solidarity fund and company subsidies. Further, the period was marked by enhanced public support to the health sector. Independently from the pandemic, Bosnia and Herzegovina is, like all countries in the Western Balkans, heavily investing in infrastructures: construction of highways, reconstruction and modernisation of existing regional and main roads are planned in the Republika Srpska Spatial plan up to 2025. An international airport and activities on constructing a second one are also in progress.

The European Commission estimates that the 2020 tax revenues have lowered by 1.2% GDP and expenditure increased by 3.6%[3] . As a response, the government has announced measures to cut on public investment as well as reduced spending on the public sector. The European Commission is concerned that reduced investment would stand in the way of stronger growth in the medium term. The Commission also anticipates intentions to further lower tax rates on labour and personal incomes whilst at the same time rely strongly on indirect taxes. (European Commission, 2021a)

Overall, analysis and projections are particularly difficult in in Bosnia and Herzegovina because of complex fragmented institutional architecture [4]

Social indicators

Unemployment rate is at 16% with strong gender gap (75% men and only 48% of women engage in the labour market). **Informal employment** accounts for one third of employment.

This is a strong area of concern for trade unions because of the precarity of workers who find themselves outside the protection of labour law.

This report has not been able to find data on poverty rate.

The Confederation of Trade unions of the Republic of Srpska reports an active **social dialogue** with the government during the pandemic, in particular concerning the safeguarding of employment. At the federation level, however, the European Commission considers that social dialogue is weak with consultations limited to labour law but not larger economic and social reforms.

On the business side, it appears from our questionnaire that the employers' organizations have an active tax agenda, calling for reduction of overall tax burdens. There does not appear to be a civil society movement engaged in tax justice.

Personal Income Tax and Labour Taxation

The country has a 10% flat tax for personal income tax and social security contributions which amount to 33%. On the latter, employees contribute three times more than employers.

In the Republic of Srpska, recent reforms include a 150% increase of the non-taxable part of income, which resulted in an increase of take home wages. According to the union, this has also led to a decrease in tax wedge which is usually considered as good sign for employment.

Table 15:
Social Security Contributions in the federation of Bosnia and Herzegovina, 2020

Type of contribution	Employee's contributions(%)	Employer's contributions(%)
Contribution for pension and invalid insurance	17.0	6.0
Contribution for health insurance	12.5	4.0
Contribution for unemployement insurance	1.5	0.5

[3] European Commission, 2021
[4] We also had limited access to trade union feedback about the state of play in the Federation of Bosnia and Herzegovina and the Brcko District.

Table 16:
Social Security Contribution in the Republic of Srpska, 2020

Type of contribution	% of gross salary
Contribution for pension and invalid insurance	18.5
Contribution for health insurance	12.0
Contribution for unemployement insurance	1.0
Contribution for child protection	1.5

Table 17:
Social Security Contributions in the Brcko District, 2020

Type of contribution	Employee's contributions(%)	Employer's contributions(%)
Contribution for pension and invalid insurance	17.0	6.0
Contribution for health insurance	12.0	-
Contribution for unemployement insurance	1.5	-

Source: Gjokutaj, 2020a

Corporate Income Tax and Tax Incentives

The statutory corporate income tax is fixed at a low 10%. It is also possible to claim tax deductions for the hiring of full time employees.

Bosnia and Herzegovina has four active special economic zones, which is less than the neighbouring countries. Tax incentives include a 30% reduction in corporate income tax if the foreign investor re-invests 50% of its profits in production and machinery and a 50% reduction for investment over 20 mn BAM over 5 years. Foreign investors established in the free economic zones also benefit from VAT exemption although the OECD reports that this exemption is not always implemented in practice.

Table 18:
Special Economic Zones in Bosnia and Herzegovina, 2014

Special economic zone	Area in hectares	Number of users	Main operating industry	Number of people employed	Total exports (EUR millions)
Hercegovina	43.6	41	Metallurgy	to be obtained	22
Visoko	17.1	23	Textile	~1000	228
Vogošća	11	30	Automotive	~500	24
Lukavac	7.5	1	Wood processing	190	7

Source: OECD, 2017

Trade union priorities

Trade unions in Bosnia and Herzegovina have a heavy focus on increasing wages and reducing informal employment. In particular, the Confederation of Trade Unions of Republika Srpska demands that any change in tax policies results in an increase in wages and reduction of unfairness.

