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TAX POLICY REFORM FOR SUSTAINABLE ECONOMIC GROWTH IN SERBIA

Reforma poreske politike za održivi privredni rast u Srbiji

Abstract

In the last two decades, the Serbian economy posted an average growth rate of 3.8 percent, which was above the average growth rate in the EU, Central and Eastern Europe (CEE)¹ and the Western Balkans². Together with sharp decline in population, this has led to some economic convergence in terms of the GDP per capita, although the gap to the EU and CEE countries remains significant (57 and 42 percent respectively). To achieve full economic convergence with the European countries, Serbian economy needs to post long run growth rates of 4-6 percent per year, in a sustainable manner, which primarily refers to a more fair distribution of growth dividend (reduction of economic inequality) and limiting negative environmental footprint. In this sense, the reform of tax policy can make a contribution to the sustainable growth of the Serbian economy, through: *i*) a slight reduction in the overall tax burden, primarily through a significant cut in labour taxes, which may be financed by means of broadening the environmental taxes base, increase in consumption taxes and reducing unproductive public expenditures, *ii*) moderately increasing the progressivity of the personal income tax, recurring property tax and inheritance tax, and *iii*) broadening the environmental taxes base (with the focus on energy and pollution taxes) and introducing the tax incentives for households to switch to green energy sources.

Keywords: *tax policy, reforms, economic growth, inequality, environment, sustainable development.*

Sažetak

U poslednje dve decenije privreda Srbije beležila je prosečnu stopu rasta od 3,8 odsto, što je bilo iznad prosečne stope rasta u EU, Centralnoj i Istočnoj Evropi (CIE) i Zapadnom Balkanu. Zajedno sa naglim padom stanovništva, ovo je dovelo do određene ekonomske konvergencije u smislu BDP-a po glavi stanovnika, iako je jaz u odnosu na zemlje EU i CIE i dalje značajan (57 odnosno 42 procenta). Da bi ostvarila punu ekonomsku konvergenciju sa evropskim zemljama, privreda Srbije bi trebalo da beleži dugoročne stope rasta od 4-6 odsto godišnje, na održiv način, što se pre svega odnosi na pravedniju raspodelu koristi od rasta (smanjenje ekonomske nejednakosti) i ograničavanje negativnog uticaja na životnu sredinu. U tom smislu, reforma poreske politike može doprineti održivom rastu srpske privrede, kroz: *i*) blago smanjenje ukupnog poreskog opterećenja, pre svega kroz značajno umanjenje poreza na rad, koje se može finansirati povećanjem poreza na potrošnju, povećanjem obuhvata ekoloških poreza i smanjenjem neproaktivnih javnih rashoda, *ii*) umereno povećanje progresivnosti poreza na dohodak fizičkih lica, godišnjeg poreza na imovinu i poreza nasledstvo, te *iii*) proširenje obuhvata ekoloških poreza (sa fokusom na poreze na energente i zagađenje) i razmatranje uvođenja poreskih podsticaja za domaćinstva za prelazak na zelene izvore energije.

Ključne reči: *poreska politika, reforme, privredni rast, nejednakost, životna sredina, održivi razvoj*

1 Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia

2 Albania, Bosnia and Herzegovina, Montenegro and North Macedonia

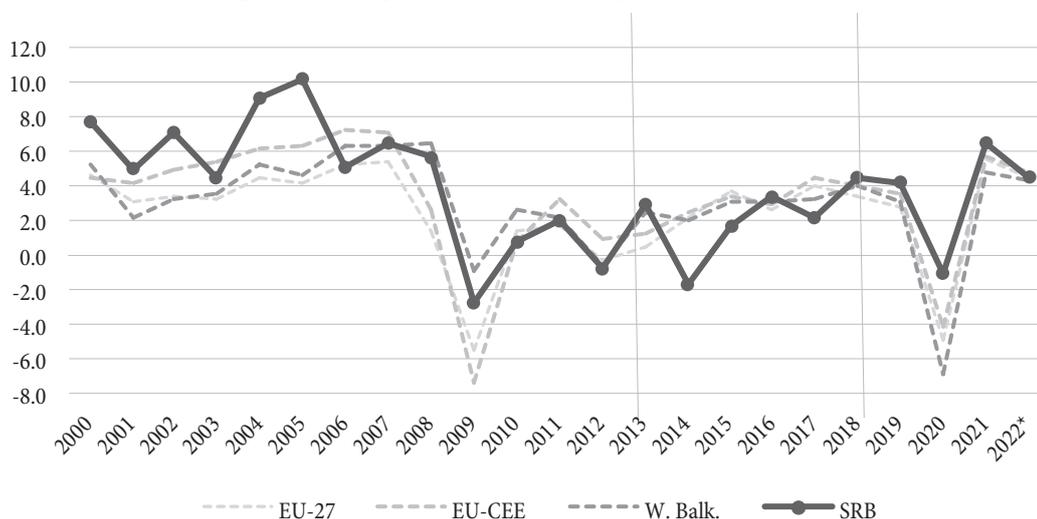
Introduction

Over the last two decades (2000-2021), Serbian economy posted relatively strong economic growth, with the average GDP growth rate of 3.8 percent per year. Economic growth in Serbia over that period exceeded the average GDP growth rate of EU member states, but also of the Central and Eastern Europe and the Western Balkans countries. In that respect, the last two decades can be decomposed into four sub-periods, based on the speed of economic growth: *i)* 2000-2008: period of strong growth of Serbian economy that significantly outweighed the growth performances of other EU, CEE and Western Balkans countries, *ii)* 2008-2012: period of recession and sluggish growth caused by the global financial crisis and Eurozone crisis, *iii)* 2013-2017: period of recession and slow growth, driven by the 2014 floods, fiscal consolidation and incomplete structural reforms, *iv)* 2018-2021: period of solid growth interrupted by the 2020 COVID-19 pandemic recession (Figure 1) through which Serbia went with milder recession than most other European countries. Solid average GDP growth

rate in Serbia over the last two decades led to notable convergence of Serbia to both the old EU member states and the CEE countries. This may be attributed to above the average growth performances from 2000 to 2007 and 2018 onwards.

