

**Fiscal and parafiscal burdens
of entrepreneurs and SMEs
in the Republic of Serbia**

Position Paper



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Summary

Surveys conducted by the credible international organizations such as the World Bank, the International Monetary Fund, as well as surveys conducted by the domestic organizations, indicate, as a rule, that the degree of taxation in Serbia is excessive, i.e. that the total tax and non-tax burden on companies and individuals is above the optimal level. High tax rates do not result in maximization of the total consolidated budget revenues of the Republic of Serbia on all the levels of authority, but practically result in significant decrease of revenues from collected taxes due to companies' escape to informal sector, i.e. due to refrain of companies and individuals from investing, or even due to disinvesting. Survey conducted by the Serbian Association of Employers under the name "Research about the costs of doing business of SMEs related to the implementation of the regulation in the Republic of Serbia" listed 499 different parafiscal burdens that result from 150 laws. The latest reports of the European Commission¹, which confirm that Serbia is not considered to have functional market economy, reports of the World Bank² that talk about the significant fall in Serbia's competitiveness, low level of the foreign direct investments to Serbia³, in spite of the significant programmes of subsidizing investments, as well as the level of the informal economy that makes in private sector almost 50% of the total GDP⁴, **speak in favor of essential reforms of legislation that determines the total burdening of the companies in the Republic of Serbia.**

It was often underlined by the entrepreneurs, during the meetings organized by the Serbian Association of Employers, that the mentioned problems were something that made **running their businesses difficult and brought additional costs**. It is important to emphasize that the parafiscal burdens are only **one of the examples that do not contribute to predictability of tax system** exactly due to existence of high number of burdens. The key point is to see **parafiscal burdens as only one of the key links in excessive taxation**, which stands out due to its unpredictability and lack of order and transparency.

¹ Republic of Serbia 2014 Progress report, www.seio.gov.rs/upload/documents/eu_

² The Global Competitiveness Report 2014-2015, www.weforum.org/docs/GCR2014-15/Serbia.pdf

³ http://www.nbs.rs/internet/cirilica/80/platni_bilans.html

⁴ Recommendations for formalization of the informal economy and its effects on economic growth in Serbia www.fren.org.rs/sites/default/files/projects/attachments/PB%20Shadow%20economy%20ser%20AR.pdf

1. Key issues

On the basis of:

- (1) detailed analysis of legislation that determines the level of costs of doing business in Serbia
- (2) analysis of positions of companies and entrepreneurs on parafiscal burdens in Serbia
- (3) analysis of surveys conducted by the other employers' associations
- (4) analysis of studies, recommendations and experiences of international organizations and domestic institutes of economy, faculties and consulting companies

conducted by the Serbian Association of Employers, the following problems that the entrepreneurs in Serbia are faced with when it comes to costs of doing business related to implementation of laws in Serbia are identified as the basic ones:

- (1) Non-existence of order/system within parafiscal burdens in Serbia
- (2) Non-existence of clear connection between the rendered service and the price that is charged for the service, which is particularly evident when using arbitrary keys for determining price - discrimination of prices for services offered by the communal companies and public companies, which results in prices that are three times higher for companies than for private persons
- (3) Unpredictability and lack of transparency of system of parafiscal burdens in Serbia.

These three groups of problems cause the reduction of efficiency and effectiveness of companies in Serbia, growth of the informal economy and lead to long-term low rates of GDP growth and low level of employment.

2. History of the problem

Ever since the beginning of changes in the economic system in 1990, Serbia has been dealing with problems of disorganized fiscal system characterized by unpredictability, excessive taxation, and the mismatch of the central and local governments, lack of transparency and large number of different types of burdens. Due to the almost constant crisis of the system and lack of the consistent reforms that should be implemented in medium and long term, the Serbian economic system is characterized by the budget deficit. The Serbian government has undertaken various measures to overcome this problem, and one of the measures that remained constant is ad hoc and unsystematic introduction of the parafiscal burdens at different levels. On the one hand, this

partially solves the problem of financing the state at different levels, but on the other hand, it brings uncertainty into the system, deteriorates business environment, discourages investment and encourages enterprises to operate, partly or completely, in informal sector.

Beside parafiscal charges introduced by the local self-government and the Republic of Serbia, there are other forms of implicit taxation through discrimination of prices for companies, practiced by the public companies, or the use of inadequate keys when charging for products and services. Also, agencies and independent regulatory bodies, which have their own sources of income, often charge amounts significantly higher than the value of services rendered to their customers, i.e. require the purchase of products and services for which doesn't exist real economic justification, such as mandatory evacuation plan in case of fire for premises with only one entrance/exit or mandatory risk assessment for workplace within each of the several buildings of the same format.

So far, the progress has been made in this area, the last one during period 2012-2013, but repealing of parafiscal burdens that was conducted those days, has been very quickly neutralized by the introduction of new burdens and reduction of tax exemption cases.

