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Fair tax policies in the western Balkans: challenges and recommendations for a trade union agenda[1]

Abstract

This article examines the structure and scale of taxation in four western Balkans countries – Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia – in the context of the work of the international trade union organisations (the ITUC and the ETUC) to improve tax fairness and justice, and in seeking to hold multinational enterprises better to account. Based on a review of evidence from publications in the field authored by the major international organisations and drawing in particular on the Staff Working Documents produced by the European Commission, supplemented by field material gathered first-hand from trade unions active within these countries, the author sets out the challenges facing each of them in coming to terms with squeezed public finances, not least as a result of Covid-19, in the context of sizeable demands for public investment to deliver better public services. She closes by setting out an agenda which trade unions might adopt in broadening their calls for tax reform and, crucially, in developing the public debate about tax fairness and building alliances for change.

Keywords*: tax fairness, multinationals, trade unions, Covid-19, tax distribution, social security contributions, public investment*

Introduction

The objective of this report is to examine the challenges of current tax policies in the western Balkans and, on this basis, to produce 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, i.e. in which the tax burden is borne disproportionately by those in the population with the lowest incomes. This has an impact on inequalities and on poverty which, in turn, feed into political and social instability. Thus, a central recommendation of this report is to increase the shares taken by the top levels of personal income and capital tax revenues within the overall tax distribution.

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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 organised by the Pan-European Regional Council of the International Trade Union Confederation in November 2021 and subsequently responded to a detailed questionnaire identifying key domestic features. The organisations involved in this study are: KSS (Confederation of Free Trade Unions) and SSM (Federation of Trade Unions of Macedonia) (North Macedonia); SSS (Confederation of Autonomous Trade Unions of Serbia) and UGS 'Nezavisnost' (Trade Union Confederation 'Independence') (Serbia); SSRS (Confederation of Trade Unions of the Republika Srpska (Bosnia and Herzegovina); and SSCG (Confederation of Trade Unions of Montenegro) and USSCG (Union of Free Trade Unions of Montenegro) (Montenegro).

The report is divided into three broad sections of which the first provides an overview of labour's key demands for fair tax policies; the second analyses in-country situations in each of the four countries covered by the report in the light of these general demands; and the third provides a brief outline of a trade union agenda for tax reform. Our 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 within the region.

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.

Why trade unions should have a tax agenda

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 sustainable and inclusive growth. In the wake of the Covid-19 pandemic, the need for increased fiscal space has never been so pressing. In December 2020, governments around the world spent over 12 trillion dollars, equivalent to 12 per cent of global GDP. That spending was significantly more pronounced in rich countries with greater fiscal firepower than in emerging economies. In the current context of increased costs of living and an energy crisis, the need for an expanded fiscal space continues to be extremely important. In particular, public investment in social protection to provide support to peoples' incomes and livelihoods is a strong priority for the International Trade Union Confederation (ITUC 2021a).

Fiscal space can be created by raising revenues, through taxes in particular, or by cutting back on public expenditure. In many cases, the International Monetary Fund 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 a great number of cases. In 40 per cent of the countries investigated, IMF austerity proposals were actually larger than the size of the response to the virus (Razavi et al. 2021).

Austerity measures are generally understood as a reduction in 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 the harmonisation of fiscal and tax rules. Indeed, trade unions are stepping up their activities in favour of tax policies that raise more and more progressive revenues.

Progressive tax policies

Beyond revenue raising, tax also has a societal role to play in ensuring fairness, inclusiveness and a positive impact on employment. Inequalities can result both from an unequal distribution of wages and from the 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 on 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 those on lower incomes pay a higher share than those on higher incomes. In addition, those who use income to 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 as a result of 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.

The ITUC advanced its arguments in favour of a stronger social protection regime in times of downturn in a report published in 2022 (ITUC 2022a). The ITUC also looked at various scenarios to finance social protection. A key finding is that financing through progressive direct taxation performs better than more regressive types of indirect taxation. 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: 11)

Table 1 – Main types of taxes and the 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 owners of capital; but can be transferred to consumers via increased prices	Progressive; 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	Applicable to all market consumers. Affects consumers' final price but not production cost	Regressive; but can be made less regressive through a higher threshold, zero rating essential consumer products and higher rating for luxury items	Moderately efficient; a uniform rate makes no distinction between sectors; does not differentiate between domestic and imported goods	High administrative and compliance cost; companies and state require a good accounting system; proportionately more expensive for small business
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; can promote domestic production/ industries and exports; but these may be less efficient and prone to rent seeking	Relatively low administrative and compliance cost; 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 cost; but total revenue must be more than the cost

Tax category	Basic features	Equity (progressive or regressive)	Efficiency	Administrative and compliance costs
Property tax (land, wealth, etc.)	A fixed rate for a certain amount of land, based on value, paid by the owner	Progressive; 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 cost; but requires a good system to assess value; can be susceptible to undervaluation

Source: Ortiz et al. (2019)

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 the impact on employment and workers' rights.

According to estimates, 312 billion dollars are lost every year due to corporate tax abuse (Tax Justice Network 2021: 6). Aggressive tax avoidance also affects workers in other ways. Corporate profits are extracted from workplaces 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 letterbox practices (Picard 2020).

Main demands

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

An effective corporate income tax rate of at least 25 per cent

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

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. Accordingly, OECD countries will soon implement a 'top-up tax' under which, where the entities of a multinational corporation (e.g. subsidiaries, establishments) are paying corporate income tax below a minimum level, fixed at 15 per cent, other countries will 'tax back' the undertaxed overseas profits up to that minimum (OECD/G20 2021: 4).

For the labour movement, this statement can be considered as only a first step: greater ambition is needed as only a 25 per cent minimum, and on the basis of 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 (OECD/G20 2015). A key area of concern for the labour movement is that Actions 8-11 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 of course a fiction: a multinational enterprise is a coherent unit, with a consistent tax and business strategy implemented throughout the company group and 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 taken a position in favour of the principle of unitary taxation in which the profits of a multinational enterprise are 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 made subject to attempts to have a real go at curbing profit shifting activities (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 in taxation than their 'bricks and mortar' counterparts. The weaknesses of transfer pricing rules are indeed particularly exacerbated for multinationals with unique and highly mobile assets. Furthermore in a world of digital transactions, taxing rights should no longer be dependent on the existence of a physical establishment but should kick in whenever a series of indices point at a significant economic presence.[2]

Tax transparency

Country-by-country reporting is a vital element in 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, provide 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.

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

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 its investments in low-tax jurisdictions. This information is precious for workers seeking to engage in collective bargaining over 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 recent decades. In the context of an explosion in the asset values of the wealthy, global labour organisations 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, to contribute more to the recovery.

The ETUC has issued a call 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 of lowering the threshold to reach a satisfactory level to enhance tax justice (ETUC 2021). Additionally, the ITUC has called for the introduction of extra taxes on profits that exceed a normal return ('economic rents') (ITUC 2021b: 7).

Taxing financial transactions

Since the 2008 financial crisis, the labour movement has also been campaigning for taxes on financial transactions; that is, small levies on transactions in the financial sector. The objective is to reduce the volume of speculative transactions by making them more costly (ITUC 2021b: 12).