The Confederation also calls for an effective taxation of dividends and corporate income at an equivalent rate than what is applicable in EU Member States.

2.2.4 Montenegro

Fiscal challenges

Predictions for recovery in Montenegro are optimistic and the economy is expected to return to its pre-crisis level already in 2022. The government adopted five COVID packages, consisting in wage subsidies, measures to maintain liquidities in companies and support to vulnerable groups. The European Commission estimates the fiscal impact of COVID for 2020 resulted in a tax shortfall of 6.2% of GDP whilst support measures increased expenditure by 1%. (European Commission, 2021d)

According to the unions, investment in public services at the time of the pandemic was very limited. Investments were made only in the field of health services in order to overcome the limited capacities of both equipment and hospital beds and other resources necessary in the fight against COVID-19. When it comes to investment in infrastructure, however, the work is continued on the completion of the Bar Boljari highway section, expected to be in use this year. There does not appear to be additional major expenditure after that.

In December 2021, Montenegro adopted a series of laws as part of a "Europe Now" programme. A set of measures doubled the amount of net minimum wages (from 250 to 450 euros) whilst at the same time reduced labour taxation for the lowest incomes. A progressive personal income tax was also introduced. According to the trade unions, the objective of this ambitious plan is to fight brain drain and reduce the size of informal economy.

Social indicators

According to official data, **unemployment rate** in 2022 is at 23.91%. The biggest rate – 32.7% was registered in July 2000, and the lowest was in August 2009 – 10.1%.

Montenegro has a large informal economy with **undeclared work** estimated at 30% of total employment. According to the European Commission, the labour taxation system (prior to the Europe Now reform) was likely to be one driver for informal economy, with adverse implications for workers, budget and social security systems.

30.5% of population is at **risk of poverty or social exclusion.**

Social dialogue is currently at a stall. Montenegro is going through a deep political crisis, which makes it difficult for trade unions to operate. Nonetheless, the unions CTUM-Montenegro and UFTUM-Montenegro report their full participation into the Coordination Body for Monitoring the Implementation of the "Europe Now" Project, which includes representatives of all relevant institutions and social partners. UFTUM reports that the programme reflects about 80% of trade union demands, which were related to the increase of minimum wage, introduction of non-taxable part of wage, progressive taxation, increase of profit tax for profits above certain threshold.

Although it does not have the status of social partner, the American Chamber of Commerce is active

in Montenegro, as well as Montenegro Business Alliance, and the Association of Employers of Montenegro.

Unlike the other countries covered by this study, taxation reform can be a visible topic in the media. The increase of minimum wage and introduction of untaxable part of the wage attracted huge media attention in 2021.

Personal Income Tax and Labour Taxation

Montenegro introduced in 2007 a 15% flat tax gradually lowering it to 9% in 2010. Following fiscal difficulties, a higher personal income tax rate of 15% - a so called "crisis tax" - was subsequently introduced for wages exceeding 1000 euros.

The 2021 reform introduces significant changes. First, it increases the non-taxable part of wages to 700 euros gross. Gross earnings between 700 and 1,000 euro are taxed at 9%. Gross earnings above 1,000 euro are taxed at 15%. The tax wedge is expected to significantly reduce from 39% to 20.6%. Further, the law on contributions for social insurance revokes the healthcare insurance paid by employee and employer (total 10.8%). The total contributions paid by employees now amount to 15.5% and contributions paid by employers to 6%.

Table 19:
Social Security contributions in Montenegro, 2022

CONTRIBUTIONS	EMPLOYEE	EMPLOYER
Pension and disability insurandce	15%	5.5%
Insurance from unemployment	0.5%	0.5%
Total	15.5%	6%

Data compiled by CTUM, 2022

Corporate Income Tax and Tax Incentives

Montenegro applies a progressive Corporate Income Tax rate, ranging from 9% to 15%. For profits up to EUR 100 000, the tax rate is 9%. For profits between EUR 100 000 and 1.5 mn there is a fixed amount of EUR 9000 + 12% on the profits above 1 mn. For profits above EUR 1.5 mn there is a fixed amount of EUR 177 000 + 15%.