Economic outcomes, growth performances and convergence are often measured using the GDP per capita indicator, which is shaped by both GDP and population dynamics. Over the last two decades migration and fertility trends led to considerable rise in population in developed European countries and decline in emerging European countries from the Central, Eastern and South Eastern Europe (Table 1). In similar way, the total population of Serbia over the last two decades declined by around 620 thousand, i.e. by 8.2 percent, which was more severe relative decrease than on average in other CEE and the Western Balkans countries. Decrease in population reduced future growth potential of Serbia economy, but at the same time, it had a positive direct contribution on GDP per capita growth dynamics.

Figure 1: GDP growth rates in Europe, 2020-2022 (in %)



Source: IMF World Economic Outlook Database, Oct 2021

Table 1: Population dynamics in Europe 2000-2021

	2000	2021	2000-2021 change	2000-2021 change	2000-2021 average annual change
	million	million	million	(%)	(%)
EU-27	426.09	445.47	19.38	4.5	0.21
EU-CEE	108.40	102.14	-6.25	-5.8	-0.28
W. Balkans	9.46	8.83	-0.63	-6.6	-0.33
Serbia	7.52	6.90	-0.62	-8.2	-0.41

Source: Author's calculations using data from the IMF WEO Database

As the result of economic growth and demographic decline, GDP per capita in Serbia increased by 125 percent over the last two decades, which is considerably above the rise posted in the EU-27 (70 percent), CEE countries (106 percent) and Western Balkans Countries (88 percent). Nevertheless, with GDP per capita of 19.4 thousand international USD (in 2017 constant prices) in 2021 Serbia ranked 28th within the group of 31 European countries (Figure 2).

Growth data suggest that over the last two decades Serbia posted sizeable economic convergence to other European countries, in the last decade outperforming the Western Balkans average (Table 2). In 2021, GDP per capita in Serbia was by around 19 percent above the Western Balkans average, but still 42 percent below the CEE average and 57 percent below the EU-27 average.

Table 2: GDP per capita (intl. USD constant prices 2017) in Serbia relative to other countries

	2000	2008	2013	2018	2021
EU-27	0.27	0.31	0.38	0.36	0.43
EU-CEE	0.50	0.46	0.55	0.49	0.58
W. Balkans	0.95	0.95	1.06	0.96	1.19

Source: Author's calculations using data from the IMF WEO Database

The above presented data show that in spite of substantial economic development posted the last two decades, Serbia still has a significant way to go until the full-scale convergence to the CEE and other EU member

states. In order to achieve that, it is necessary to have lasting GDP growth rate of 4-6 percent per year in the coming decades. For growth to be lasting, the growth dividend needs to be shared in a more equitable manner, while taking more care of the environmental footprint. In that sense, this paper provides analysis of the properties of the current tax system of Serbia and assesses the potential space for its improvement, in order to contribute to acceleration of economic growth in a sustainable way, i.e. by ensuring improvement of welfare distribution and reduction of negative impact on environment.

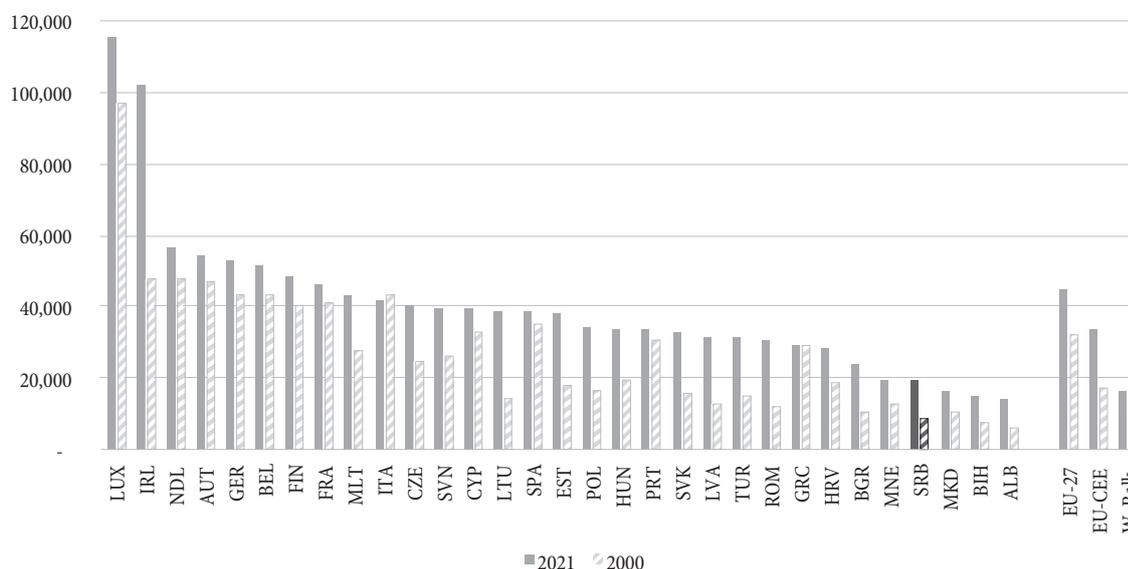
Consequently, in the second section, we discuss the impact of tax system on economic growth to identify the key tax policy reforms in Serbia intended to promote growth. The following sections discuss the impact of tax system on economic inequality to identify space for improvement of redistributive capacities of Serbian tax system. In the fourth section, the issue of environmental taxes is discussed, both from normative, European and Serbian perspective, while the final section concludes.

