

**Serbian Association of Employers**

# **Position Paper**

## **Fiscal Burdening of Wage Income**

**May 2013.**

## ***Executive Summary***

Republic of Serbia is characterized by high fiscal burdening of wage income, which weakens the competitiveness of the economy in relation with the surrounding countries. Reduction of fiscal burdening of wages would positively influence the employment, in the sense of saving the existing and opening of new workplaces, as well as on the increase of the low wages. Increase in the number of workplaces and higher income would increase domestic demand which would consequently improve the business sector. In order to reduce fiscal burdening of the wages in a sustainable manner it is necessary to conduct appropriate reforms in the public sector in order to reduce the expenses: the reform of the pension system and pension fund; reform of health security fund, as well as the reform of public administration and local self-government.

Serbian Association of Employers therefore recommends the following actions:

1. Reduction of wage tax and social security contributions of 40%, from the current 60% to 40% of the net wage
2. Fiscal unburdening of low wages through the increase of non-taxable amount to equal the gross minimum wage.
3. Expansion of support measures for the IT sector to cover other economic activities, especially the labour-intensive industries (textile, leather and footwear industry, etc.)
4. Urgent implementation of necessary reforms of pension and health security systems, through which those sectors could “absorb” the income reduction caused by the aforementioned reduction of fiscal burdens.

### ***The Issue of High Fiscal Burdening of Wages***

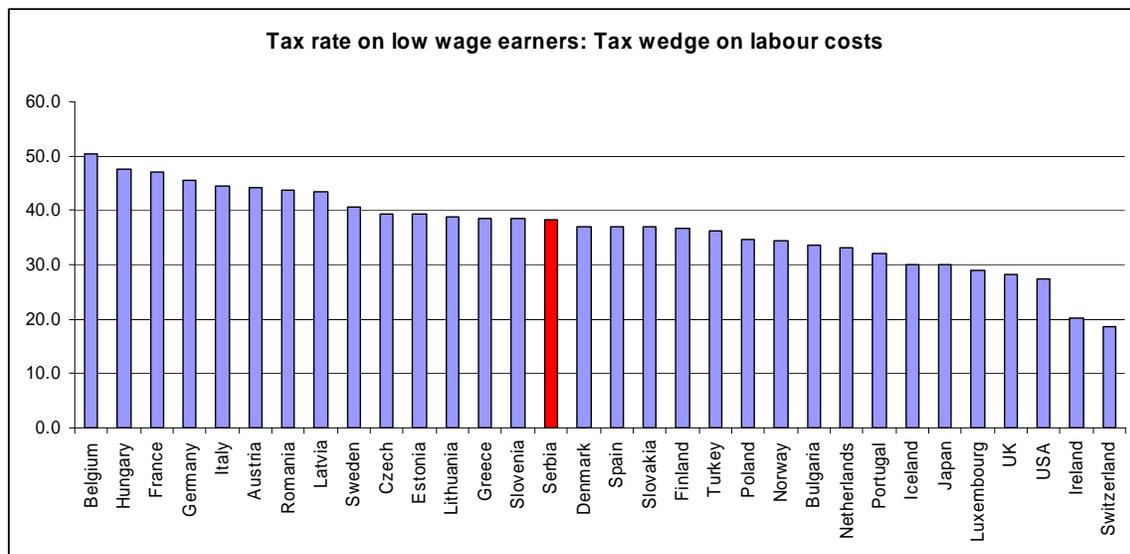
The amount of tax and social security contributions represent one of the fundamental issues that inhibits the economic development of the Republic of Serbia. Serbia is characterized by the high level of wage tax and contributions, similar to the level observed in the developed countries of Western Europe, whose economies are characterized by the significantly higher level of productivity, expressed in higher gross value added per employee.

Loss of competitiveness due to unproportionally high labour costs especially effected the increase in the unemployment. In the annual survey of 1000 companies performed by the USAID Business Enhancement Project 96% of the surveyed companies stated that wage tax and contributions have a negative impact on business. The recent survey of Serbian Association of Employers, which focused in-depth on the issues which fiscal burdens of wages cause to the economy identified a high influence that the amount of wage tax and contributions have on the employment. In the survey conducted in over 200 companies, 59% of the companies stated that they are unable to employ new workers due to the high amount of taxes and contributions, while 28% stated that they are forced to further reduce their number of workers.

