

A low wage, high tax trap in the Western Balkans

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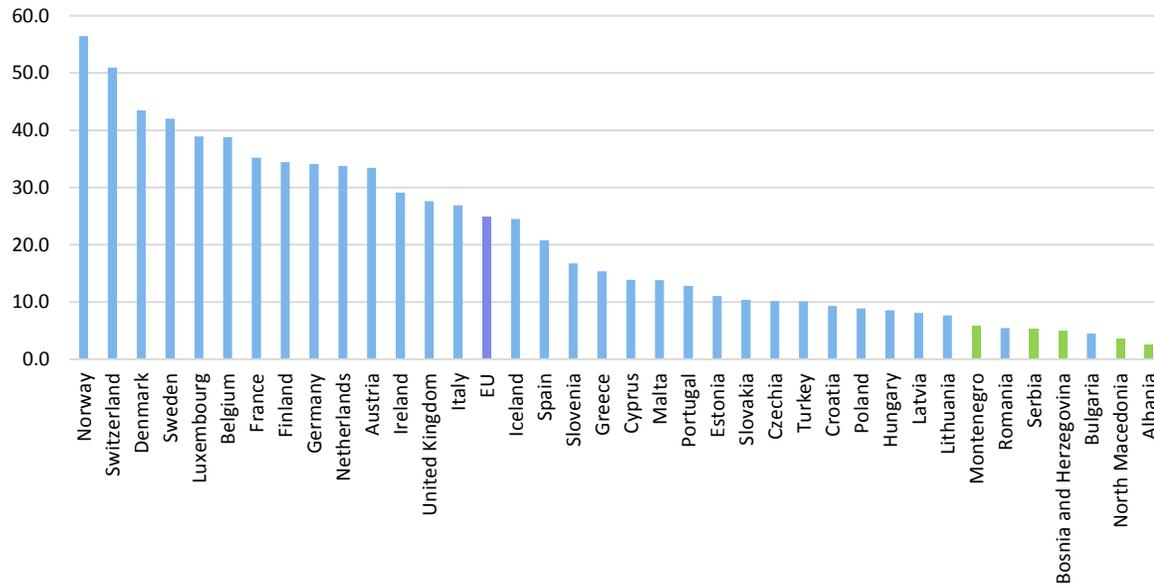
Motivation

- Need to reassess the level and structure of labour taxes, as institutional features that have been identified as the most likely causes for the poor performance of Western Balkan labour markets.
- Data drawn from two EU-wide labour market surveys: the Labour Cost Survey (LCS) and the Structure of Earnings Survey (SES)
- This enables comparability between the region and the EU.

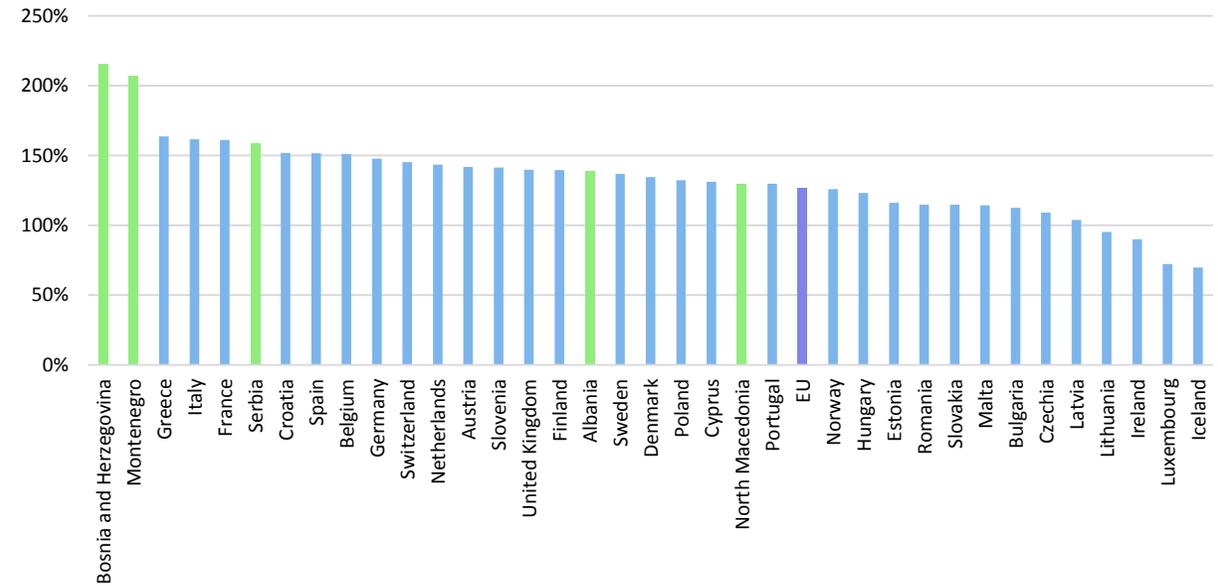
Total Labor Costs in the Western Balkans are low in absolute terms...