3. International comparison

There are no comparative statistical data currently, and in many countries of the region there are no registers of parafiscal charges, nor the studies like the ones that exist in Serbia. Available information indicate that Croatia has 572 parafiscal burdens, and in Bosnia and Herzegovina, due to its internal organization, it is difficult to come out with summary indicators.

Sources of information provided by the international organizations show the relative indicators of the regional economies. Global Competitiveness Index⁵ of the World Bank for 2014 gives the next indicators for countries in this region.

	1.8 Useless State Costs	1.9 Cost of Regulation	1.12 Transparency in Low Adoption
Serbia	2,2	2,2	3,6
Croatia	2,2	2,2	3,3
Monte Negro	3,4	3,6	4,4
Macedonia	3,8	4,0	4,6
Greece	2,2	2,4	3,4
Hungary	2,6	2,6	3,4

⁵ http://www.weforum.org/docs/WEF_GlobalCompetitivenessReport_2014-15.pdf

In shortest, Serbia has high level of useless costs which that most often bring excessive taxation, high costs of regulation and average level of transparency in adoption of laws.

4. Impact on companies and economy

Identified problems have multiple effects on companies, and the strongest influence impact is realized through:

- (1) Excessive costs imposed by the state, that lead to decrease or absence of companies' profits, and consequently make impossible the long-term growth and development, creation of new jobs and investments
- (2) Locating enterprises in the informal economy, either partially or completely. High burdens and high tax rates consequently lead to lower overall fiscal incomes.
- (3) Inadequate allocation of resources within a company, where resources coming from the sell of goods/services are directed to administrative tasks.
- (4) Reduction of competition through setting up barriers to enter or even stay in the branch. Reduction of competition decreases consumer surplus, i.e. the overall surplus in the economy.
- (5) Increase of corruption that occurs as a way to bypass or accelerate unreasonable demands put in front of the economy.

5. Possible policies

Acknowledging

- (1) Current problems of fiscal consolidation in the Republic of Serbia and the plans of the Government of the Republic of Serbia related to that process
- (2) Strategic economic and political orientation of the Republic of Serbia and
- (3) Results of the social dialogue in Serbia and existing good practice

And guided by the principles of:

- (1) Fiscal neutrality
- (2) The rule of law and transparency of the activities of state authorities
- (3) Equality between legal entities and natural persons

(4) Maximization of the entire wellbeing in the Republic of Serbia

Serbian Association of Employers recommends the following policies to address critical issues that have been identified through the activities listed in this position of the Serbian Association of Employers on the costs of doing business of small and medium size enterprises related to the implementation of legislation in the Republic of Serbia:

(1) Introduction of system in the field of parafiscal burdens in Serbia

A serious approach to this problem would mean analysis of purposefulness of each of these burdens and introduction of those burdens which are purposeful to the system of public finances, so the collected funds would be really used for fulfillment of the legitimate objectives.

It is necessary to introduce system to parafiscal burdens because it is necessary to change the present situation, which involves reading “forest of regulation” in order to get to an answer to a simple question about which burdens are paid for certain business activity.

(2) Establishing clear connection between the value of the rendered service and the price charged for it, through measurement per unit of actually rendered service, and only in special cases through keys that represent the standard in countries that are taken as examples of good practice

This bad practice is particularly visible when it comes to use of arbitrary keys for determining prices/discrimination of prices for services rendered by the public communal companies and public companies, which results in prices three times higher for companies than for natural persons.

The basic problem is that the services offered by the state on all the levels do not correspond to the value that is charged for them. There are different forms of this bad practice such as usage of arbitrary keys for pricing which are at the expense of the companies, discrimination of prices for legal entities, charging for services that do not have clear justification, i.e. charging for services offered by the state that are not delivered on time and with satisfactory quality.

(3) Introduction of predictability and transparency of system of parafiscal burdens in Serbia

Different forms of burdens are introduced by a large number of laws and bylaws. Within 150 laws that were analyzed by the Serbian Association of Employers, 499 parafiscal burdens were identified. From the aspect of predictability of tax and therefore of business environment, it is extremely important that any changes, including increase/introduction of parafiscal burdens, are

transparent and leave enough time for entrepreneurs to get informed about them and adjust their business operations. Transparency of the process can be achieved through the mandatory consultations with the relevant employers' organizations on the local, provincial and republic level, and due to the institutional weaknesses and present focus on the regulatory reform, this process should be maintained at the beginning within the working groups formed only for this purpose.

6. Recommendations

Acknowledging the principles and policies (6) that are presented in this document, the following set of the measures, for each of the suggested policies, is proposed:

(1) Introduction of system in the field of parafiscal burdens in Serbia

Key measures in this area include:

- a) Bringing order to the system of parafiscal burdens through repealing double and multiple burdens (Republic, Province, municipalities, independent bodies). The primary short term task is to repeal multiple burdens for similar services and to pay fees for one service only to one level of authority or regulatory body/agency.
- b) Arranging income system of local self-governments and give them back incomes from taxes which belong to them by nature. It is necessary that the Republic of Serbia to make a long term commitment not to change the sources of income for local self-governments, except in cases when new authorities are given to them, i.e. to have the income collected on those levels of authority that actually render the particular service.

