

Labor Costs and Labor Taxes in the Western Balkans

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Betcherman&Arandarenko-labor_taxes_western_balkans.pdf](http://siteresources.worldbank.org/INTECAREGTOPHEANUT/Resources/Betcherman&Arandarenko-labor_taxes_western_balkans.pdf)

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Overview

- Research questions
- Labor market context
- Macro fiscal trends
- Wage and labor cost trends
- Underlying wage and labor cost data
- Statutory rules for PIT and SSC
- Tax wedges
- Labor market outcomes
- Conclusions and recommendations

Main research objectives and policy questions

- Collect comparable data on labor costs and labor taxes in WB5
- Assess impact of structure of labor taxes (PIT relative to SSC; tax rules; tax wedges) on labor market structures (formal vs informal employment; employment by economic sectors; unemployment)
- Assess impact of labor costs on labor market demand and competitiveness
- How to restructure labor taxes to boost employment, stimulate activation and labor-intensive investment and reduce poverty?

What to compare and for what purpose? Which source to use?

- Net (take home) wages – comparison of living standard, consumption
- Total labor costs – competitiveness
- Gross wages – almost useless
- LFS data – include cash payments, but general under-reporting
- Establishment survey data – private sector under-reporting, but full formal economy coverage

Labor market context in the Western Balkans

- Very high unemployment (registered and LFS)
- Low employment rates (below 50%)
- Shrinking or stagnant formal employment levels despite the economic growth
- Dual labor markets (formal vs informal, primary vs secondary)
- Informal employment – includes farmers, much of self-employment and SMEs practicing double payrolls

Macro fiscal trends – Government expenditures in WB5, % of GDP

	2003	2005
Albania	29.0	28.3
Montenegro	39.9	40.4
Serbia	46.7	44.4
Bosnia and Herzegovina	52.4	50.2
Macedonia	34.5	35.3
WB5 average	40.5	39.7
EU27 average	47.4	46.9

Fiscal trends – PIT and SSC as a share of GDP in %, WB5 in 2005

	PIT	SSC revenues	SSC expend.
Albania	0.9	4.4	6.7
Monten.	4.5	10.5	17.7
Serbia	6.4	11.8	19.2
B & H	1.8	13.4	14.4
Macedonia	3	10.1	15.0
WB5 avg.	3.3	10.0	14.6
EU27 avg.	12.4	13.9	

Macro fiscal trends

- If formal employment rates considered, SSC burden per employee higher in WB5 than in EU27, while PIT burden is still lower
- Albania repeatedly occurs as outlier (because of extremely high informality)