...But high when taking into account level of GDP per capita.

Average labour costs per hour for the business economy (B–N), 2016, in EUR, at current exchange rates



Annual labor costs (B-S_X_O) per full-time-equivalent employee as a % of GDP per capita, 2016, in current Euros

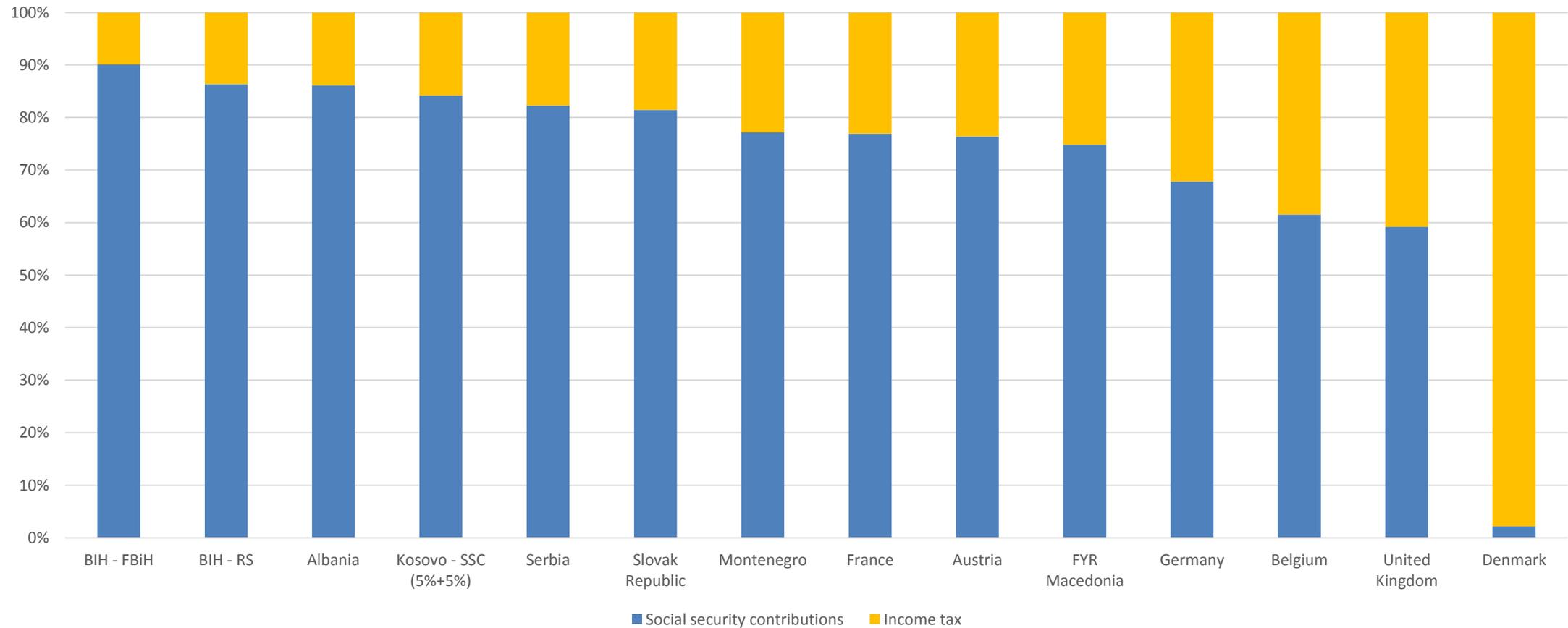


A sign of low competitiveness

Labour Taxation in the region: Similarities and differences across countries

- Recently the variability in taxation rules and tax wedges across the region has increased.
- Common, long-standing characteristics, remain:
 - social security contributions as the main component of labor taxes
 - low progressivity of labour taxation
- Individual income tax system (all), Personal tax-free allowance (except Montenegro).
- Tax-free allowance for dependents only in BiH.
- Direct progressivity only in Albania and Kosovo, but top tax rates still low (especially in Kosovo at 10%)