Tax policy and economic growth

Tax policy and public finance stability

The main objective of a tax system is to provide sufficient volume of tax revenues for funding of government

Figure 2: GDP per capita, intl. USD constant prices 2017



Source: IMF World Economic Outlook Database, Oct 2021

services, thus ensuring public finance sustainability and macroeconomic stability. If that aim is not met, public finance system generates public debt, which after certain threshold may have adverse impact on macroeconomic stability and economic growth. Empirical literature on the effects of public debt on economic growth suggests that the threshold level of debt, above which the negative impact kicks-in, is increasing in the level of economic development. Thus, [13] found that public debt threshold in developed countries ranges from 90 percent to 94 percent of GDP, while in developing countries ranging from 44 percent to 45 percent of GDP. Recent studies on European emerging economies imply that in more developed CEE countries the threshold of public debt is around 71 percent of GDP, while in the less developed Western Balkans countries the threshold is considerably lower, standing at around 58 percent of GDP [6].

At the end of 2021 public debt of Serbia stood at 56.9 percent of GDP, which was below the EU-27 average (77.9 percent of GDP) and the Western Balkans average (66.7 percent of GDP), but still higher than the CEE average (54 percent of GDP). This means that after successful implementation of fiscal consolidation programme, both on spending and the revenue side of the budget, public debt of Serbia is not far from sustainable level, although lower debt (below 50 percent of GDP) would be beneficial, as it would create space for counter-cyclical fiscal interventions in the future. In that respect, considering relatively modest level of structural fiscal deficit and the trajectory of public debt, it may be concluded that the tax system of Serbia currently delivers in terms of its main objective, by generating close to sufficient amount of tax revenues, required for fiscal sustainability. Further steps in terms of curbing the shadow economy and promoting tax compliance would enhance the revenue performances of Serbian tax system, with positive impact on economic efficiency.

Level and structure of tax burden

Tax system can affect the drivers of economic growth through two channels: level of the total tax burden and the structure of tax burden/level of particular taxes [11].

Tax revenues are a precondition for provision of public goods and other government services that are crucial enablers of economic activity, such as security, rule of law, education, public administration, etc. However, above certain level burden, efficiency costs associated with taxation (their negative impact on labour supply, education, consumption/savings behaviour, investment, risk taking, entrepreneurship, etc.) outperform the benefits from tax-funded public goods and services. Empirical literature on optimal size of government sector is rich (see [7]), but it provides no unanimous view on the optimal size of government, suggesting that it depends on the country characteristics, structure of government expenditures, government efficiency, structure of the tax system, etc. Literature also shows that on average 10 percent increase in tax burden is associated with the reduction in GDP growth rate by 0.2 percent [1].

The most of empirical studies dealing with the link between the level of tax burden/size of government and economic growth, take tax-revenue-to-GDP ratio as the indicator of the size of the total tax burden. Data presented in Figure 3 show that in term of the relative volume of total tax revenues, Serbia is close to European median. However, distribution of countries also indicates that the total tax burden in less developed European countries from CEE and Western Balkans region is on average lower than in Serbia. Considering theoretical and empirical argument, it may be concluded that slight reduction in the overall tax burden in Serbia, bringing it closer to the CEE average might be beneficial for economic growth. However, substantial cut in the overall tax burden would not be feasible, if the government is to provide public goods and services in line with social-democratic, mechanistic paradigm.

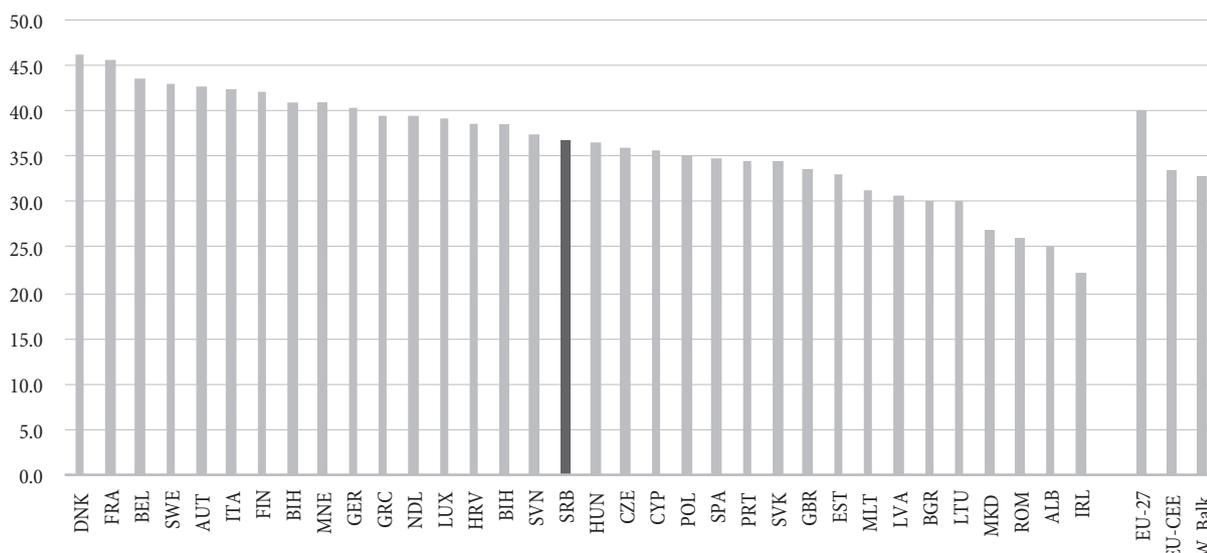
All taxes, except for lump-sum tax, change relative prices thus distorting economic efficiency. Due to equity concerns, lump-sum taxes are usually not part of contemporary tax systems, which mostly consist of taxes on personal and corporate income, property/wealth and consumption. All of these taxes may affect the economic behaviour, including the labour/leisure, consumption/saving, consumption/investment, education, risk taking and other decisions. Since not all taxes affect economic behaviour in the similar way, it is argued that structure