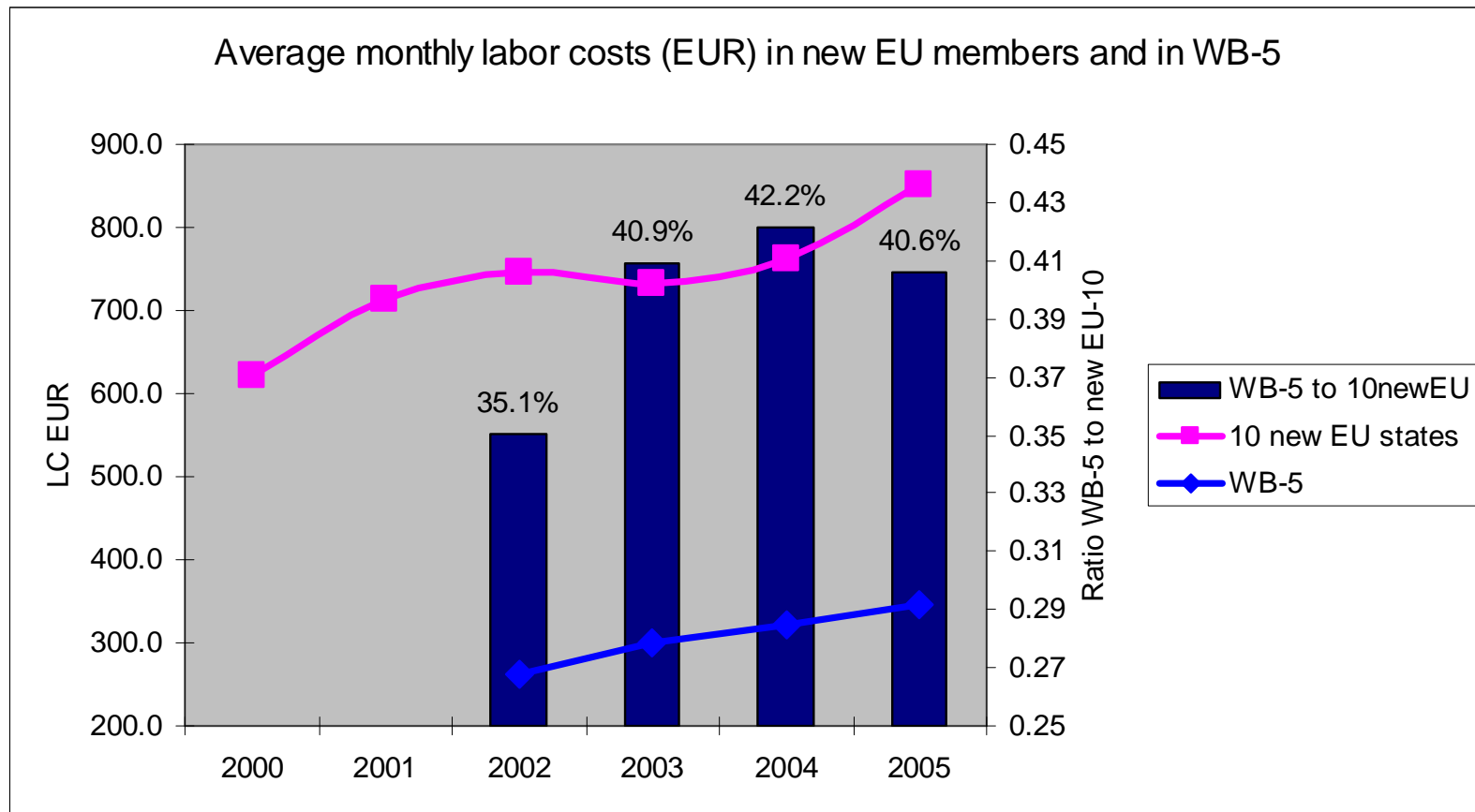
Monthly total labor costs in WB4 (except Albania) 2001-2006, in Euros - fast growth and convergence

	2001	2002	2003	2004	2005	2006
Serbia	176	262	306	332	362	445
Montenegro	204	224	315	352	379	438
BiH-FBiH	389	418	454	462	483	523
BIH-RS	241	270	295	330	362	406
Macedonia	291	309	323	335	343	370
Average wage (unweighted)	260	297	339	362	386	436
Standard deviation	84	74	65	57	56	57

Labor costs per employee, annual real growth rates, WB5, 2002-2006

	2002	2003	2004	2005	2006
Serbia	30.3%	13.9%	8.7%	7.2%	11.7%
Montenegro	8.6%	14.9%	9.1%	5.3%	12.2%
BiH-FBiH	7.7%	8.5%	2.1%	1.5%	0.8%
BIH-RS	10.2%	7.3%	9.8%	4.3%	4.4%
Macedonia	4.4%	3.8%	4.3%	1.8%	4.3%
Albania	6.3%	9.7%	-0.5%	2.9%	-0.6%
WB-5 Avg.	11.2%	9.7%	5.6%	3.8%	5.5%

Wage and labor cost trends 2001-2006



Assessment of underlying wage and labor cost data

- Establishment surveys cover mostly public wages and wages in large firms
- Potential for growing (and/or changing) bias as transition unfolds
- Assessment of 'true' wage / LC data using PIT or SSC collection data
- Informality and double payrolls not a problem since it is all about formal wages

Underlying ('true') wages in WB5, compared with reported, around 2005

Serbia	10% lower than reported; decreasing difference
Montenegro	About the same
BiH, Fed. BiH	7% lower; decreasing difference
BiH, R. Srpska	20% lower; increasing difference
Macedonia	n.a.; bias probably decreasing (better coverage since 2004)
Albania	25-30% lower