Tax policies in the western Balkans

The EU accession process has been opened for North Macedonia (2005), Montenegro (2012), Serbia (2014), Albania (2014) and, most recently, Bosnia and Herzegovina (2022), while Kosovo remains a potential candidate for accession. This process implies the implementation of complex reforms, fiscal reforms in particular, 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. The section immediately below reviews the shared challenges especially with regard to inequalities and the insufficient level of tax raising capacities; following that, a country-by-country analysis is provided.

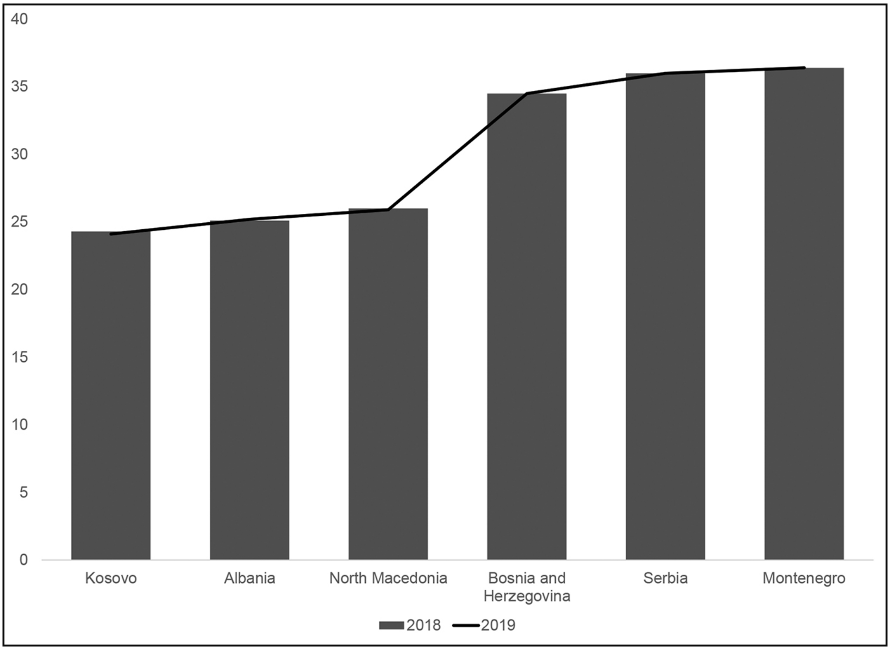
Overview of western Balkans tax policies

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

The share of tax revenues in western Balkan budgets is higher than in the OECD and also than the EU average. In 2018, on average, 64.5 per cent of government revenues came from direct taxes, compared to 59.4 per cent for OECD countries and 59.6 per cent for EU Member States (OECD 2020: section 2.4). At the same time, the tax burden in the western Balkans (including all forms of direct and indirect taxation as a percentage of GDP) is significantly lower than the averages for the EU and the OECD: total tax revenues account for 30.4 per cent of GDP in the western Balkans, at least 11 percentage points lower than in the EU (41.5 per cent) (see Figures 1 and 2 below).

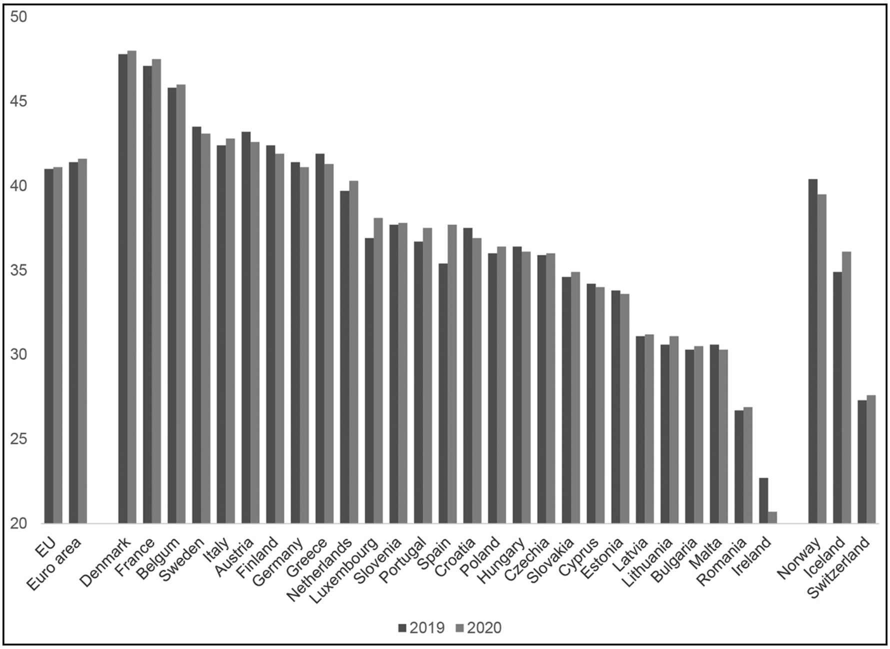
This comparatively low tax burden is explained by low tax policies. The whole region is marked by the low taxation of capital, in particular through the use of tax incentives and low corporate income tax rates, as well as flat tax regimes or personal income tax rates which have little progressivity. As illustrated by Figures 4a to 4d (further below), such low levels of taxation are compensated – at least to some degree – by high social security contributions and an extreme dependence on consumption (valued added) taxes.

Figure 1 – Tax burden in western Balkans, 2018-19



Source: Altax (2020: 42)

Figure 2 – Total tax revenue in EU Member States and EFTA countries, 2019-20, % of GDP



Source: Eurostat 2020 (gov_10a_taxag)
Note: Data for Luxembourg is 2016 and 2017.

Personal income tax: flat taxes and low progressivity

A 'flat tax revolution' was widely implemented in the western Balkans in the early 2000s. A flat tax consists of 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 amount of income.

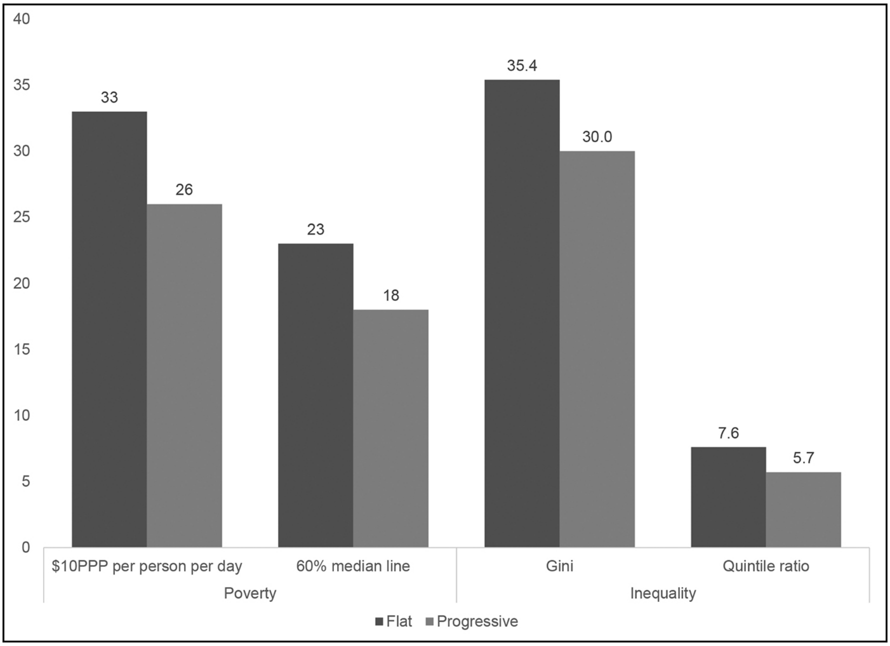
The key argument in favour of flat taxes lies in their simplicity: a simpler tax policy is easier to understand and administer and thus assists with the reduction of tax avoidance. In addition, flat taxes were believed to boost growth since a reduction in the tax burden was seen as contributing to higher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