of the overall tax burden and the tax system is also a significant driver of economic growth. Earlier literature [12] divided taxes into distortionary (those which affect investment decisions, such as personal and corporate income tax) and non-distortionary (those that affect labour/leisure decisions only, such as consumption taxes), arguing that shifting tax burden from distortionary to non-distortionary may foster economic growth. Since then it became almost a common view in academic and policy literature that income taxes are more distortive to economic growth than consumption or property taxes ([3], [10]). In their empirical study for the set of developed countries, [3] found that corporate income taxes appear to have the

strongest negative impact on economic growth, followed by personal income tax. On the other hand, consumption taxes have been found to have considerably less negative effects on economic performance, while property taxes being the least harmful for growth (in particular recurring taxes on immovable property and inheritance).

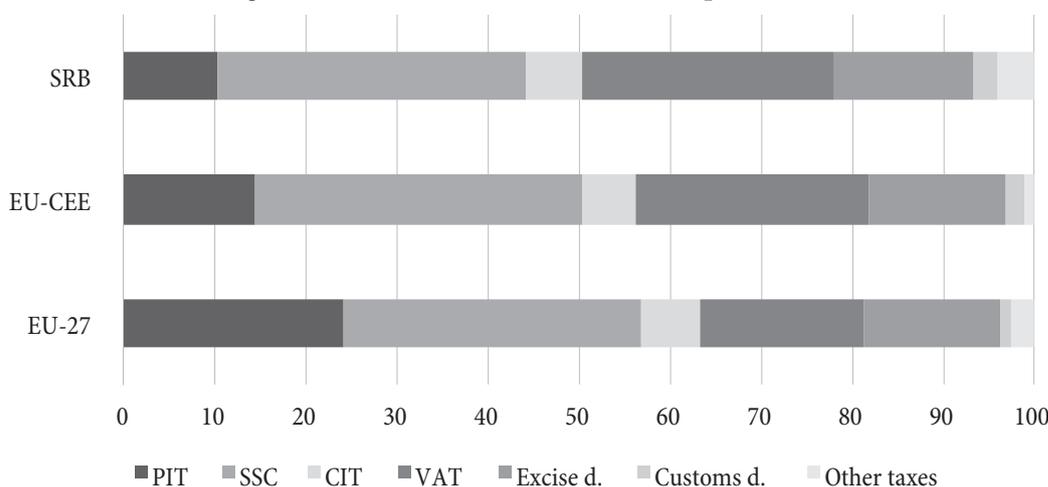
Data on the structure of tax revenues show that in Serbia tax burden is almost equally split between (personal and corporate) income taxes and consumption taxes, while in the CEE countries and especially in developed European countries, income taxes account for much larger share of the total tax revenues (Figure 4). Considering above mentioned empirical insights it can be argued that

Figure 3: Total tax revenues in Europe, 2019 (% of GDP)



Source: Author's calculations based on the Eurostat data and [17]

Figure 4: Structure of tax revenues in Europe, 2019 (%)



Source: Taxation Trends in the EU, IMF WEO Database, [17]

structure of the tax system in Serbia is not more harmful for economic growth than it is the case in other European countries on average.

Since some empirical studies suggest that taxes can be ranked in terms of their negative impact on economic growth, it may be useful to evaluate properties of the Serbian tax system also from the point of view of individual taxes. Data presented in Table 3 show that all statutory tax rates in Serbia are below the EU-27 and CEE average. In comparison to the Western Balkans countries, all taxes are higher in Serbia (except for the property transfer tax), the difference being particularly salient in respect of labour taxes (personal income tax and social security contributions).