Statutory PIT rules – WB5, 2001-2006

	2001	2002	2003	2004	2005	2006
Albania	Progressive; 8 brackets; up to 168,000 – 0% , 168,000-300,000 5% , 300,000-720,000 10% , ... top rate over 1,800,000 – 25%					Same but 1 st bracket - 1%
BIH Federation	Flat rate 5% ; no zero bracket, but tax exempt fringe benefits Annual PIT over 5 average wages – 0-40% (cantons)					
BIH Rep. Srpska	Flat rate 10% on net wage; no zero bracket, no tax exempt fringe benefits; no annual PIT					
Macedonia	Progressive; zero bracket, 15% and 18% (but progressivity only nominal since highest bracket affects less than 2% of workers)				Progressive; 0% , 15% , 18% , 24% (two higher brackets affect only 2% of workers)	
Montenegro	Flat rate 19% ; no zero bracket	Progressive: zero (below 728 E) and three brackets 17, 21, 25% Payroll tax		Progressive; 0% below 785 Euro; three brackets of 15, 19 and 23% , Surtax 13-15% on PIT paid		
Serbia	Flat rate 14% ; no zero bracket, no tax exempt fringe benefits Annual PIT over 5 AW – 10% Payroll tax 3%			Flat rate 14% ; no zero bracket, no tax exempt fringe benefits		

SSC statutory rates in WB5, 2001-2006

	2001	2002	2003	2004	2005	2006
Albania	Employee based 11.7%	Employee based 11.2%	Employee based 11.2%			E-e 11.2%, E-r 21.7%
	Employer based 34.2%	Employer based 30.7%				
BIH Federation	Employee based 32%	Employer based 11.5%				
BIH Rep. of Srpska	42% paid on net wage incl. fringe benefits					
Macedonia	32% paid from total labor costs (gross wage II concept), employer paid					
Montenegro	Employee based 20%			E-e 20%	Employee based 20%	
	Employer based 20%			E-r 17.8%	Employer based 16.1%	
	Paid out / on full gross wage					
Serbia	Employee based 16.3%	E-e 16.8%	Employee based 17.9%			
	Employer based 16.3%	E-r 16.8%	Employer based 17.9%			
	Paid out/on full g.wage					

Minimum mandatory SSC rates in WB5, 2001-2006

	2001	2002	2003	2004	2005	2006
Albania	Tied to minimum wage, adjusted annually; range of minimum wage to average public sector wage 40-45%; enforced by law / decree					
BIH Federation	Implicit through General Collective Agreement defined base (minimum) wage, set at over 50% of average wage					
BIH R. Srpska	50% of economy wide average wage in previous month					
Macedonia	65% of economy-wide average wage for pension and unemployment contributions; 65% of sector average wage for health contribution					
Montenegro	Implicit through General Collective Agreement regulation of base wages; 50 Euros for simple work (25-30% of average economy wage), with skills/education coefficients up to 3,2 (until 2003) and up to 4 (from 2004)					
Serbia	Differentiated by education; range from 40% of average wage for basic to 127% for higher education; enforced by law			40% of average wage; enforced by law		

Fringe benefit regimes in WB5

	Hot meal allowance	Holiday cash allowance (“regres”)	Other, what
Albania			
BIH Federation	Minimum 20% AW, up to 2% AW per day worked (max 44% AW)	Yes	Travel and other
BIH R. Srpska	No	Yes	Travel, per diems
Macedonia	20% AW	Annual leave allowance New year allowance	Travel, per diems, awards
Montenegro	25 euros monthly (50% of min. wage)	150 euros annually	Awards, seniority premiums
Serbia	No	No	Travel, per diems, awards

PIT rules in WB5 in 2007

Country	Nature of the tax system*	Headline tax rate	Zero tax bracket/ Threshold	Progressive Vs Proportional	Nontaxable Cash allowances
Albania	Dual	1%	No	Progressive	No
Bosnia and Herzegovina					
<i>FBIH</i>	<i>Semi-Dual</i>	<i>5%</i>	<i>No</i>	<i>Proportional</i>	<i>Yes</i>
<i>RS</i>	<i>Comprehensive</i>	<i>10%</i>	<i>Yes, minimum wage</i>	<i>Progressive</i>	<i>No</i>
Serbia	Semi-Dual	12%	Yes, 5000 CSD monthly	Proportional	No
Macedonia	Semi-Dual	12%	Yes, 25% of average net wage	Proportional	Yes
Montenegro	Semi-Dual	15%	Yes, 70 EUR monthly	Proportional	Yes