The reality, however, is very different. In a 2022 report, the ITUC collected evidence on the social harm being done by flat taxes, arguing that:

> The reforms have arguably reflected a broader ideological signalling towards a neoliberal market-led model for countries' political economy. (ITUC 2022b: 13)

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 (ITUC 2022b: 23) (see also Figure 3). The ITUC report also quotes substantial literature pointing at the negative distributional effects at the expense of people on low or middle incomes. In other words, those on lower incomes pay a higher proportion of taxes than their counterparts on higher incomes and this exacerbates inequalities.

Figure 3 – Simulated poverty and inequality measures after hypothetical flat and progressive tax scenarios



Source: ITUC (2022b: 23)

In 2022, out of the four countries covered by this study, two continue to implement a flat tax regime: Bosnia 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 countries of the western Balkans is 23% (see Table 2) – and that is something of an outlier – compared to an average of 35.3% in the EU (see Table 3).

Table 2 – Personal income tax rates in south-east Europe, 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 (766 euros) 11% – portion of monthly gross salary exceeding the amount above
Slovenia	16% – income up to 8021.34 euros 27% – income up to 20 400 euros 34% – income up to 48 000 euros 39% – income up to 70 907.20 euros 50% – income exceeding 70 907.20 euros 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 ALL 150 000 15% – all other income except dividends (8%)
Kosovo	0% – income between 0 and 960 euros 4% – income between 960.01 euros and 3000 euros 8% – income between 3000.01 euros and 5400 euros 10% – income exceeding 5400 euros

Source: Deloitte (2019: 51)

Table 3 – Top personal income tax rates in Europe, 2022

Country	Top statutory personal income tax rate	Country	Top statutory personal income tax rate
Austria	55.0%	Lithuania	32.0%
Belgium	53.5%	Luxembourg	45.8%
Czech Republic	23.0%	Netherlands	49.5%
Denmark	55.9%	Norway	39.4%
Estonia	20.0%	Poland	36.0%

Country	Top statutory personal income tax rate	Country	Top statutory personal income tax rate
Finland	51.2%	Portugal	53.0%
France	55.4%	Slovakia	25.0%
Germany	47.5%	Slovenia	50.0%
Greece	54.0%	Spain (Valencia)	54.0%
Hungary	15.0%	Sweden	52.3%
Iceland	46.2%	Switzerland	44.8%
Ireland	48.0%	Turkey	40.8%
Italy	47.2%	United Kingdom	45.0%
Latvia	31.0%		

Source: PwC Worldwide Tax Summaries

Another legacy of flat tax policy regimes is their implication of reduced revenues for public budgets. In a bid to compensate for such diminished revenues, governments that rely on flat taxes tend to turn to other forms of taxation such as labour taxes and VAT.

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 current labour taxation policies are unfair to workers 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. The World Bank has already singled out the taxation of labour as 'one of the most problematic features of institutional labor markets in the Western Balkans' (World Bank 2019: 50). This is due to the high regressivity of the system which incentivises the informalisation of the economy and reduces competitiveness.

The personal income tax components of labour taxation tend to be 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 even more pronounced in the western Balkans (World Bank 2019: 57). In addition, social security contributions are more heavily borne by employees than by employers: in North Macedonia, all social security contributions are paid by employees; in Bosnia and Herzegovina, employees contribute three times more than employers; and in Serbia, the balance of the contribution is almost level (see Table 4).

As a result, labour tax progressivity is lower in the western Balkans than in most EU or OECD countries while the tax burden on workers earning the minimum wage is significantly high. As lower income workers make up two-thirds of employment, the majority of the population is bringing 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 dependants. 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, labour intensive industries in these three countries are less competitive than their counterparts in the European Union.

As the country analysis below also describes, there is, as a result, a worryingly high level of undeclared employment in the region.

Table 4 – Social security contributions

Country	From gross salary (cost to employee)	On top of gross salary (cost to employer)
Bosnia and Herzegovina	FBiH: 31% RS: 33% Brčko: 30.5% or 32%	FBiH: 10.5% RS: - Brčko: 0% or 6%
Croatia	20%	16.5%
Serbia	19.9%	17.9%
Montenegro	24%	10.3%
Slovenia	22.1%	16.1%
North Macedonia	27%	0%
Albania	11.2%	16.7%
Kosovo	5%	5%

Source: Deloitte (2019: 52)

Low taxation of capital

Corporate income tax rates in the western Balkans are lower than anywhere else in the EU and also lower than the OECD average. They range between a statutory rate of 9 per cent and one of 15 per cent (see Table 5). These are statutory rates of corporate income tax, meaning that the effective rates (corresponding to the payments actually made by companies) may well turn out to be considerably lower. The research on which this report is based has not been able to find any estimates of effective tax rates, which points at a problem of transparency and a lacking accountability among western Balkans tax authorities. In the EU, the average statutory rate is 23.5 per cent, whilst in OECD countries this ranges between 20 and 25 per cent.

As described in the first main section of this report, a 25 per cent effective tax rate is a strong priority for the labour movement across the globe. This is a necessary reform to increase revenues, stop tax competition and re-establish some fairness between the respective shares of income held by capital and labour.

In addition to the 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 risky investment. By increasing FDI, countries expect to foster economic growth through job creation, increased exports and positive spillovers into the domestic economy. Of critical interest for this research are the tax incentives that are deployed in these special economic zones. Broadly, they consist of tax reliefs in the form of tax holidays (exempting firms from corporate income taxation during the initial stage of investment), as well as 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 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, North Macedonia, Montenegro and Serbia have attracted almost 400 foreign companies, mostly manufacturing investments in the automotive components industry, with a cumulative investment of 2.5 billion euros. In terms of job creation, the report estimates that companies active in special economic zones have generated over 30 000 jobs in the region. Serbia is by far the largest recipient of FDI (OECD 2017).