Pro-growth tax policy reforms opportunities

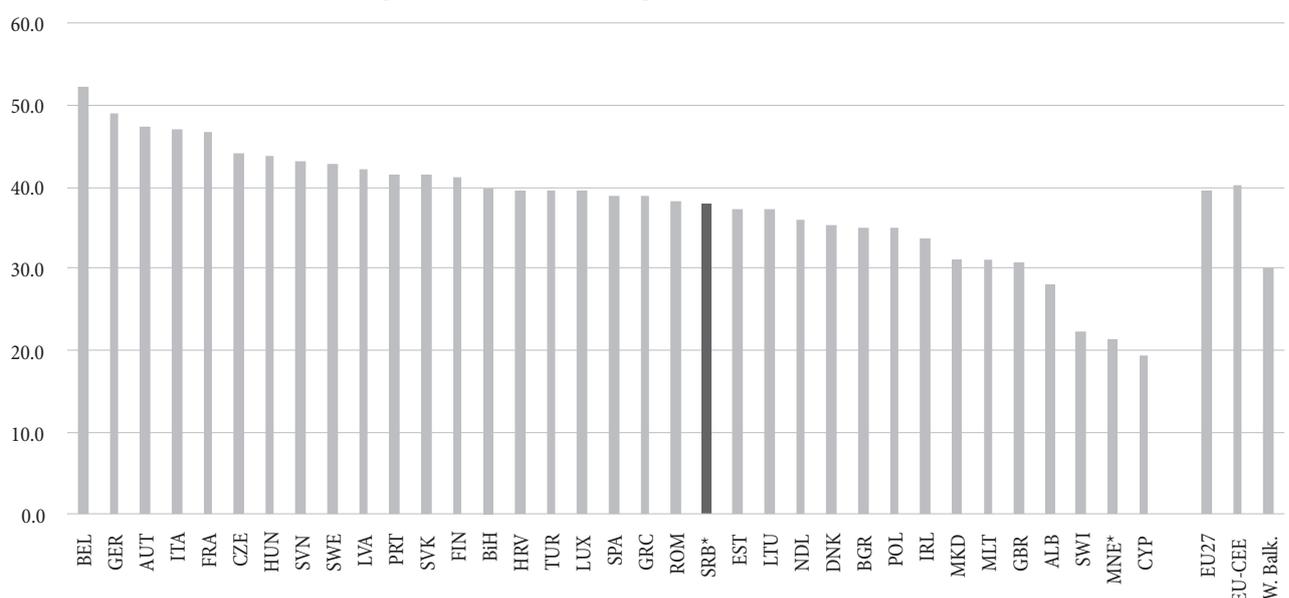
Serbian labour market saw improvement in the last few years in terms of rise in employment and reduction in work informality, due to labour market reforms implemented in 2014, stronger economic growth performances since 2018 and slight reduction in the labour taxes wedge. However, the unemployment rate in Serbia in the third quarter 2021, according to the Labour Force Survey data, stood at 10.5 percent, which was still significantly above the CEE average (around 6.3 percent), while employment and activity rates in Serbia being lower than the CEE average. At the same time, around 15 percent of employees in Serbia have been working in informal sector.

Table 3. Statutory tax rates in Serbia and Europe (%)

	EU-27	EU-CEE	W. Balkans	SRB
CIT	21.9	15.5	12.5	15
Labor taxes: PIT+SSC (% of labor costs)	39.5	40.2	30.0	37.9
Property tax	0.7	0.4		0.40
Inheritance tax	25.3	14.6	2.42	2.5
Property transfer tax	4.1	2.2	4.9	2.5
VAT - standard	21.5	21.3	18.8	20
VAT - lower	11.3	10.8	7.0	10
Excise - cigarettes (EUR/pack)	2.83	2.11	1.08	1.14
Excise - fuel (EUR/lit)	0.54	0.46	0.46	0.48

Source: Author's calculations using the data from Eurostat and [17]

Figure 5: Labour tax wedge (% of total labour costs)



Source: Eurostat, Western Balkans Labour Market Trends, author's calculations*

*Data for Montenegro refer to tax rules in 2020, except for Serbia and Montenegro, for which the data refer to 2022

Labour and capital income taxes are among the most distortive, only the corporate income tax being more harmful for growth. At the same time, labour taxes in Serbia are significantly higher than in the most other Western Balkans and some CEE countries (Figure 5). Therefore, further reduction of labour taxes could be beneficial for labour market activation, work formalization, discouraging of outbound migrations and economic growth in general. In the last few years Serbia has slightly reduced the labour tax wedge, by raising the non-taxable threshold and modestly cutting the rates of social security contributions on behalf of employer, but the overall tax wedge remain fairly high from the regional perspective. However, to trigger stronger labour market and growth effects, more pronounced reduction in labour tax wedge may be required.

To be sustainable and not to harm macroeconomic stability, that reform should be accompanied with increase in other (less distortive) taxes, such as VAT, excise duties, other environmental taxes or property taxes and/or reduction in government expenditures. For instance, abolishing healthcare contributions, in the same manner as done in Montenegro since 2022, would reduce the labour tax wedge in Serbia from 38 percent to around 29 percent. However, such reform would imply salient decrease in tax revenues by around 3.3 percent of GDP. To compensate for revenue

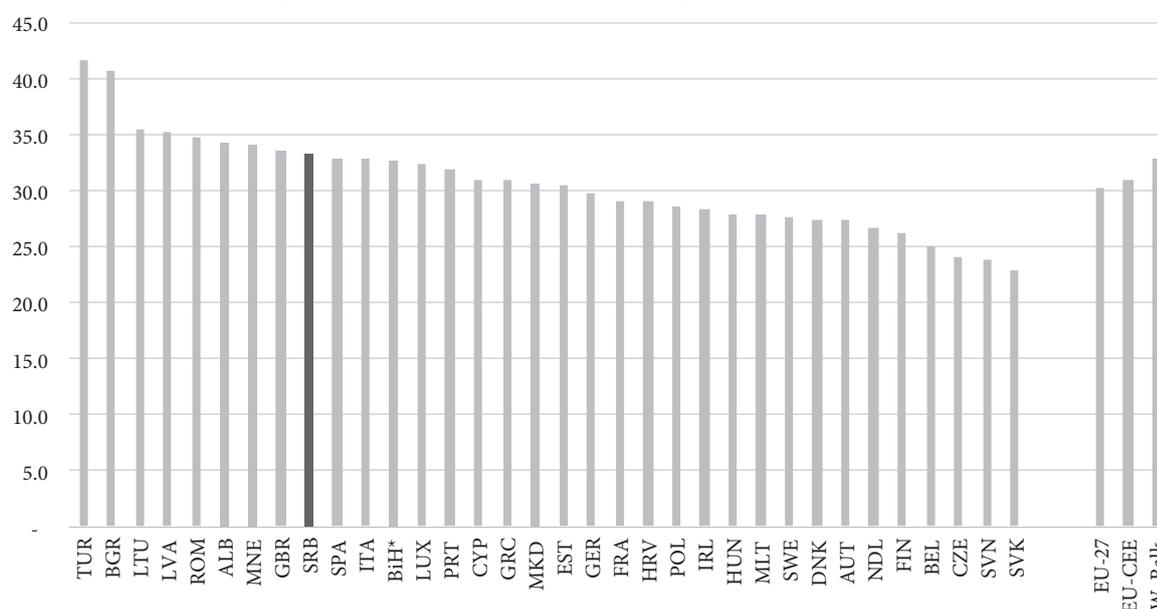
loss, increase in VAT rate from 20 percent/10 percent to 26 percent/13 percent would be required. If other taxes are to be raised (e.g. broadening the base for energy taxes) too and some government expenditures to slightly reduced (e.g. cut in subsidies), less pronounced increase in VAT rates would be required. In addition to reduction in the overall labour tax wedge, a reform should also focus on parametric improvement of labour tax scheme, which is currently particularly burdensome for low skilled/part time workers [19].