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*

SSC rules in WB5 in 2007

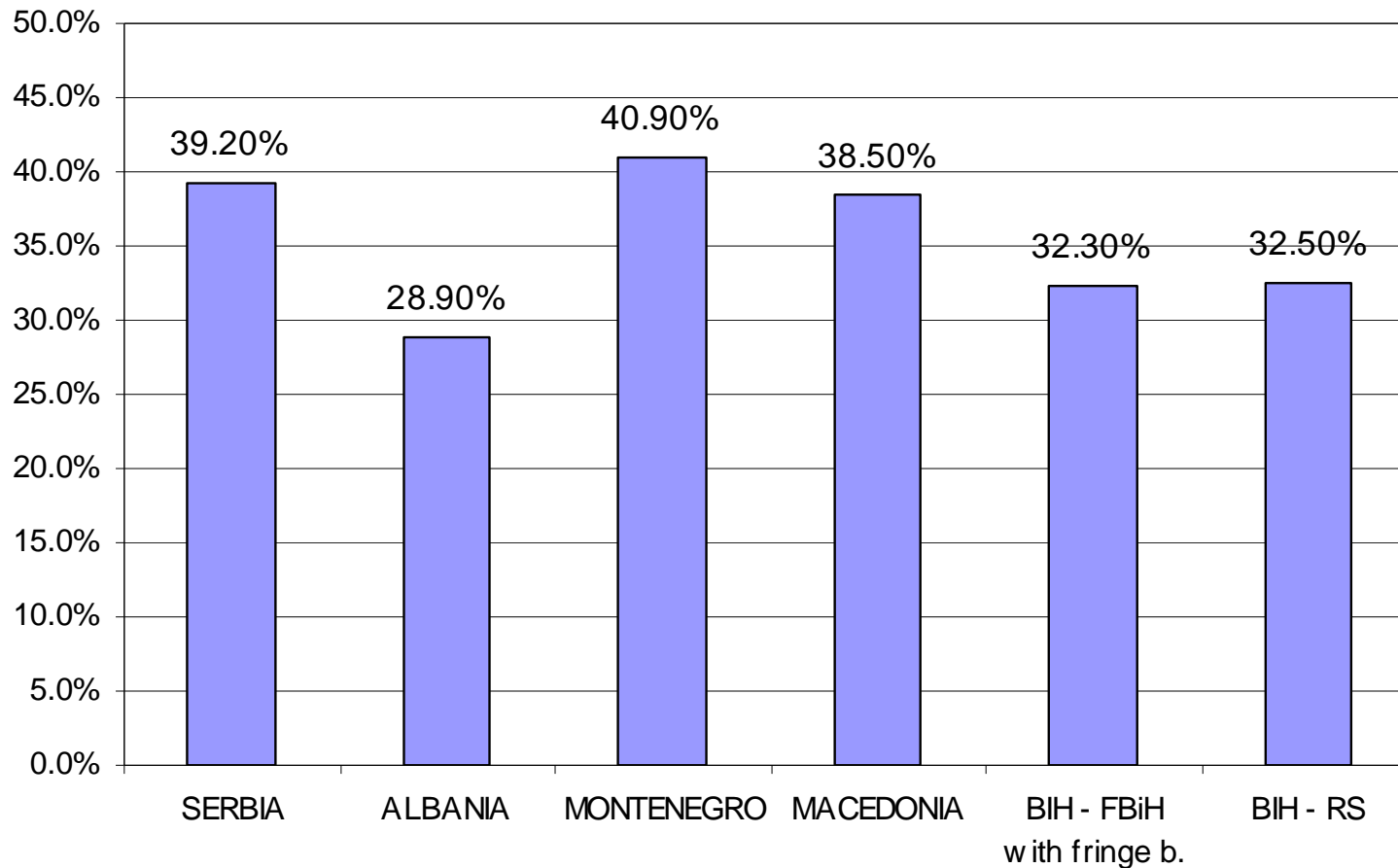
Country	SSC rates			Contribution base definition	Minimum contribution base	Maximum contribution base
	SSC total	SSC employee	SSC employer			
Albania	32.9%	11.2%	21.7%	Gross wage	13,140 Lek	65,700 Lek
Bosnia and Herzegovina						
<i>FBIH</i>	43.5%	32%	11.5%	<i>Gross wage excluding fringe benef.</i>	<i>minimum wage (approx 55% of average wage)</i>	-
<i>RS</i>	42%	-	42%	<i>Net wage incl. all cash fringe benefits</i>	<i>50% of average wage</i>	-
Serbia	35.8%	17.9%	17.9%	Gross wage	35% of average wage	5 x average wage
Macedonia	32%	-	32%	Gross wage excl. fringe benefits	65% of average wage	-
Montenegro	36.1%	20%	16.1%	Gross wage	minimum wage	18070 EUR annually (pension insurance)