Also, there is a clear influence of high tax and contributions on the wages in the business sector during the recession. 95% of the surveyed companies stated that the amount of tax and contributions are a barrier to the increase of salaries.

### *International Comparison*

Total fiscal burden on wages in the Republic of Serbia, measured according to the EUROSTAT methodology, which evaluates the share of income tax and social security contributions in total labour costs, calculated for 67% of an average wage in the business sector, amounts to 38.44%, which is equal to the share of 62.44% of net wage, placing Serbia in the same rank as Slovenia (38.5%) and Denmark and Spain (37%). It is important to notice that the Republic of Serbia has significantly higher fiscal burden on labour than 10 „new“ EU Member States (36.5%), especially compared to Poland (34.6%) and Slovakia (36.9%), which are the countries that achieved high industrial growth by joining the EU. When comparing Serbia with countries in the West Balkans region, we come to the conclusion that fiscal burdening of low wages in Serbia is at a similar level to Croatia (38.4%), while they are significantly higher compared to Macedonia (30.9%) and Albania (34%).



Source: Eurostat (earn\_nt\_taxwedge)

### *Tax Reform of 2013 and the Influence on Fiscal Burdening of the Wages*

Ministry of Finance and Economy of the Republic of Serbia conducted a tax reform in 2013, which in one segment influenced wage taxation, by reducing the wage income tax and increasing the compulsory social security contributions for pension fund, while simultaneously increasing the non-taxable amount of wage from 8,776 RSD to 11,000 RSD. This tax reform, while essentially fiscally neutral, contributed to a slight reduction of wage taxation (to 38.08% according to the EUROSTAT methodology). However, considering the low fiscal unbundening of the wages, it is hard to expect this reform to have an observable effect on the labour market.

## *Influence of the Reduction of Wage Tax and Contributions*

Reduction of fiscal burdening of the wages would have a direct positive impact on:

- **Employment in the Republic of Serbia.** Reduction in labour costs would positively influence on the competitiveness of the business sector, improve the business environment and provide the preconditions for the increase of investments aimed at opening of the new workplaces in the business sector.
- **Wages.** In the recent survey of Serbian Association of the Employers conducted on the sample of 200 companies 32% of the respondents stated that they would use the funds “liberated” through the reduction of fiscal burden on wages entirely for the increase in the employee wages. In addition, 64% of the respondents stated they would use a part of those funds for the increase of employee wages. This position of the employers can be understood by having in mind the fact that wages in the business sector were either kept at the same level or had a real drop since 2010, which additionally deepened the inequality between the employees in the private and public sector. Through this increase of salaries, employers would partially reduce the discontent of the employees caused by low wages and bad social situation.
- **Minimum wage policy.** The reduction of tax burden on lower than average wages would contribute to the increase of net wages, which would reduce the pressure of Trade Unions for the increase of minimum wage.
- **Keeping of the current and creation of the new workplaces,** which would contribute to the increase of domestic demand and consequentially improve the business sector.

On the other hand, reduction of fiscal burden on wages would have a negative influence on:

- **Budget of Republic Pension Security Fund.** Currently, 48.9% of annual income of pension fund consists of transfers from the Budget of the Republic of Serbia (Financial Report for 2012). Reduction of contributions for pension security would negatively impact the financing of the pension fund and demand higher budgetary expenses to ensure regular payment of pensions. On the other hand, we should keep in mind that the current pension system in the Republic of Serbia is not sustainable: the current employee-pensioner ratio in the RoS is 1:1.1, while the pension fund estimates that the sustainable ratio is 1:3. However, that ratio in the current demographic situation would imply full employment, which shows the need for changes in the pension policy and restructuring of the pension fund in order to make the pension system in RoS sustainable. Serbian Association of Employers considers that the necessary reform of the pension system and the restructuring of the pension fund must be implemented in a way that would enable the creation of preconditions for the reduction of contributions for pension security.

- **Budget of Republic health insurance fund.** Currently, 69.94% of annual income of health security fund comes from the social security contributions. The current healthcare system in the Republic of Serbia is considered ineffective and expensive, and the reforms in the past decade are largely considered to be a failure. This signals a need for a more serious reform of the healthcare sector which would reduce the costs and increase the efficiency of the healthcare system, and thereby create the preconditions for the reduction of social security contributions.
- **Budget of the Republic of Serbia and budgets of units of local municipal governments.** Keeping in mind that the Government of the RoS introduced the changes in the legislation which turned 80% of income tax into the income of local self-governments, the effect of the reduction of wage tax on the Republic budget will be relatively insignificant. The real effect of the reduction of wage tax would be felt by the local governments, which generate 58% of their current income through income tax.