Tax policy and economic inequality

For economic growth to be sustainable, growth dividend should be shared in a manner that does not aggravate economic inequality. High economic inequality may be harmful for social welfare, due to diminishing marginal utility of income, but it can also have adverse impact on social and political dynamics, creating a fertile ground for populist political agenda [14]. Economic inequality can be observed from income/consumption or wealth distribution perspective.

According to Survey of Income and Living Conditions (SILC) data (Figure 6), disposable income inequality in Serbia, measured with Gini coefficient in 2019 stood at 33.3, which was above the EU-27 and CEE average (30.2

Figure 6: Gini coefficient based on disposable income, 2019



Source: Eurostat. For BIH data refer to 2015

and 30.9 respectively) and close to (but still higher than) the Western Balkans average (33.0). Although it can be argued that inequality measures using SILC data are not fully comparable across Europe, due to its structure and peculiarities of earning and consumption patterns in particular countries, it still may be read as an approximate signal of the scale of inequality.

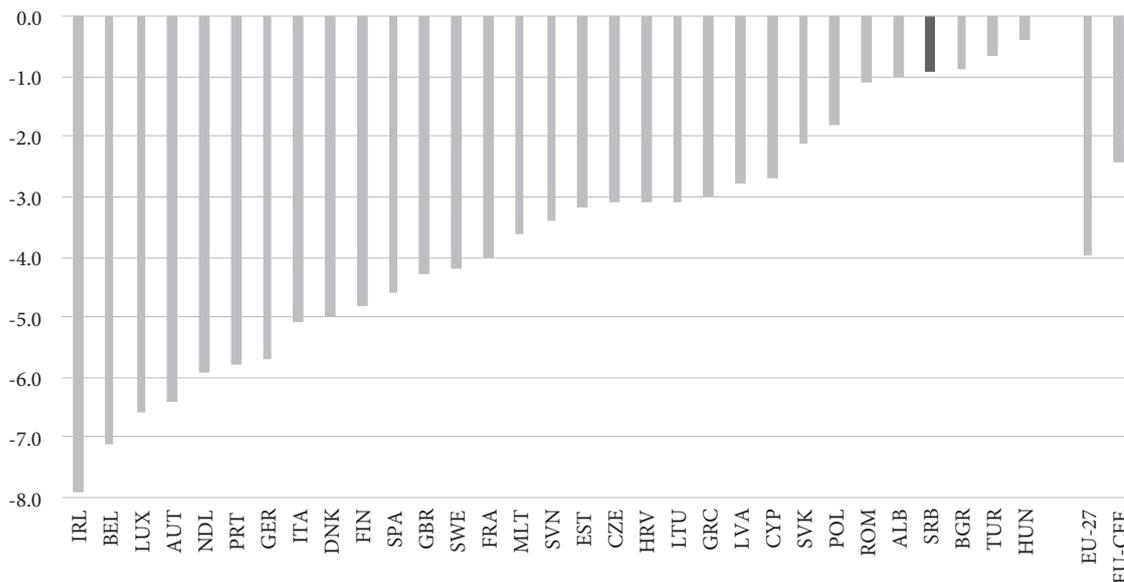
Disposable income inequality is the results of market income distribution and characteristics of personal income tax, social security contributions and the social benefit systems. In line with the focus of this paper, we will concentrate on the impact of the tax system. In majority of European countries, personal income tax systems have been designed in progressive manner, thus making after-tax income distribution less unequal than the pre-tax income distribution. Data presented in Figure 7 show that in EU-27 and CEE countries, personal income tax reduces Gini coefficient by 4.0 and 2.4 pp respectively. At the same time, studies for Serbia show that impact of income tax in Serbia on reduction of Gini coefficient ranges from close to 0.4 pp [2] to 0.9 pp (as indicated by microsimulations based on administrative data). Therefore, it may be concluded that the personal income tax system in Serbia is less progressive and less redistributive than in other EU and CEE countries on average, which means that the reform of labour taxes should be done not only

with the aim to reduce the tax wedge, but also to modestly increase the degree of tax progressivity.

Considering the aforesaid, it is concluded that to enhance contribution of tax system to reduction of income inequality, Serbia may require a reform income tax system that would increase progressivity (e.g. bringing it close to the CEE average) by raising non-taxable threshold and/or considering introduction of one or two higher marginal tax rates, to be applied to higher incomes. In that respect, when designing the reform, government should take into account also the adverse negative effects a strongly progressive tax system may have on capital flows, labour supply/demand, work informality, entrepreneurship, etc.