Table 5 – Corporate income tax rates in the EU and the western Balkans, 2022

Country	CIT rate (%)	Country	CIT rate (%)
Austria	25	Malta	35
Belgium	25	Netherlands	25
Bulgaria	10	Poland	19
Czech Republic	19	Portugal	30
Denmark	22	Romania	16
Estonia	20	Slovak Republic	21
Finland	20	Slovenia	19
France	28.4	Spain	25
Germany	15.8	Sweden	20.6
Greece	24		
Hungary	9	Albania	15
Ireland	12.5	Bosnia and Herzegovina	10
Italy	24	Bulgaria	10
Latvia	20	North Macedonia	10
Lithuania	15	Serbia	15

Country	CIT rate (%)	Country	CIT rate (%)
Luxembourg	18.2		

Source: Data extracted on 20 July 2021 from OECD.stat

Table 6 – Key indicators of special economic zones in the western Balkans

	Albania	Bosnia and Herzegovina	North Macedonia	Kosovo	Montenegro	Serbia
Total no. zones	3	4	15	3	1	14
No. active zones	0	4	6	0	1	10
Size (ha)	494 (planned)	79.5	893	530	130	1615
No. enterprises	0	95	23	0	36	241
Cumulative investment (€m)	0	n/a	207	0	5	2240
No. employees	0	1700	6800	0	398	22 242
Total turnover (2015)	0	303	1475	0	7.6	2431
Zone exports as % of total	0	6.4	36.4	0	n/a	17.6

Source: Data from zone authorities, compiled by the OECD (2017) and OECD calculations based on national statistics.

Notes:

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

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

3. Data for Bosnia and Herzegovina refer to 2014 whereas total turnover for North Macedonia is estimated from the share of total exports for 2015.

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

Overall employment levels have to be compared with the quality of the jobs being created. As companies operate in a legal vacuum, the trade union experience with special economic zones is that jobs often consist of precarious forms of employment, poor wages, insufficient health and 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 and Heimberger 2022). There can indeed be no guarantee that investment would not have been made without the tax incentives: other factors, such as political and economic stability, geographical location, existing infrastructure and the workforce, may be more influential ones on choice of location for real investment.

Further, FDI in special economic zones does not always create positive spillover effects in 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 point, the OECD raises some serious questions as to whether special economic zones in the western Balkans contribute to higher added value activity in global value chains. Foreign investment tends to be in labour intensive industries with limited added value activity and insufficient technological upgrading (OECD 2017: 56-57).

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

In addition to low corporate tax rates, the western Balkans rely on transfer pricing rules which the labour movement criticises as inadequate to tackle corporate tax avoidance by multinational enterprises (see above). In parallel, the unions interviewed for this report underlined the lack of capacity in tax administrations to take up the fight against tax avoidance and tax evasion. In a catch-22 situation, poor enforcement further feeds into insufficient resources to strengthen the hands of tax administrations.

Revenues are inevitably lost as a result of these structural weaknesses. Table 7 shows estimated revenue losses in absolute numbers and in terms of the equivalent share of Covid-19 vaccinations during the pandemic. These estimates are based on the current low tax rates.

Table 7 – Estimated revenue losses through corporate tax avoidance

	Serbia	Montenegro	North Macedonia	Bosnia and Herzegovina
Total annual tax loss ($m)	239.6	17.2	38.9	27.1
Total annual tax loss (% GDP)	0.5	0.4	0.3	0.1
Of which: corporate tax abuse ($m)	234.8	16.3	37.1	25.6

	Serbia	Montenegro	North Macedonia	Bosnia and Herzegovina
Of which: offshore wealth ($m)	4.8	0.9	1.8	1.5
Full vaccinations possible (m)	13.9	1.0	2.3	1.6
Full vaccinations possible (% of population)	197.4	161.0	108.7	46.2

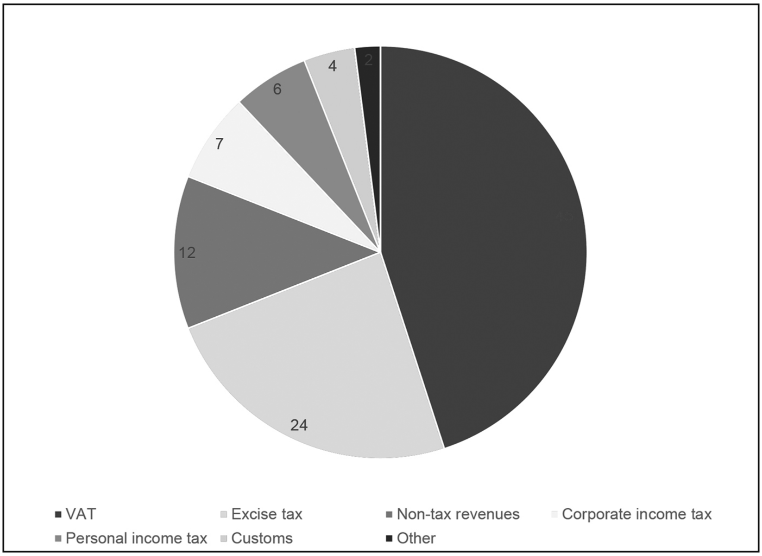
Source: compiled from Table 2 in Tax Justice Network (2021)

Consequences: regressive tax policies, risk of poverty and depleted budgets

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

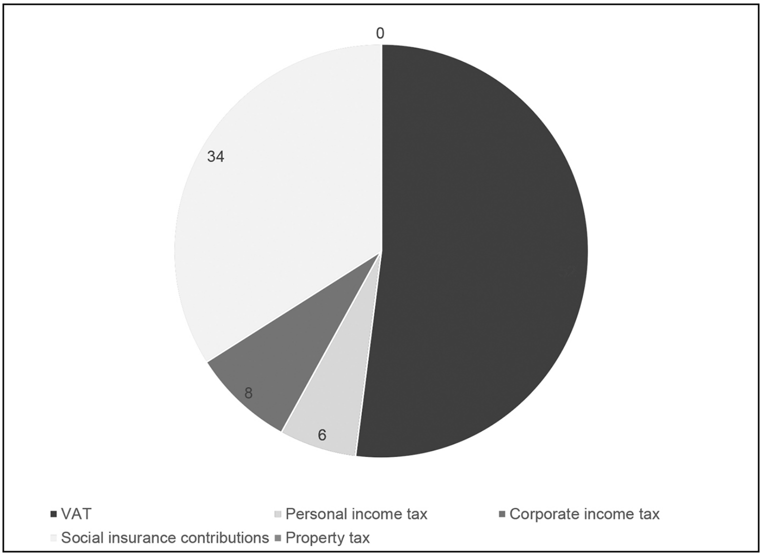
The lack of progressivity in personal income tax regimes as well as foregone corporate revenues have led to massive reliance on workers' social security contributions and consumer-provided VAT. As illustrated by Figures 4a to 4d, western Balkans countries tend to be extremely dependent on VAT, much more so than in the EU or in terms of OECD average.