Tax wedges for various income/family situations, before and after most recent PIT changes

	Year	Tax wedge						
		Single person				Couple		
for percent of average wage		50%	67%	100%	167%	100+0%	100+33%	100+67%
Country								
SERBIA	2006	42.3%	42.3%	42.3%	42.3%	42.3%	44.7%	42.3%
	2007	37.6%	38.4%	39.2%	39.7%	39.1%	39.8%	38.8%
ALBANIA	2006	34.1%	27.9%	28.9%	29.8%	28.9%	...	28.2%
MONTENEGRO								
w/o fringe benefits	2006	40.8%	42.7%	45.1%	48.6%	43.9%	42.8%	43.6%
w/o fringe benefits	2007	40.4%	41.8%	43.2%	44.3%	43.2%	41.8%	42.7%
with fringe benefits	2006	36.7%	39.3%	42.6%	47.0%	41.5%	39.4%	40.9%
with fringe benefits	2007	36.3%	38.6%	40.9%	42.8%	40.9%	38.5%	39.9%
MACEDONIA	2006	46.3%	39.2%	40.2%	41.0%	40.2%	40.7%	41.0%
	2007	44.9%	37.6%	38.5%	39.2%	38.5%	38.9%	39.2%
BOSNIA AND HERZEGOVINA								
---Federation BiH w/o fringe	2006	46.5%	40.8%	40.8%	40.8%	40.8%	41.9%	40.8%
---Federation BiH with fringe b.	2006	30.6%	29.3%	32.3%	35.3%	32.3%	30.2%	31.0%
---Republika Srpska	2006	37.2%	34.2%	34.2%	34.2%	34.2%	37.5%	34.2%
---Republika Srpska	2007	31.7%	31.6%	32.5%	33.2%	31.7%	31.0%	31.7%