Measuring wealth distribution (particularly at the right tail of the distribution) is associated with more complications than measuring income distribution, which is why the results based on various methods and data sources may differ considerably. According to Global Wealth Databook (GWD) data [9], Gini coefficient based on wealth distribution in Serbia in 2021 was around 70.6, while the World Economic Forum (WEF) database results indicate that wealth Gini coefficient in Serbia was 54.2, which is 1.6 times higher than disposable income inequality. Wealth inequality in Serbia, according to these data is comparable to the EU-27, CEE and Western Balkans average (Figure 8). In spite of the differences in the level off

Figure 7: Change in Gini coefficient after PIT, 2019 (pp)



Source: Author's calculations using Euromod and Commitment to Equity databases

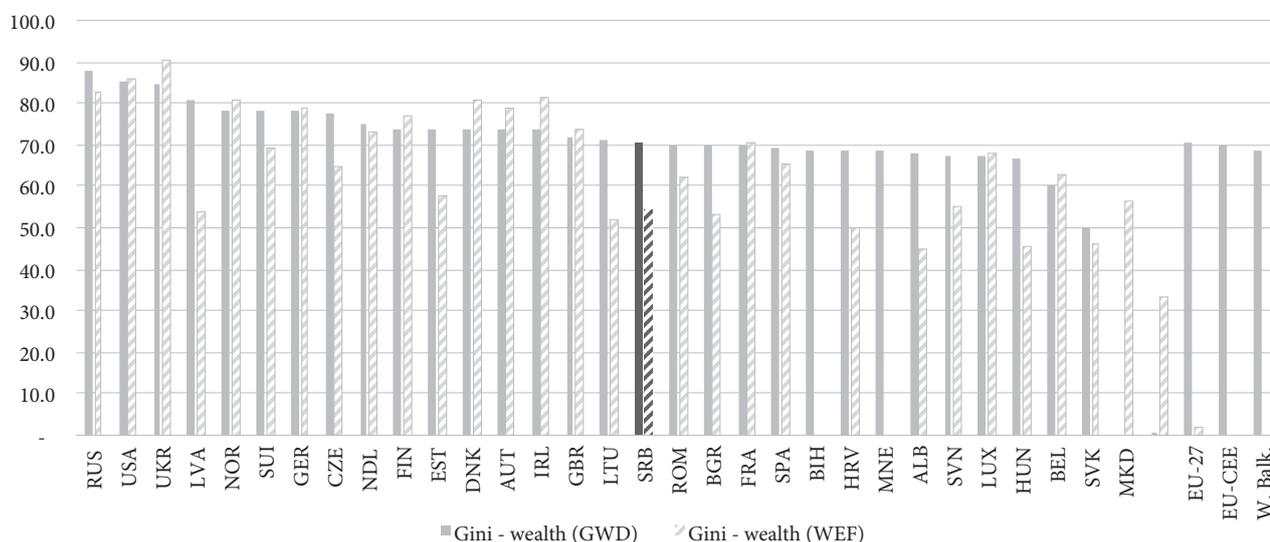
inequality, there is a relatively high correlation between the Gini indices based on GWD and WEF data. In both cases wealth inequality is substantially higher than the income inequality in all European countries [18], which suggests that economic inequality should be addressed not only from income, but also from wealth perspective.

Although high wealth inequality is not a mere consequence of lack of redistributive capacities of the tax system, tax instruments can play a significant role (together with other public policy instruments) in alleviating wealth inequality, which is globally on the rise since late 1990s. In respect of the impact of tax system on wealth inequality, property taxes play a central role. Recurring property tax rates (0.4 percent for legal entities and 0.4 – 2 percent for individuals) in Serbia are comparable to the tax rates in other CEE countries, although effective rates are below the EU-27 average (Table 2). Therefore, structure of the tax rates in Serbian property tax system is not seen as the central issue, in terms of enhancing its redistributive power, even though differentiation of tax rates by the types of taxpayers creates space for arbitrage. To improve the equitability and progressivity of Serbian property tax, a set of parametric changes may be needed [18]: *i*) introducing property tax base deductions for housing loans, this reducing the burden on those with high gross, but relatively low net wealth, *ii*) stating the tax credit in the absolute amount, rather than *ad valorem*, *iii*) improving tax enforcement by means of update of tax

records, *iv*) reforming the system of taxation of “luxury goods” (tax on use, holding and carrying goods), by linking the tax base and tax liability closer to the actual value of those goods, *v*) extending the property tax jurisdiction worldwide for tax residents, with introduction of double taxation avoidance methods, thus enabling cross-check of income and wealth dynamics.

One of the reasons of high concentration of wealth is linked to failure of inheritance tax schemes. Although most of European countries (except for Cyprus, Slovakia, Czechia, Sweden, Portugal, etc.) do have inheritance tax in their tax systems [16], the taxation rules are designed in a way that provides exemptions or allowances in majority of cases (usually for heirs in the first line), which is also the case in Serbia. In addition to that, inheritance tax rates in most European countries are higher than in Serbia, some of them applying progressive tax rates in the range from 3 to 80 percent, while in Serbia the flat rates of 1.5 percent or 2.5 percent apply. Low statutory tax rates in comparison to other European countries (Table 2) and widespread system of exemptions, significantly narrows the tax base and redistributive capacities of this tax. Therefore, to improve economic equalization power of tax system in Serbia, parametric changes to the inheritance tax system may be useful. In that sense, the main changes aimed to enhance tax progressivity would be focused on the following issues [18]: *i*) abolishing general tax exemption for the first line of heirs and introducing the general non-taxable amount of

Figure 8: Gini coefficient based on wealth in Europe



Source: Author's calculations based on WEF Database, [9] and [18]

inheritance equivalent to present value of lifetime average earnings (e.g. around EUR 300 thousand), *ii*) evaluating the options to enhance direct tax progressivity, by means of the reform of tax schedules, *iii*) extending Serbian tax jurisdiction to worldwide inheritance, in case the testator was Serbian tax resident.