Figure 4a – Revenue structure in Serbia, 2022



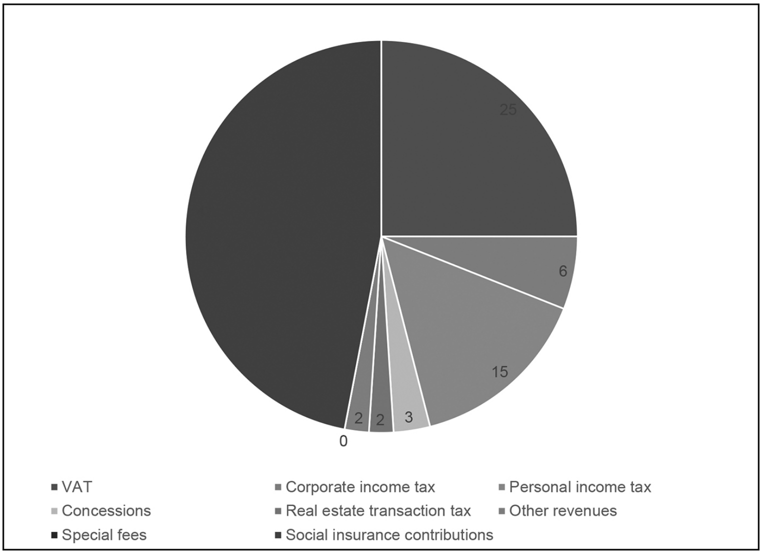
Source: Serbian Finance Ministry website

Figure 4b – Tax distribution in Republika Srpska, 2022



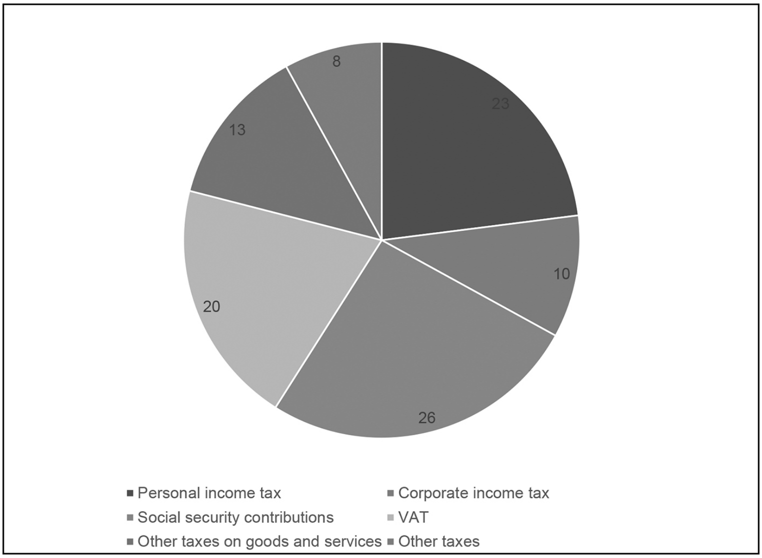
Source: Data compiled by the Confederation of Trade Unions of Republika Srpska

Figure 4c – Tax collection in Montenegro, 2019



Source: Montenegrin Finance Ministry website

Figure 4d – Tax distribution, OECD average (2018)



Source: OECD stats, 2018

The following section shows that, for each country covered by this study, there are fiscal challenges linked to the 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 yet are enjoying neither strong public services nor effective social protection regimes.

Lastly, current tax policies are taking a heavy toll on labour market indicators, with high levels of unemployment and undeclared work. The whole region is facing high levels of the population who are at risk of poverty, ranging from 21.9 per cent (North Macedonia) to 30.5 per cent (Montenegro). In comparison, the population at risk of poverty in the EU-27 stands at 20.9 per cent.

Country analysis

North Macedonia

a. Fiscal challenges

Public finances in North Macedonia were hit hard by the pandemic. The share of foregone revenues due to low tax rates and insufficient enforcement was further reinforced by the slowdown in economic activity. In parallel, public spending had to rise to finance Covid-19 related measures: wage subsidies; financial support for households and companies; reduction in the rate of VAT; extension of tax deadlines; etc. The European Commission reports that the total impact of Covid-19 measures in 2021 amounted to an equivalent of 2.9 per cent of GDP (European Commission 2021b: 8).

In parallel, the North Macedonian government has been pursuing an intensive programme of investment. Up to 2025, the government has announced that it will focus on the implementation of infrastructure projects in roads and railways, energy and utilities as well as investments to improve conditions in the health, education and social systems as well as in agriculture and environmental protection. These projects amount to a total of 3.1 billion euros, partly financed with budget funds of 1.16 billion euros.

Thus, there are tensions between, on the one hand, foregone revenues and, on the other, an acute need for fiscal consolidation. According to the trade unions, the IMF and the World Bank are advising the need to increase the progressivity and efficiency of the country's tax policies. In 2021, the European Commission also recommended broadening the tax base in order to improve revenue collection, at the same time expressing concerns about public announcements that would translate into an erosion of tax revenues. For instance, a Tax System Reform Strategy published in 2020 heralded further measures to strengthen revenue collection while also holding out the promise of further tax incentives for companies and households (European Commission 2021: 12).

b. Social indicators

According to 2021 data from MAKSTAT, the national statistical office, the labour force in North Macedonia numbered 937 482 people of whom 795 276 were employed while 142 206 were unemployed, giving an unemployment rate of 15.2 per cent. Trade unions report that the Covid-19 pandemic has aggravated the unemployment situation with collective dismissals, often in violation of workers' rights.

The European Commission estimates that undeclared employment and partially undeclared wages concern almost 44 per cent of employees. A key driver in this situation is the high taxation of wages, in particular for those on lower incomes. Workers appear to prefer to receive a higher net wage in spite of foregoing their right to pension and social protection (European Commission 2021: 21). The high level of undeclared work is an area of particular concern to the North Macedonian trade unions. For instance, SSM 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 the formal economy, have unstable earnings and do not have access to any form of social protection.

Poverty figures are also high, with 21.9 per cent of people being at risk of poverty in 2019. KSS reports higher risks among lower income earner groups within the population, given that they tend to be employed in vulnerable sectors most affected by the pandemic (such as trade and transport).

Concerning social dialogue, SSM assesses its relationship with the current government as positive, in particular in relation to recent reforms to the minimum wage. That said, the general state of social dialogue remains preoccupying for the European Commission which considers that social dialogue in the private sector remains weak and marked by the absence of engagement with private sector unions. This is confirmed by KSS which raises concerns about unions' lack of influence over the management of the pandemic crisis.

On the business side, it appears from our questionnaire that the Chamber of Commerce of Macedonia has an active policy advocacy agenda on tax-related issues. This agenda appears generally hostile to increases in tax rates, however, including on personal income tax, expressing concerns about the loss of competitiveness.

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

c. Personal income tax and labour taxation

North Macedonia applied between 2007 and 2018 a flat rate tax, firstly at a rate of 12 per cent and then at one of 10 per cent. The declared reason was that this would make the business environment more friendly to doing business, while increasing tax revenues due a reduction in the incidence of tax evasion. Although the flat tax was in force for 12 years, a comprehensive analysis of its effects still has never been conducted. In 2019, a higher tax rate of 18 per cent was introduced for incomes above 90 000 denar (approximately 1460 euros). This was a symbolic reform affecting, in the admission of the Finance of Ministry itself, only the highest earning one per cent of the total population (World Bank 2019: 55).

Social security contributions coming from wages are, on the other hand, much more significant, as evidenced by Table 8. Table 9 provides an illustrative calculation of gross and net minimum wages in which, out of a gross wage of 22 146 denars, the worker will take home 15 194. Both tables have been compiled by KSS on the basis of official information.