There is only one special economic zone in Bar, with a small number of foreign investors, mainly offering customs and VAT exemptions.

Trade union priorities

Both CTUM and UFTUM express overall satisfaction about the recent reforms which address their long-standing demand for increased net minimum wages and more progressive personal income tax. In addition to increased standards of living, they expect that such reform will help addressing the informal economy.

In addition, UFTUM calls for the doubling of current corporate income tax rates, which they do not believe is a genuine factor for FDI attraction. UFTUM also demands higher taxation of the wealthy through for instance a luxury tax.

Section III: Recommendations for a trade union agenda

The previous Section has outlined some of the fiscal challenges faced by the Western Balkans: reduced revenues and increased public spending. The context is therefore very favourable for tax reforms aiming at consolidating tax revenues. This Section argues that to address recurrent issues of inequalities and budgetary resources, more attention needs to be paid to the taxation of capital income. This is particularly relevant in the light of international developments on a global minimum tax rate. As far as personal income taxation is concerned, Section 3.2 suggests more progressive scales of taxation.

3.1 A better taxation of capital income

Western Balkan countries are overly reliant on consumption and labour taxes while sheltering capital income. Many trade unions in the region focus their revendications on the increase of minimum wages and reduction of labour taxation for lower incomes. These are natural demands for the labour movement and quite necessary in order to address the incentives for undeclared work and reduce risks of poverty. However, a narrow focus on labour taxation is unlikely on its own to increase tax revenues to the level that is required for public investment and adequately funded public services.

The central recommendation of this report is therefore to explore solutions to broaden the corporate income tax base. In addition to increased revenues, this would go a long way towards the reduction of the gap between capital and labour shares of income. An obvious first step is the increase of statutory corporate income tax rates, which are significantly lower than the EU and OECD average. Second, increasing minimum rates should go hand-in-hand with an in-depth rethinking of transfer pricing rules towards unitary taxation so as to prevent revenue leakage. Third, the capital invested in special economic zones goes virtually untaxed and there are some serious questions as to the contribution of untaxed FDI to sustainable growth and quality jobs. A fourth issue is the need to increase the efficiency of corporate income tax collection.

To address these challenges, trade unions could envisage integrating the following policy demands into their agenda for tax reform:

- **Increase effective tax rates to at least 25%**

We are referring here to an effective tax rate, as opposed to statutory, which implies a commitment by tax authorities to enforce actual payments. Western Balkans would not be isolated in this reform. As described in Section 1.2, the momentum for increasing effective tax rates is global as a result of a recent G20/ OECD agreement. OECD countries are expected to introduce a “top-up tax”, or right to “tax back”, designed to compensate the under taxation of overseas corporate profits.

The OECD model rules give a clear priority to resident countries (i.e. where the multinationals are registered) in the application of the right to tax back. The country of residence would come first by imposing the “top up” tax on the parent company to account for the under-taxed profits of its subsidiaries/ establishments. It is only if the residence country does not use this right that source jurisdictions (i.e. countries where subsidiaries/establishments are situated) can in turn claim tax adjustments (PSI, 2021).

In this context, it makes little sense for low tax countries to maintain their reduced corporate income tax rates. If they persist in doing so, multinational corporations active on their territory would still have to increase their tax payments but the revenues would be collected by resident countries. For Western Balkans to get a fair share of the pie, it is therefore essential to increase their effective tax rates to at least the agreed minimum.

The G20/ OECD agreement has fixed that minimum to 15%. The global labour movement is urging countries to build on that momentum and to implement a 25% effective minimum rate. This is necessary to effectively curb tax competition and would lead to substantial revenue increase.

- **Switch to unitary taxation with fair allocation factors**

In parallel to increasing minimum rates, countries can address the risks of revenue leakage through an in-depth reform of transfer pricing rules towards unitary taxation and formulary apportionment. As described in Section 1.2, such reform entails attributing taxing rights in proportion to the value that a multinational enterprise is creating in the region - and no longer by reference to where the multinational is formally declaring its profits. We advise ensuring that employment becomes an important factor in determining where value is created, and thus where taxes can be raised. As a general rule, this substantially increases revenue prospects for labour intensive source countries. A switch to unitary taxation with employment as one of the allocating factors (along with sales and assets) is therefore a perfectly appropriate solution for the Western Balkans.