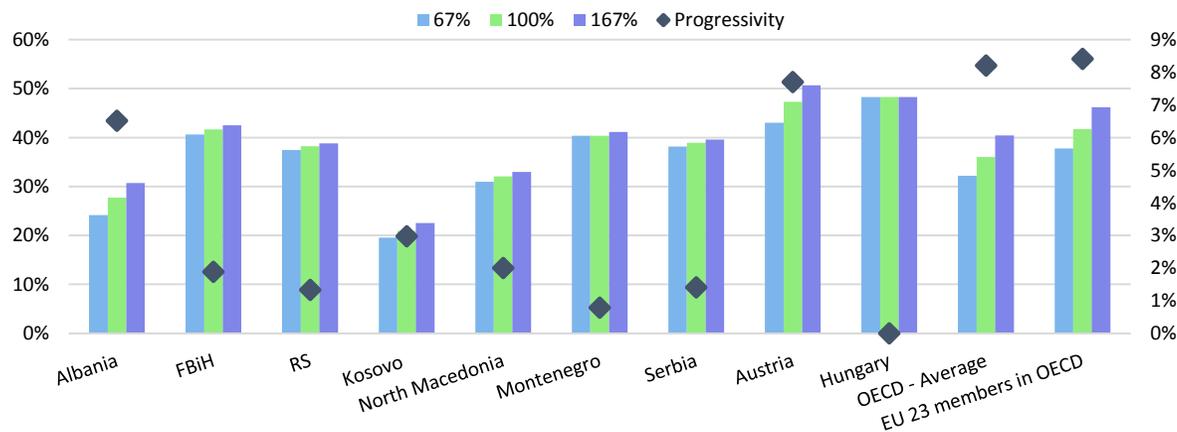
Tax wedge structure for the single worker at 100% average wage



Tax Wedges

- Measure the proportion of labour taxes on total labor costs.
- The higher the tax wedge, the greater is both the disincentive for someone to work and the disincentive for an employer to hire a worker.
- In most jurisdictions, tax wedges vary by wage level, family composition and other sources of income → OECD methodology for international comparisons based on hypothetical or “representative” workers.

Labor tax wedges in Western Balkans for a single worker at 67%, 100%, and 167% of average wage, in a comparative perspective