Table 8 – Rates of social security contributions in North Macedonia, 2022

Contribution to pension fund and disability insurance of Macedonia (PFDIM)	18.80%
Health insurance contribution	7.50%
Additional health contribution	0.50%
Employment contribution	1.20%

Table 9 – Calculation of gross and net minimum wages in North Macedonia, 2022

Gross wage	**22 146**
Contribution to PFDIM	4163
Health insurance contribution	1661
Additional health contribution	111
Employment contribution	266
Total contributions	**6201**
Gross salary reduced for contributions	15 944
Tax exemption	**8438**

Basis for calculation of personal income tax	**7506**
Accrued personal income tax (10%)	751
Net wage	**15 194**

Source: Data compiled by KSS, 2022

d. Corporate income tax and tax incentives for corporations

North Macedonia implements a low corporate income tax rate of 10 per cent. In addition, the country offers foreign investors no less than 15 special economic zones (see Table 10). Table 11 provides a comparison between the tax due by foreign investors established in special economic zones and that due by domestic companies. Foreign investors enjoy considerable tax incentives, including a zero per cent corporate income tax rate for ten years and zero VAT.

Table 10 – Special economic zones

Special economic zone	Area (ha)	No. enterprises	Main operating industry	Cumulative investment (€m)
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	Electronics/ 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: 70)

Table 11 – Comparative tax advantages in special economic zones

	Rate in the zone	Rate outside the zone
Tax duties		
Corporate tax	0% up to 10 years	10%
Personal income tax	0% up to 10 years	10%
VAT	0%	18%
Excise tax	0%	5% – 62%
Customs duties		
Equipment, machines and spare parts	0%	5% – 20%

Source: Data compiled by KSS, 2022

e. Trade union priorities

The priorities of both KSS and SSM are focused on core labour issues, including the increase of wages and reforms to the pension system. 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 current tax policies and income inequalities.

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

Serbia

a. Fiscal challenges

The global slowdown which resulted from the pandemic did not affect Serbia as substantially as the majority of European countries. This is due to its previous dynamics in terms of growth, financial stability and the structure of the economy.

Nonetheless, like everywhere in the region, the country put in place a sizeable level of support measures which had an impact on the budget. The government issued three successive support packages, with a total amount of eight billion euros. These measures included employment subsidies to SMEs and large companies, tax relief and other public subsidies. In 2020 alone, the support packages amounted to six billion euros, some 12.7 per cent of GDP.

Aside of pandemic-related spending, close to half Serbia's capital expenditure is earmarked for public investment in road and rail transport infrastructure (European Commission 2021c: 12).

b. Social indicators

The unemployment rate in Serbia is 10 per cent of the population. Informal employment remains high, at 16.7per cent, but plays significantly less of a role than in the other three countries covered in this article. Like everywhere in the region, however, high labour taxation is a strong incentive for undeclared work from the perspective both of employers and of workers.

In 2019, 31.7 per cent of the population was at risk of poverty. The European Commission considers that the further increase in non-taxed wage allowances to a level close to, or equal to, the minimum salary would have a significant impact on in-work poverty (European Commission 2021c: 19).

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.

On 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 Foreign Investors Council, Privredna Komora Serbia (Chamber of Commerce and Industry), the American Chamber of Commerce, the National Alliance for Local Economic Development (NALED), USAID and associations of employers of Serbia.

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

c. Personal income tax and labour taxation

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

Social security contributions exceed 37.05 per cent of the gross wage, more than half of which is borne by employees. The non-taxed 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 who has been registered for at least six months with the Employment Bureau are entitled to a 65-75 per cent tax return, depending on the number of newly-employed workers
b) those who employ a person who, in 2019, did not have status as an insured worker are entitled to a reduced tax return for three years, first in the amount of 70 per cent, then 65 per cent in the second year and, finally, 60 per cent.

d. 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 zero per cent CIT rate for the first 10 years of investment exceeding 8.5 million euros. Foreign investors also benefit from VAT exemptions.

Table 12 – Special economic zones in Serbia, 2017

Special economic zone	Area (ha)	No. manufacturing enterprises	Main operating industry	No. people employed	Total turnover (€m)
Apatin	415	Zone 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
Smederovo	143	6	Metal	1363	36
Svilajnac	33	1	Electric works	392	85
Kragujevac	176	7	Automotive	4354	2490
Užice	55	6	Copper	1950	393
Kruševac	64	1	Rubber/ Chemicals	1150	15
Pirot	116	16	Rubber/ Pneumatics	5808	689
Vranje	123	Zone not fully active	Footwear	0	0
Beograd	98	Zone not fully active		0	0

Source: OECD (2017: 75)

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

e. Trade union priorities

Both trade unions we interviewed for this research, SSS and UGS 'Nezavisnost', have developed detailed sets of proposals for tax reforms which, to date, are not being considered by the government. These demands are summarised in 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 indirect taxes (VAT, excise duties and customs). A functional state, legal security, a low level of corruption, etc. are more important attraction factors for 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 funds (pension and disability fund, healthcare insurance fund) experience difficulties in their operation. Social contributions should be sufficiently 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 security inspectors;
- mandatory payment of wages, compensation and other earnings (such as bonuses) via a bank account;
- obligation to pay commercial transactions (especially those of higher amounts) via a bank account;
- establishment of a central register of all bank accounts and control of bank accounts safeguarding against indications of tax fraud;
- control of sensitive goods related transactions such as antiquities, pieces of art, gold, jewellery, etc;
- introduction of fiscal cash registers in areas where they are not yet mandatory;
- inclusion of questions about foreign bank accounts or insurance policies in 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 employer associations;
- simple and transparent tax laws and simplification of the legislation applicable to bookkeeping, accounting and business records;
- reform of the existing system of social and healthcare insurance and the creation of a stimulating environment for due respect toward the payment of taxes and contributions (extending the tax base and the introduction of progressive taxation);
- more efficient sanctions.

Bosnia and Herzegovina

a. Fiscal challenges

Bosnia and Herzegovina was hit hard by the Covid-19 crisis, with a 4.5 per cent contraction in GDP in 2020, although the crisis accelerated a slowdown that was already present before the pandemic. 2020 saw a reduction in export activities, a major source of the country's economic activity, and public finances experienced a marked drop in revenues.

In parallel, public spending is on the increase. Covid-19 support packages included wage support measures, tax deferrals, the establishment of a solidarity fund and company subsidies. The period was also marked by enhanced public support for the health sector. Independently of the pandemic, Bosnia and Herzegovina is, like all countries in the western Balkans, trying to invest in its infrastructure where there are some noted failings. Even so, the European Commission points out that what investment is being undertaken is driven mainly by the availability of external financing (European Commission 2021a: 2).

The Commission estimates that 2020 tax revenues have been lowered by 1.2 per cent of GDP while expenditure increased by 3.6 per cent (European Commission 2021a: 8). The response has been for the government to reduce public sector spending, including the announcement of measures to cut back on public investment which, expressed as a share of GDP, is set to fall sharply by 2023 (to 2.0 per cent from 2.9 per cent in 2019). The European Commission is particularly concerned that reduced investment would stand in the way of stronger growth in the medium term. Furthermore, it also concerned that, in the context of poor efficiency in tax collection, a reliance on regressive indirect taxes, coupled with a failure to improve contributions from higher income groups, leaves the quality of public finances and budget planning at a rather low ebb (European Commission 2021a: 12).

Overall, analysis and projections are particularly difficult in Bosnia and Herzegovina because of the fractured institutions.

b. Social indicators

The unemployment rate is at 16 per cent and the labour market experiences a strong gender gap (75 per cent of men but only 48 per cent of women are engaged in the labour market). Additionally, informal employment accounts for one-third of employment. This is a strong area of concern for trade unions because of the precarity of workers in such a situation who find themselves outside the protection of labour law.