We advise great caution when deciding to join or maintain adherence to the OECD BEPS Action Plan. As illustrated by the recent agreement on a global minimum tax, OECD outcomes tend to reflect bias in the allocation of taxing rights towards developed countries that are home to many multinationals, to the detriment of smaller non-OECD economies. Some of the BEPS actions, including in particular actions 8-10, would make it more difficult for Western Balkan governments to move away from transfer pricing rules towards unitary taxation. All countries should carry a careful evaluation of revenue impact before implementing the recommended actions, and any case adjust some of the OECD model rules to domestic considerations.

- **Reconsider tax incentives**

The rather intensive use of special economic zones needs to be reconsidered. Since their establishment, free zones in Western Balkans attracted a cumulative investment of EUR 2.5 bn. Exemptions from corporate income tax thus entail sizeable foregone revenues especially as tax incentives may not be a decisive factor in companies' decisions to invest.

Importantly, attracting FDI should not be a blind target in itself. Rather, incentives should be part of broader industrial policy strategies that have for objective green and sustainable development, higher productivity and R&D intensity and, above all, quality jobs. Tax incentives, if any, need to be adjusted to reflect that agenda.

- **Improve tax enforcement**

Low tax morale and insufficient enforcement capacities are often cited as a key problem in the Western Balkans. Adequate capacities must therefore be devoted to tax administration. This, however, is a catch 22 situation as the availability of technical and human resources is very dependent on the state finances. For this reason, the demand for better tax enforcement, whilst fundamental, cannot be a standalone solution. Structural changes as suggested above are also necessary to broaden the tax base.

In addition to capacities, transparency and exchange of information between tax authorities are an essential aspect of enforcement. Adopting a mandatory country by country reporting for multinational corporations is therefore a crucial step. Companies should be required to report all information necessary to assess their global operations, where they register profits and losses and where they create value in particular through employment.

Action 13 of the BEPS Action Plan contains a reporting template which can easily be transposed into domestic legislations. Another source of inspiration is the Standard 207 of the Global Reporting Initiative; a reporting template relied upon by investors who wish to assess the tax strategy of investee companies. Trade unions favour the GRI standard because it requires public disclosure. As exposed in Section 3.2, public data is indeed an important trade union demand.

Overall, the reporting obligation should have a broad scope of application so as to cover all multinational corporations active in the region. The EUR 750mn threshold foreseen by the OECD Action 13 should be lowered to at least EUR 40 mn. This is in line with the EU accounting Directive 2013/34 which considers that with a net turnover above EUR 40 mn a company should be considered as medium sized and therefore subject to more stringent accounting requirements.

According to the OECD public database, only Serbia and Bosnia and Herzegovina have such legal framework in place[5].

Beside, none of the four countries covered by this study seem to have put in place a format shareable with other tax administrations. All four countries are part of the Global Forum, an OECD hosted body aiming at improving transparency and exchange of information between tax authorities. Compliance with OECD standards is still under review. Judging by the Serbian trade unions demands on the necessity to carry operations through bank accounts (see Section 2.2.2), chances are that these standards may not really be complied with.

Serbian trade unions also call for dissuasive penalties. In addition to those, a powerful enforcement tool can be the exclusion of tax dodging companies from state support and public procurement.

Last but not least, trade unions should include in their revendications the creation of beneficial ownership registries that are interlinked with other registries worldwide and publicy accessible. Such tool is indispensable for the identification of natural persons who ultimately owns, controls or benefits from any asset.

3.2 A more progressive taxation of personal income

The tax wedge in the four countries covered by this study is high. On the one hand, the progressivity of personal income tax is low – this is the legacy of the flat tax revolution. On the other hand, the need to find revenues in particular to finance pension systems has led to increased labour taxation.