### *Proposal of the Possible Reforms*

Serbian Association of Employer's 2013 Survey of the business sector identified that the company owners in the Republic of Serbia hold the opinion that it is necessary to reduce the fiscal burden of the wages for 40% compared to the current level. The employers feel that such level of tax and social security contributions would provide competitive labour costs in relation to the surrounding countries, as well as create the conditions for the salary increase in the real economy.

However, simple reduction of the wage taxation would contribute to the growth of already high budget deficit. Serbian Association of Employers acknowledges that it is at presently impossible to conduct without jeopardizing the solvency of the public sector.

On the other hand, in 2013 Ministry of Finance and Economy introduced support measures for the IT industry, which also include the reduction of labour costs in the covered field through the introduction of special procedure for calculation and payment of contributions for compulsory health and unemployment insurance, based on the reimbursement of actual costs of using these services. Through this measure the fiscal burden of net wages would reduce for 24 pp, to 43%. Serbian Association of Employers proposes the monitoring and evaluation of these measures in order to estimate the effects on the Healthcare fund and the budget of National Employment Agency, in order to consider the gradual extension of these measures to the other types of economic activity.

One of the possible directions of wages taxation policy is the introduction of measures for increase of progressivity aimed at the reduction of fiscal burden on low wages. According to the SAE survey, a slight majority of the employers agrees with introduction of progressive taxation rates on the income tax. Introduction of this measure would contribute to greater wage equality and higher employability of most vulnerable groups on the labour market.

Other possibility for the increase of tax progressivity is the raising on non-taxable amount of wages to the level of gross minimum wage. The exemption of minimum wages from taxation would create possibilities for the growth of lowest wages and higher employment in labour-intensive industries, while the influence on the compulsory social security funds would remain limited.

Finally, there is a possibility of the reduction of fiscal burden of wages in individual economic activities. This option would imply the extension of support measures aimed at the IT industry to other economic activities, especially on the labour-intensive sectors (textile industry, leather and footwear industry, etc.)

### ***Rationale for the Proposed Measures***

Reduction of wage tax and compulsory social security contributions is necessary to stop the current trend of the reduction of the loss of jobs in the business sector. Together with stopping the drop of employment in the real economy, in short term it would contribute to the increase of wages in the private sector and improve the social position of low-income employees. In medium- and long-term the competitiveness of the economy of the Republic of Serbia would improve, especially regarding the surrounding countries, contribute to the positive perception of the business environment in Serbia, and consequentially create the conditions for the opening of new jobs in the economy through the increase of the investments.

Negative effects of the reduction of fiscal burden of wages can be prevented through the reform of the afflicted sectors; primarily the pension and health insurance systems, but also of the public sector, including the state administration and local self-governments. Here it is very important to analyze the effects of the Government's support measures for IT industry on the Republic Health Insurance Fund, in order to consider the possibility of their extension to other economic activities.

The second possibility is the compensation of the loss of income of social security funds through the redistribution of the income coming from the income tax and increased financing of the social security funds from the Republic budget. We remind that redistribution of 80% of citizen income tax to the local self-governments was a temporary measure to compensate the losses of budgetary transfers to the local governments. Taxation reform of 2013 introduced the calculation of property tax for legal entities based on the method of fair or market value, which will contribute to the increased revenues of the local governments from this source. In this situation is it possible to consider a new change to the citizen income tax, which would again completely become a revenue of the central authorities, which would use the income surplus to finance the social security funds.

Finally, it is necessary to conduct the reform of the pension fund, which has the most significant influence on the fiscal burden of the wages (approximately 53% of total wage burden). Reform of pension security system is necessary due to the unsustainability of the current pension policy. Having in mind the high deficit of the pension fund which is

currently being covered through the budgetary transfers of the Republic of Serbia, we consider that the government must immediately start the reforms in this sector, in order to create the preconditions for the sustainability of the compulsory pension security system and reduce the pressures to retain the current high level of fiscal burden on wages.