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

SSRS, to which confederation we were able to speak in the course of our research, reports an active social dialogue with the government during the Covid-19 pandemic, in particular concerning the safeguarding of employment. At country level, however, the European Commission considers social dialogue to be weak, with consultations limited to labour law but not larger economic and social reforms (European Commission 2021a: 16). In Republika Srpska, collective agreements are largely confined to the public sector although private sector agreements can be found in some industry sectors in the Federation.

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

c. Personal income tax and labour taxation

The country has a 10 per cent flat tax rate for personal income tax. Social security contributions amount to up to one-third of the gross wage and, here, at best, employees contribute three times more than employers. In Republika Srpska and the District of Brčko, employer contributions are either zero or extremely low. In Republika Srpska, however, recent reforms include a 150 per cent increase in the non-taxed allowance, resulting in an increase of take-home pay. According to the union, this has also led to a decrease in the tax wedge which is usually considered a good sign for employment.

Table 13 – Social security contributions in the Federation of Bosnia and Herzegovina, 2020

Type of contribution	Employee contributions (%)	Employer contributions (%)
Contribution for pension and disability insurance	17.0	6.0
Contribution for health insurance	12.5	4.0
Contribution for unemployment insurance	1.5	0.5

Table 14 – Social security contributions in Republika Srpska, 2020

Type of contribution	% of gross salary – paid only by employees
Contribution for pension and disability insurance	18.5
Contribution for health insurance	12.0
Contribution for unemployment insurance	1.0
Contribution for child protection	1.5

Source: Gjokutaj and Gjokutaj (2020) for each of Tables 13 and 14 (respectively: 2020: 32; 2020: 39)

In the District of Brčko, employees may choose to pay into either the Federation pension and disability fund, in which case there is also an obligation for a six per cent contribution from the employer, or the one in Republika Srpska (zero employer contribution). Health insurance contributions are 12 per cent of gross salary.

d. Corporate income tax and tax incentives

Statutory corporate income tax is fixed at a low rate of 10 per cent. It is also possible to claim tax deductions for the hiring of full-time employees.

Bosnia and Herzegovina has four active special economic zones, fewer than in neighbouring countries. Tax incentives include a 30 per cent reduction in corporate income tax if the foreign investor re-invests 50 per cent of its profits in production and machinery and a 50 per cent reduction for investments of over 20 million Bosnian marks (c. 10 million euros) over five years. Foreign investors established in the zones also benefit from VAT exemptions although the OECD reports that this exemption is not always implemented in practice.

Table 15 – Special economic zones in Bosnia and Herzegovina, 2014

Special economic zone	Area (ha)	No. users	Main operating industry	No. people employed	Total exports (€m)
Hercegovina	43.6	41	Metallurgy	n/a	22
Visoko	17.1	23	Textiles	c. 1000	228
Vogošća	11	30	Automotive	c. 500	24
Lukavac	7.5	1	Wood processing	190	7

Source: OECD (2017)

e. Trade union priorities

Trade unions in Bosnia and Herzegovina have a heavy focus on increasing wages and reducing informal employment. In terms of the position on taxation, SSRS demands that any change in tax policies results in an increase in wages and a reduction in unfairness. SSRS is also calling for the effective taxation of dividends and corporate income at a rate equivalent to that which is applicable in EU Member States.

Montenegro

a. Fiscal challenges

Predictions for recovery in Montenegro are optimistic and the economy is expected to have returned to its pre-crisis level in 2022. The government adopted five Covid-19 packages, consisting of wage subsidies, measures to maintain liquidity in companies and support for vulnerable groups. The European Commission estimates that the fiscal impact of Covid-19 for 2020 was a tax shortfall of 6.2 per cent of GDP whilst support measures increased expenditure by 1 per cent (European Commission 2021d: 8)

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

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

b. Social indicators

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

Montenegro has a large informal economy with undeclared work estimated at 30 per cent of total employment. According to the European Commission, the scale of phenomenon is diverse but, as regards the labour market, the labour taxation system (prior to the 'Europe Now' reform) was likely to be one driver, having adverse implications for workers, the budget and the country's social security system (European Commission 2021d: 22).

Some 30.5 per cent of the population is at risk of poverty or social exclusion.

The social dialogue is currently stalled. Montenegro is going through a deep political crisis, making it difficult for trade unions to operate, and the improvement of dialogue and its mainstreaming have been specifically identified as a structural reform measure (European Commission 2021d: 35). Nonetheless, SSCG and USSCG report their full participation in the co-ordination body monitoring the implementation of 'Europe Now', which includes representatives of all the relevant institutions and social partners. USSCG reports that the programme reflects about 80 per cent of trade union demands, which were related to the increase of the minimum wage, the introduction of a non-taxable wage allowance, a progressive taxation regime and an increase in the tax on profits above certain threshold.

Although it does not have the status of social partner, the American Chamber of Commerce is active in Montenegro as is the Montenegro Business Alliance and Unija Poslodovaca Crne Gore (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 in the minimum wage and the introduction of anontaxed wage allowance attracted significant media attention in 2021.

c. Personal income tax and labour taxation

Montenegro introduced in 2007 a 15 per cent flat tax regime, gradually lowering this to 9 per cent in 2010. Following fiscal difficulties during Covid-19, a 2021 reform – a so-called 'crisis tax' – introduced significant changes. First, it increased the non-taxable wage allowance to 700 euros. Gross earnings between 700 and 1000 euro are still taxed at 9 per cent, but gross earnings above 1000 euro are taxed at 15 per cent. The tax wedge is expected to reduce significantly from 39 per cent to 20.6per cent.

However, the 2007 law on contributions for compulsory social insurance revoked the previous healthcare insurance paid jointly by employees and the employer (total 10.8 per cent). The total contributions paid by employees amount to 15.5 per cent and those by employers to 6 per cent.

Table 16 – Social security contributions in Montenegro, 2022

Type of contribution	Employee contribution (%)	Employer contribution (%)
Pension and disability insurance	15%	5.5%
Unemployment insurance	0.5%	0.5%
Total	15.5%	6%

Source: Data compiled by SSCG, 2022

d. Corporate income tax and tax incentives

Montenegro applies a progressive corporate income tax rate, ranging from 9 per cent to 15 per cent. For profits up to 100 000 euros, the tax rate is 9 per cent while for profits between 100 000 euro and 1.5 million euro there is a fixed amount of 9000 euros plus 12 per cent on profits above 1 million. For profits above 1.5 million euro, there is a fixed charge of 177 000 euros plus 15 per cent.

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

e. Trade union priorities

Both SSCG and USSCG express overall satisfaction about recent reforms which address long-standing demands for increases in the net minimum wage and a more progressive personal income tax regime. In addition to an improved standard of living, they expect that such reforms will help to address the informal economy.

In addition, USSCG has been calling for a doubling of current corporate income tax rates which it does not believe is a genuine factor in the attraction of FDI. The union is also demanding higher taxation of the wealthy through, for instance, the application of a luxury tax.