Recent years have seen increases in the minimum wages throughout the Western Balkans (World Bank, 2022). A related trade union demand is to increase the amount of tax-free allowances. This has a beneficial impact on low earners and contributes to reducing the tax wedge. The Montenegrin “Europe Now” programme, fully backed by the trade unions, constitutes an interesting development that may serve as a source of inspiration for other reforms in the region.

Additional solutions can also be explored to ensure greater progressivity of personal income taxation. The objective is to reduce income inequalities between wage earners. Flat tax rates should be abandoned in Bosnia and Herzegovina, and North Macedonia. In all four countries, personal income tax can be made further progressive, especially with the introduction of top tax brackets of 40% or more. It may be that due to the small number of individuals with higher earnings, the tax base for higher tax brackets is too narrow to generate significant revenues effect. It would however go a long way towards ensuring more fairness in the tax system, thereby addressing economic resentment, which itself feeds into social and political instability. More equity can also help with the low tax morale in the region.

In a 2019 report, the World Bank suggested to readjust the shares of social security contributions and personal income tax, lowering the former and increasing the latter. This would be a neutral revenue

[5] https://www.oecd.org/tax/transparency/country-monitoring/

reform with overall positive effects on employment. It could also help with the overall progressivity of labour taxation as social security contributions are largely borne by employees. That said, the labour movement is traditionally cautious in calling for reduced social security contributions as this is usually done to the detriment of sustainable pension systems.

Therefore, this solution must be carefully explored – taking into account not only short term effects but also longer term impact on social protection regimes.

Finally, it is worth noting the Montenegrin union's demand for a progressive VAT structure with higher rates (of 25% or more) on luxury goods and a minimum rate (of 5% or less) for basic products and services.

3.3 Improved public scrutiny

Trade unions in the region report a lack of impact assessment of past policies on employment, fiscal space and sustainable growth. There is therefore a strong case to improve the policy making with stronger evaluation of past policies and future proposals. Those evaluations need to be made public.

Trade unions can to some extent carry themselves some evaluations. They can for instance assess the progressivity of existing policies through the Oxfam Fair Tax Monitor that provides a simple methodology to assess, among other, the progressivity of tax systems, risks of tax leakages, transparency and accountability. Among the indicators to evaluate progressivity, the methodology suggests the identification of different rates for different brackets, types of taxation of capital and importance of VAT in the tax distribution. With regard to corporate tax, indicators include the rate but also loopholes such as loose rules on loss carry forward, interest deductions and penalties.

Action 11 of BEPS Action Plan provides six indicators to measure and monitor tax avoidance practices at country level, including profit rates in various parts of company groups and a comparison between the tax payments of foreign multinationals and those of domestic companies. It may be that the required information is not in the public space. For this reason, public country-by-country reporting is a fundamental labour demand. It will go a long way towards increasing the accountability of tax authorities as well as strengthening collective bargaining strategies for a fairer share of corporate wealth.

Conclusion and strategic considerations

Trade unions in the four countries covered by this report unanimously criticize the high tax burden on low wages, which is particularly problematic since the majority of employees is on lower incomes. They also express concerns about the size of informal economy and brain drain, which unions largely attribute to current tax policies.

This research has confirmed that the tax distribution is particularly unfair in the Western Balkans, with heavy reliance on VAT and social security contributions, which themselves are borne more heavily by employees than businesses. In contrast, revenues from higher incomes and capital are relatively sheltered.

Our main recommendations therefore consist in increasing the effective taxation of corporate profits as well as the progressivity of personal income taxes. Government accountability should also be improved through higher tax transparency and more open and inclusive policy-making.

These recommendations echo the revendications of the global labour movement and several of them are already part of the union agenda in the region. The key issue may not be lack of technical expertise but rather difficulties in building power for change.

This is not a problem specific to the Western Balkans. The tax policy-making agenda is captured by business associations and powerful corporations, which can go as far as negotiating their tax bills directly with governments. With the exception of Montenegro, where tax was integral part of a recent reform, all trade unions have highlighted a weak public debate and the absence of a tax justice movement.