Tax wedges in 2007, single worker, average wage

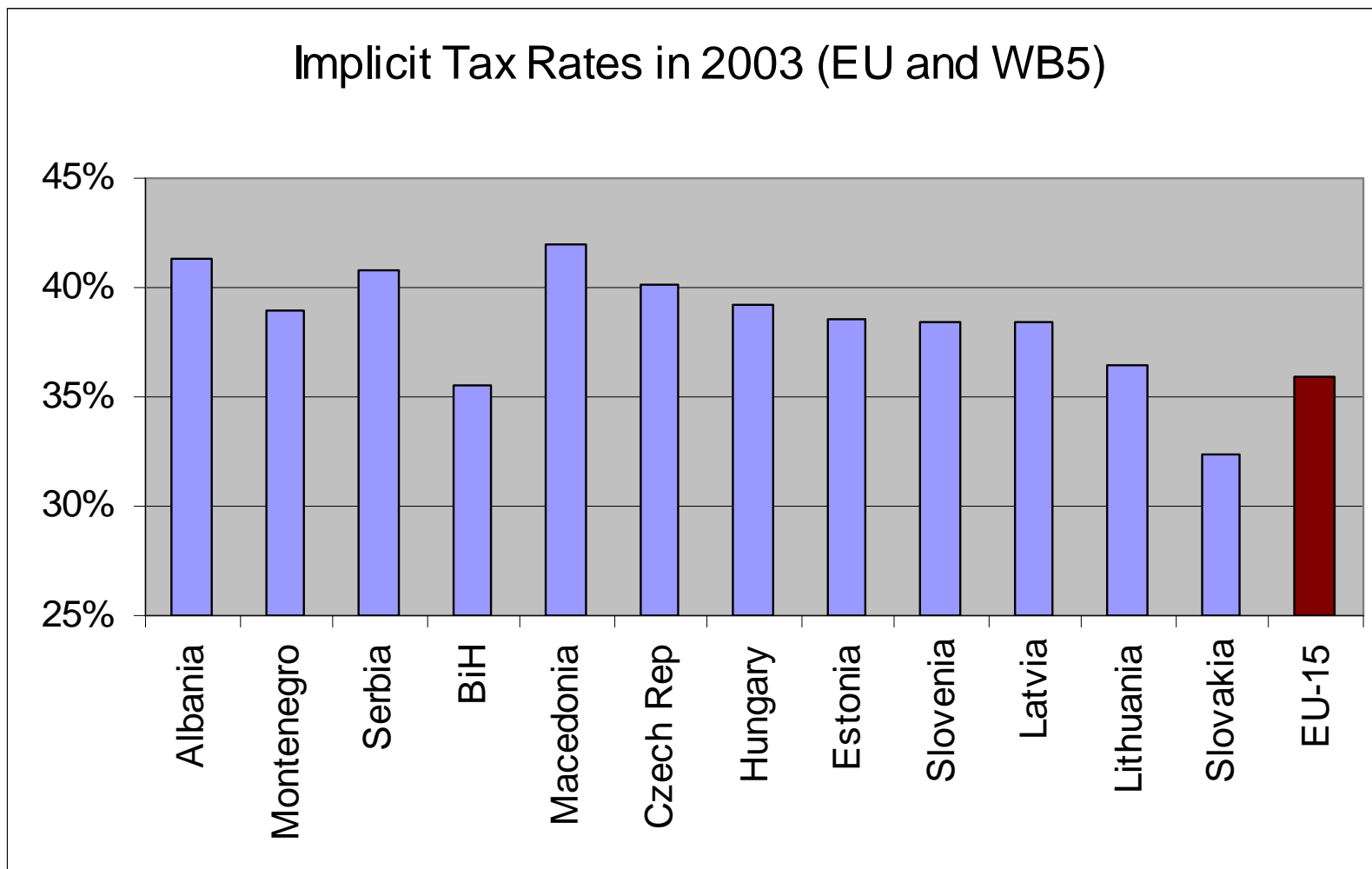
Current tax wedges in WB-5, on average wage



Tax wedge progressivity estimates for WB5

		100 to 50%	167 to 67%
SERBIA	2006	1.00	1.00
	2007	1.04	1.03
ALBANIA	2006	0.85	1.07
MONTENEGRO			
w/o fringe benefits	2006	1.11	1.14
w/o fringe benefits	2007	1.07	1.06
MACEDONIA	2006	0.87	1.05
	2007	0.86	1.04
BOSNIA AND HERZEGOVINA			
---Federation BiH w/o fringe	2006	0.88	1.00
---Republika Srpska	2006	0.92	1.00
---Republika Srpska	2007	1.03	1.05

Implicit (macro) tax rates on labor, WB5 in 2003



Conclusions - regressivity

PIT regimes often effectively regressive or proportional within the densest areas of wage distribution (50-100% of average wage) and beyond because of

- Absence of zero tax brackets (Serbia, RS/BiH until 2007)
- High minimum SSC (all)
- Removal of untaxed cash benefits (S, RS/BiH)
- Upper brackets start at very high wage levels and their wedge effects offset by SSC ceilings

Recommendations 1

Reduce burden on low-wage labor to encourage formalization, job creation and investment in labor-intensive sectors by

- Introducing more generous zero tax bracket for PIT (around poverty line)
- Removing minimum SSC
- Introducing family allowances and simple tax credit schemes

Recommendations 2

Preserve fiscal neutrality of overall reform

- Increase headline PIT rate if flat tax
- If progressive, introduce higher PIT bracket around average wage to also moderate wage pressures in public sector
- Remove ceiling for health insurance; raise for other types