Recommendations for a trade union agenda

The previous section has outlined the fiscal challenge faced by the countries of the western Balkans: increased public spending at a time of reduced revenues. The context is therefore highly favourable for tax reforms which are aimed at consolidating tax revenues. This section argues that, to address the recurring issues of inequalities and budgetary resources, more attention needs to be paid to the taxation of capital income, examined immediately below. This is particularly relevant in the light of international developments on a global minimum tax rate. As far as personal income taxation is concerned, a later sub-sections suggests more progressive scales of taxation.

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 have focused their policy calls on an increase in minimum wages and the reduction of labour taxation for those on lower incomes. These are natural demands for the labour movement and quite necessary in order to address incentives for undeclared work and to reduce the risk 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 for adequately funded public services.

The central recommendation of this report is therefore to explore solutions to broaden the base of corporate income tax. In addition to increased revenues, this would go a long way towards reducing the gap between the shares of national income held by capital and labour. An obvious first step is an increase in the statutory rates of corporate income tax, which are significantly lower than the EU and OECD averages. Second, increasing these 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 per cent

We are referring here to the effective tax rate as opposed to the statutory one, which implies a commitment by the tax authorities to enforce the actual payments due. The western Balkans would not be isolated in such a reform: as described above, the momentum for increasing effective tax rates is global as a result of the recent OECD/G20 agreement in which OECD countries are expected to introduce a 'top-up tax', or the 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 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 where the country of residence 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 other countries in which they are resident. For the 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 OECD/G20 agreement has fixed that minimum at 15 per cent.

However, the global labour movement is urging countries to build on that momentum and to implement a 25 per cent minimum effective rate. This is necessary to curb tax competition effectively and would lead to a substantial increase in revenues.

Switch to unitary taxation with fair allocation features

In parallel to increasing the minimum effective rates, countries can address the risks of revenue leakage through an in-depth reform of transfer pricing rules towards unitary taxation and formulary apportionment. Ensuring that employment becomes an important factor in determining where value is created, and thus where taxes can be raised, is critically important. 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.

However, great caution is advisable 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 governments in the western Balkans to move away from transfer pricing rules towards unitary taxation. All countries should carry out a careful evaluation of the revenue impact before implementing the recommended actions and, in any case, should adjust some of the OECD model rules to domestic considerations.

Reconsider tax incentives

The rather intensive use of special economic zones needs also to be reconsidered. Since their establishment, such zones in the western Balkans have attracted a cumulative investment of 2.5 billion euros (as at 2017). 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.

Moreover, attracting FDI should not be a blind target in itself. Rather, the incentives that are offered should form part of broader industrial policy strategies that have as their objective green and sustainable development, higher productivity and R&D intensity and, above all, the delivery of 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 since the availability of technical and human resources is very dependent on 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 the exchange of information between tax authorities are essential aspects of enforcement. Adopting mandatory country-by-country reporting for multinationals is therefore a crucial step. Companies should be required to report all the information necessary to assess their global operations, where they register their profits and their 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 legislatures. Another source of inspiration is GRI Standard 207 (Global Reporting Initiative 2019); 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 we also note further below in the context of a discussion about public scrutiny, public data is indeed an important trade union demand. Overall, however, the reporting obligation should have a broad scope of application so as to cover all multinational corporations active in the region. The threshold foreseen by Action 13 in the BEPS Action Plan, of consolidated group revenues of 750 million euros, should be lowered to at least 40 million euros. This is in line with EU accounting Directive 2013/34 which considers that, where net turnover is above 40 million euros, 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 of the countries covered by this study have implemented such a legal framework in their domestic law.[3] Moreover, none seem to have put something in place which is in 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 the exchange of information between tax authorities. Nevertheless, compliance with OECD standards is still under review and, to judge by the demands of the Serbian trade unions concerning the need to carry out operations through bank accounts (see Box 1), the chances are that these standards are not really being complied with elsewhere, too.

Serbian trade unions are also calling for dissuasive penalties. In addition, 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 demands the creation of beneficial ownership registries that are interlinked with other registries worldwide and which are publicly accessible. Such a tool is indispensable in establishing the ultimate identity of those who ultimately own, control or benefit from any asset.

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, the need to find revenues in particular to finance pension systems has led to increased labour taxation.

Recent years have seen increases in minimum wages throughout the western Balkans (World Bank 2022). A related trade union demand is to increase the amount of tax-free allowances which has a beneficial impact on low earners and contributes to reducing the tax wedge. The Montenegrin 'Europe Now' programme, fully backed

3 And neither does Albania. See: https://www.compareyourcountry.org/tax-cooperation/en/2/630/default (accessed 23 August 2022).

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 in the taxation of personal incomes. The objective is to reduce income inequalities between wage earners. Flat tax rates should be abandoned in Bosnia and Herzegovina and in North Macedonia. In all four countries, personal income tax can be made more progressive, especially with the introduction of top tax brackets of 40 per cent 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 a significant revenue 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. Greater equity can also help with the situation of low tax morale in the region pointed to specifically by the European Commission in the case of North Macedonia (2020e: 123) but also alluded to elsewhere.

The World Bank suggested the need for a readjustment of the shares of social security contributions and personal income tax in its 2019 report on labour market trends in the region, lowering the former and increasing the latter (World Bank 2019: 69). The World Bank correctly indicates that this is potentially a thorny reform but, in principle, it would be revenue neutral with overall positive effects on employment while it could also help with the progressivity of labour taxation since social security contributions are largely borne by employees. Its controversial nature lies in the labour movement being traditionally cautious about 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 the effects in the short term but also the long term impact on social protection regimes.

Finally, the demand of USSCG in Montenegro for a progressive VAT structure with higher rates (of 25 per cent or more) on luxury goods and a minimum rate (of 5 per cent or less) for basic products and services is also worth noting.

Improved public scrutiny

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

Trade unions can, to some extent, carry some evaluations themselves. They can, for instance, assess the progressivity of existing policies through the Fair Tax Monitor developed in 2015-16 by Oxfam and the Tax Justice Network Africa that provides a simple methodology for assessing, amongst others, the progressivity of tax systems, the risks of tax leakages and regimes' overall 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 the importance of VAT in the tax distribution. With regard to corporate tax, indicators include not only the rate but also loopholes such as loose rules on loss carry forwards, interest deductions and penalties.

Additionally, Action 11 of the 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 as well as 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. This 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 take issue with the high tax burden on low wages found in each one, which is particularly problematic since the majority of employees are on lower incomes. They also express concerns about the size of the informal economy and the ‘brain drain’ which they attribute largely to current tax policies.

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

Our main recommendations therefore consist of increasing the effective taxation of corporate profits as well as the progressivity of the taxation of personal incomes. Government accountability should also be improved through higher tax transparency and more open and inclusive policymaking.

These recommendations echo the calls of the global labour movement and several are already part of the union agenda within the region. The key issue, however, 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 policymaking 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 an integral part of a recent reform, all trade unions highlight weak public debate and the absence of a tax justice movement.

A first step therefore is to build a base for action, rooted in public pressure and a coalition of progressive forces. Alliances could be sought with labour organisations and civil society active in the global tax agenda with a view to increasing international attention on the damaging tax policies that are found 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 regarding the relatively low contribution that multinationals make to public budgets. Overall, trade unions need to prepare their arguments carefully on the alleged links between tax hikes and lower business investment and job creation. Finally, a coordinated trade union agenda in the region can deliver a powerful counter-argument.

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