A first step therefore is to build a base for action, based on public pressure and a coalition of progressive forces. Alliances could be sought with labour organisations and civil society active on the global tax agenda with a view to increase international attention to damaging tax policies in the region. Domestically, trade union campaigns targeting multinational corporations should fully integrate the tax avoidance angle. Experience has indeed shown that outing corporate tax practices is often effective in raising public attention to the relatively low contribution of multinationals to public budgets. Overall, trade unions need to carefully prepare their argument on the alleged links between tax hikes and lower business investment and job creation. A coordinated trade union agenda in the region can be a powerful counter-argument.

List of tables and figures

Sources

ALTAX	2021	*Tax burden, its structuring and tax rates in the Western Balkans in 2018 – 2019 (blog post)*
Arandarenko	2019	*A low wage, high tax trap in the Western Balkans (blog post)*
Deloitte	2019	*Guide for investing in Bosina and Herzegovina (plus Western Balkans comparatives)*
ECB	2007	*Flat taxes in Central and Eastern Europe: economic and monetary developments*
ETUC	2021	*ETUC Resolution on EU taxation and own resources*
European Commission	2021a	*Economic Reform Programme of Bosnia and Herzegovina (2021-2023) - Commission assessment, Staff Working Document SWD (2021) 91 final*
European Commission	2021b	*Economic Reform Programme of North Macedonia (2021-2023) - Commission assessment, Staff Working Document SWD (2021) 95 final*
European Commission	2021c	*Economic Reform Programme of Serbia (2021-2023) - Commission assessment, Staff Working Document SWD (2021) 96 final*
European Commission	2021d	*Economic Reform Programme of Montenegro (2021-2023) - Commission assessment, taff Working Document SWD (2021) 94 final*
European Parliament	2022	*The economic and investment plan for the Western Balkans: assessing possible economic, social and environmental impact of the proposed Flagship projects*
Gechert, Heimberger	2022	*Do corporate tax cuts boost economic growth?*
Gjokutaj	2020a	*Taxation Trends in Western Balkans*
Gjokutaj	2020 b	*Tax burden in Albania, Kosovo and Western Balkans 2020*
Global Reporting Initiative	2019	*Standard 207 on tax*
ILO	2021	*Social Policy Advice to Countries from the International Monetary Fund during the COVID-19 crisis: Continuity and Change, Working Paper 42*
ITUC	2021a	*Fair Corporate Taxation - Key ITUC demands*
ITUC	2021b	*Tax - Why is it relevant for trade unions?*
ITUC	2022a	*Investments in Social Protection and their Impacts on Economic Growth*
ITUC	2022b	*Fiscal Reforms that fall flat? The social and economic impacts of flat tax and social security reforms in Eastern Europe*

Mijovic Hristovska, Zivcic	2018	*Tax Justice in Southeast Europe - how to reduce inequalities*
OECD 2	017	*Tracking Special Economic Zones in the Western Balkans - Objectives, Features and Key Challenges*
OECD 2	020	*Government at a Glance: Western Balkans*
OECD 2	015	*BEPS Actions*
OECD/ G20	2021	*Statement on a Two Pillar Solution to Address the Tax Challenges arising from the Digitalisation of the Economy*
Ortiz, Chowdhury, Durán-Valverde, Muzaffar & Urban	2019 F	iscal Space for Social Protection: A Handbook for Assessing Financing Options
Oxfam	2016	*Fair Tax Monitor*
PERC-ITUC	2015	*Taxation and Budgetary Policies in the countries of the European Union and of the Western Balkans*
Picard 2	020	Fair Corporate Taxation - Why and How International Tax Rules need to be changed, ETUI Policy Brief 14/2020
PSI 2	021	*G20 agreement on international taxation - briefing note for PSI affiliates*
Tax Justice Network	2021	*State of Tax Justice*
World Bank	2022	*Western Balkans Regular Economic Report n°21 Spring 2022 - Steering through crises*
World Bank	2019	*Western Balkans Labor Market Trends*

ITUC
International Trade Union Confederation

info@ituc-csi.org
www.ituc-csi.org
Phone: +32 (0)2 224 0211
Fax: +32 (0)2 201 5815

Boulevard du Roi Albert II, 5, Bte 1
1210 Brussels - Belgium

Publisher responsible in law:
Sharan Burrow, General Secretary

ITUC CSI IGB