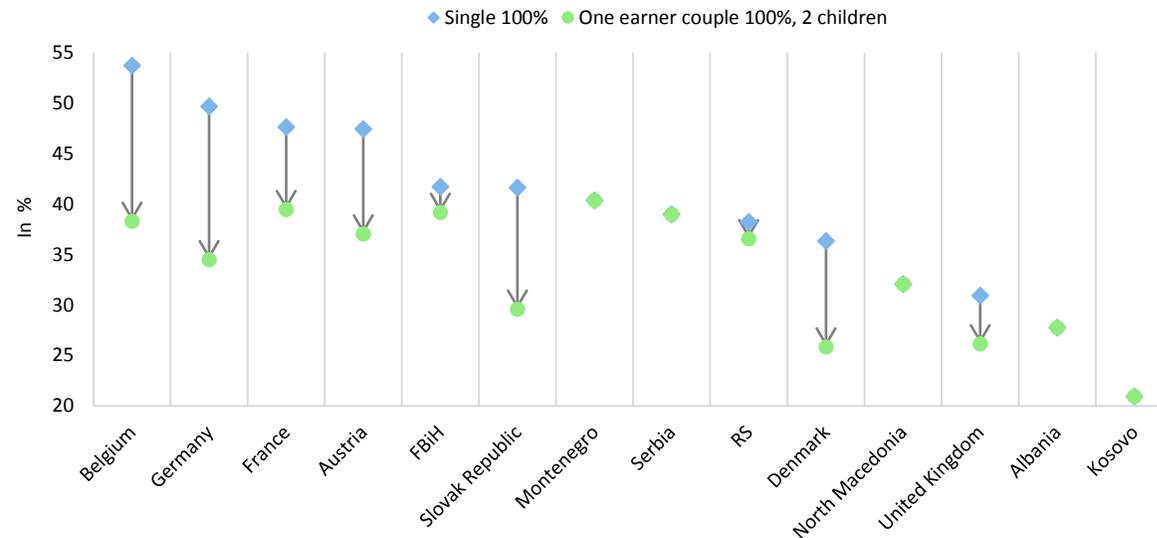


- Bosnia and Herzegovina, Montenegro and Serbia appear as high tax wedge countries, especially taking into account their income level
- Tax wedge increases only slightly with income in the Western Balkans (between 0.8 and 3 pp in 5 of the 6 countries compared with 8.2 in OECD).
- Only Albania shows progressivity levels that are close to OECD or EU.

Tax wedge for workers with dependent family members is even larger in comparative perspective

- Comparison based on single earner tax wedges may be misleading for the Western Balkans.
- Absence of family allowance implies higher tax wedge for worker with dependents in the Western Balkans compared with EU.

Comparison of tax wedge for a single worker (100%) and one-earner couple with two children (100+0%)

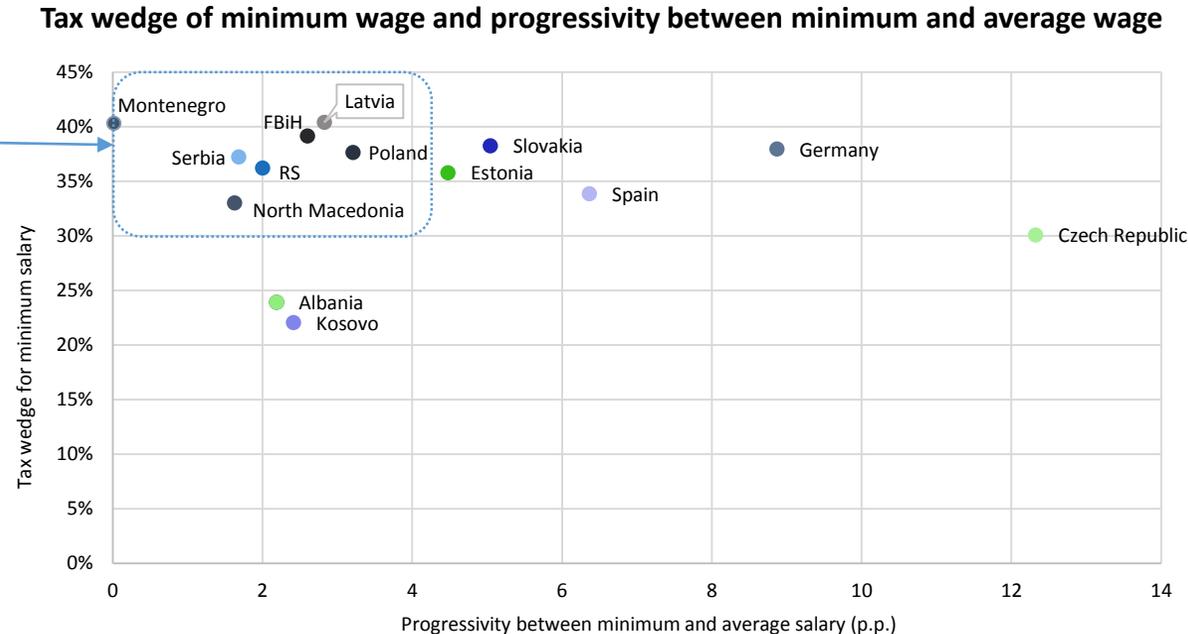


Low wage earners

- Low-wage earners are internationally defined as those who make less than two thirds of the median wage in their country.
- The 3 W.B. countries that participated in SES 2014 have high incidence of low-wage earners, Montenegro with the highest and North Macedonia 3rd among all SES countries. (Serbia is above average)
- Furthermore, SES likely underestimates incidence of low wage/income earners, since its sample covers formal firms with at least 10 employees.
- Low wage earners are more likely to be women (except Montenegro), low educated (especially MNE) and in temporary contracts.