(2) Establishing clear connection between the value of the rendered service and the price charged for it, which is particularly evident with use of the arbitrary keys for determining prices/discrimination of prices of services rendered by the public communal companies and public companies that result in prices three times higher for the companies than for the natural persons

Key measures in this area include:

- a) Charging for services of the public companies and public communal companies based on real service, and not on keys that punish companies (three times higher price for legal entities). Public companies and public communal companies should change the methodology of calculating rates and use the keys that approximately correspond to the value of service in exceptional cases, i.e. to use clear ways of measuring offered

services that are quantitative and easy verifiable and to make prices for legal and private persons equal.

- b) Harmonizing amount of fees and price of offered service. Fees cannot be seen primarily as sources of income for the state, but as charging for the services rendered by the state. It is necessary to develop clear guidance for determining price of services of all state bodies and to include representatives of employers in this process.
- c) Eliminating parafiscal burdens, for which no service or value is received, and adjusting their names to their real nature.
- d) Reassessing parafiscal burdens that represent big costs for companies, and for which the relevant institutions have a lot of problems to deliver the service in time (documents which require work of more ministries and bodies).

(3) Introduction of predictability and transparency of system of parafiscal burdens in Serbia

Key measures in this area include:

- a) Changing of laws and bylaws in order to ensure predictability and transparency of non-tax burdens. It is necessary to make sure that the whole process in this field is public and conceivable and that no changes can be adopted without participation of employers' organizations, through a mechanism that is proposed in point (6).
- b) Creating standards for measuring performance of those who render services related to parafiscals. Beside process that involves reduction of fees for services offered by the state in order to establish equivalence of benefits, it is necessary to introduce standards for quality of services that define time of service, content included by service and standards of quality related to the service.
- c) Making a system of reporting to citizens about the way of spending funds collected from parafiscals (where they are source income and not paid to the budget). All institutions that collect parafiscals that are their source income should develop system of reporting to the public about the way of spending funds collected in that way, as a part of wider and comprehensive system of reporting to citizens about spending budget by the budget users.

8. Validity

The implementation of the proposed policies is not in any way redistribution within the existing GDP, but a way for an overall improvement of well-being. By realization of the recommendations, the sources of inefficiency in the economic system are eliminated, the effects are fiscally neutral, and the number of net winners resulting from these measures is a several times higher than the number of net losers who are almost entirely located in areas identified as requiring urgent reform (public enterprises and public administration). The effect of the measures is fiscally neutral.

The proposed measures are consistent with the findings of the studies previously conducted by the Serbian Employer Association, "Employers' views concerning business environment" and "Conditions for doing business and measures for development", and the research of the National Alliance for Local Economic Development "Non-tax and parafiscal charges in Serbia in 2014"⁶.

The advantages from realization (9) will be used by:

- (1) Companies that completely operate in the formal sector (not in the informal sector),
- (2) Companies that operate partially or completely in the informal sector, by elimination of reasons for their locating in this segment of the economy, which will make available for these companies mechanisms of financial and non-financial support that they currently cannot use,
- (3) the State, through increase of income that will be created by the reduction of informal economy, by converting it into a formal sector,
- (4) Employees in companies, who will share with the owners of companies newly created value⁷ in ration not less than 60:40 percent⁸ in favor of employees.

9. Realization

The advocacy and lobbying will be carried out through four sets of activities:

- (1) Public representation of recommendations that will be carried out through contacts with the representatives of electronic and printed media, the organization and participation in

⁶ <http://www.naled-serbia.org/sr/parafiscals/index/Registar-neporeskih-i-parafiskalnih-nameta>

⁷ It is not a classical newly created value, but the value created by reduction of costs imposed by the state to a company.

⁸ „Employers' views concerning business environment“, Serbian Association of Employers (2013)

events that are aimed to improving the business environment and through actions on the social networks.

- (2) Lobbying with the relevant decision-makers, or with organizations that are able to more effectively convey recommendations to the key decision makers, which includes parliamentary groups in the National Assembly of the Republic of Serbia, committees of the National Assembly of the Republic of Serbia, focus groups, the economic committees of political parties, relevant ministers and state secretaries, as well as representatives of organizations such as the World Bank, International Monetary Fund, the European Union and other relevant organizations.
- (3) The promotion of reforms in the field of parafiscal charges, as a way to raise awareness about the necessity of improving the business environment as a precondition for growth of living standards in Serbia. This set includes permanent contacts with the creators of the public opinion from various fields of expertise, such as economists, consultants, lawyers, managers, etc.
- (4) Presentation of findings acquired through the monitoring activities (10)

10. Monitoring and evaluation of effects

Serbian Association of Employers will follow, in cooperation with other employers' organizations or partner organizations, and on the basis of already existing database of parafiscal charges in Serbia, the process of implementation of the recommendations realized through amendments to the relevant laws and regulations, i.e. the progress made in implementing the recommendations presented. In addition to the implementation, the regular annual survey of small and medium size enterprises and entrepreneurs will be continued.