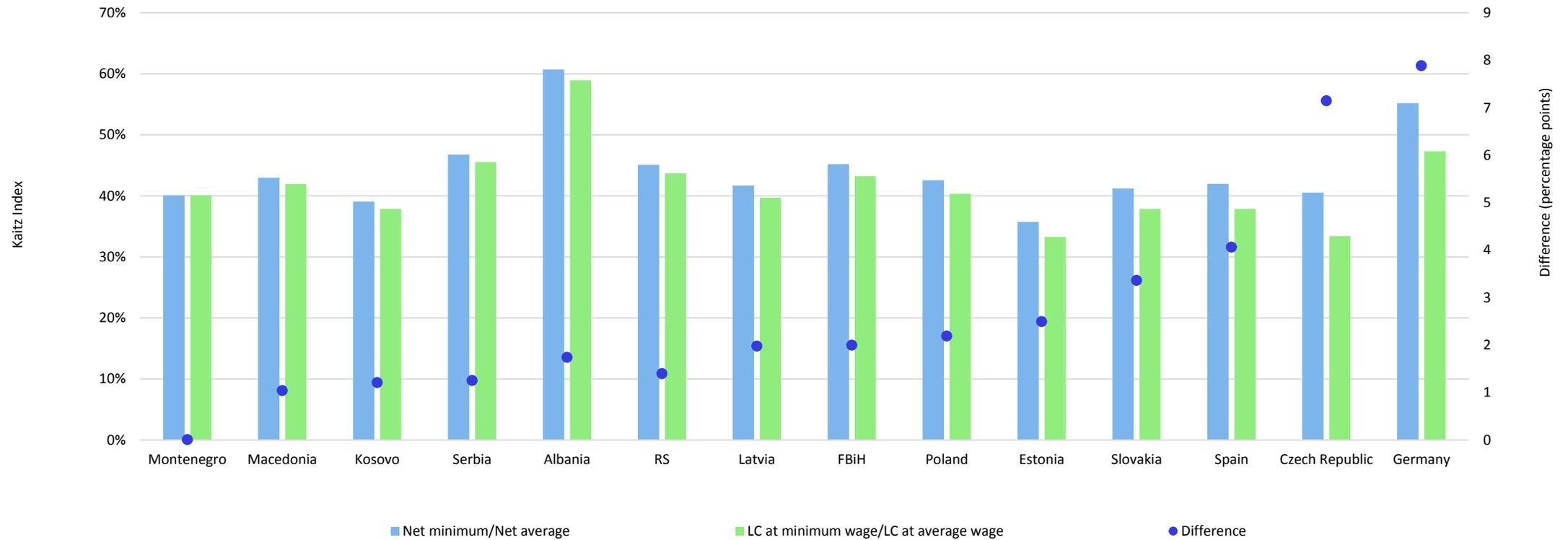
Tax burden for Low wage earners

High tax wedge
and low
progressivity



- Low-wage, high-tax trap for low-skilled workers means less incentives to:
 - (1) work, especially in formal sector (on the supply side)
 - (2) hire low-wage workers and invest in labour-intensive low-wage sectors (on the demand side)
- Compared with median wage workers, low wage workers are at a further disadvantage in the Western Balkans in terms of the labor costs associated with them

Two versions of the Kaitz index: net wage versus labour cost



Adverse consequences of low-wage, high tax trap

- fewer incentives to work (at least in the formal sector) for low-skill workers
- creates disincentives for employers to hire low-wage workers and to invest in labor-intensive low-wage sectors
- lower overall employment and activity rates
- higher share of informal work
- deepening of regional disparities
- worsening of relative position of youth, women and vulnerable groups in general
- eventually resulting in higher inequality in disposable wages and income.

Labour tax reform in the region is necessary

- Main considerations for labor tax reform in the region:
 - (1) Increase of the income tax rates
 - (2) Introduction of direct progressivity
 - (3) Reduction of the social security contributions.
- The reform should be undertaken in parallel with the reform of social insurance system, in the first place pension system.