Tax policy and environment protection

Environment protection has gained importance in academic and policy debates in the last decade. Three out of 17 UN Sustainable Development Goals are directly linked to environment protection, while several other goals implicitly affect the environmental issues. In similar way, the European Union has set out the goal to reduce CO₂ emission by 30 percent by 2030 in comparison to 1990. Environmental issues are discussed in economics within the negative externalities framework. Therefore, environment protection can be tackled by means of market-based instruments (as suggested by the Coase theorem) and/or government actions. Since market-based instruments often provide no sufficient correction, there is an increasing focus on the options in terms of government policies, which may be grouped into three pillars: environmental taxes, “cap and trade” emission scheme and environmental standards.

Environmental tax is defined as a tax whose tax base is a physical unit (or a proxy of a physical unit) of something that has a proven, specific negative impact on the environment [5]. Being broadly defined, environmental taxes entail four groups of taxes: energy taxes, pollution taxes, resources taxes and transportation taxes. Environmental taxes are seen as a way to correct for market deficiencies and make private agents account for negative social costs of their actions in their optimization process. As such, environmental taxes yield double dividend - they discourage behaviour that leaves negative environmental footprint, while raising tax revenues by means of environmental taxes creates fiscal space for reduction in other more distortive taxes, such as income taxes. Meta-analysis conducted by [8] concluded that 55 percent of all simulations did result in a double dividend, as suggested by the theory. As they raise the price of goods that (in their production or use) have a negative impact on environment (e.g. raising the

price of energy), environmental taxes may be harmful for economic growth. However, if the extra tax revenues raised by means of environmental taxes enable reduction in other taxes, the negative growth consequences may be partially or fully reverted. In their study on growth impact of carbon taxes, [4] found that a \$30/ton carbon tax would reduce GDP by roughly 3.5 percent in 2050, while when introduction of carbon tax is accompanied with the revenue neutral cuts in capital income taxes, the growth impact becomes positive - leading to a 1.3 percent higher level of GDP in 2050.

EU environmental policy is strongly relying on energy taxation and emission trading system. In terms of energy taxation, the EU has adopted the Energy taxation directive (Directive 2003/96/EC on the taxation of energy products and electricity), which makes introduction of energy consumption taxes in all member states mandatory, with prescribed lower ceilings in terms of the tax rates. In addition to that, all EU member states participate in Emission Trading Scheme, while member states are free to impose other types of environmental taxes in line with their policy goals [6].

Environmental policy in Serbia is relying on taxation, with the great focus on energy taxation and some contribution of other environmental taxes. Environmental taxes in Serbia generate tax revenues of around 3.3 percent of GDP, which is considerably above the EU-27 and CEE average (2.5 and 2.8 percent of GDP respectively). However, around 95-96 percent of the total environmental taxes revenues in Serbia come from energy taxation, around 3 percent from pollution taxes, close to 1 percent from transportation taxes, while the share of resources taxes is very small.

Energy taxes (excise duties) in Serbia are to some extent aligned with the relevant EU directives. To attain full harmonization, the base for energy taxation in Serbia should be broadened, by imposing the excise duties on coal and coke. In 2018 Serbia has enacted the Law on Charges for Use of Public Goods, which imposes 15 groups of charges (with more than a hundred types of charges), many of which having features of pollution or resources tax. That law has replaced numerous other laws and bylaws, thus making the system of charges systemic, coherent,

transparent and foreseeable. However, low revenue effects of these charges (in comparison to European countries) suggest that there is a space for their further refinement, following the polluter-pays principle. In addition to that, participation in the European Emission Trading scheme in the future may generate additional tax revenues in Serbia, together with the benefits in terms of reduction of pollution.

Since environmental taxes in Serbia are already relatively high (due to energy taxes), while above listed reforms imply broadening the tax base, reform of environmental taxes in Serbia may be seen as an opportunity to reduce other distortive taxes (e.g. labour taxes) and to offer tax breaks to households for their investments in environmental friendly energy sources.

Conclusion

After a period of solid economic growth (2000-2008), Serbian economy saw weaker and volatile growth dynamics over the next decade (2009-2017), due to exogenous factors (global economic crisis, Eurozone crisis, floods) and internal constraints (fiscal consolidation, challenges regarding structural reforms, etc.). Finally, since 2018 Serbian economy performed relatively well in terms of growth dynamics from the comparative perspective, even during the pandemic crisis. However, to attain substantial convergence with the developed European countries and the CEE economies, Serbia needs to post 4-6 percent annual GDP growth rates over the long run - in the next decades. To be able to achieve that, it is necessary to ensure lasting macroeconomic stability and considerable leap in terms of structural reforms, including improvement in structural characteristics of fiscal policy and public finances. Growth outcomes in the coming period will be crucially dependent on the success in boosting public and domestic private investment in physical capital (and maintaining high inflow of foreign investments), dynamics of human capital shaped by the quality of education, fertility and migration trends, and the capability to generate and absorb new technologies. Willingness to invest in physical capital and individual's propensity to invest in education and not to migrate abroad, substantially depend on the development

of institutions, defined as set of inclusive, fair and efficient rules applied in non-selective and effective manner [15].

In terms of improvement of the structural characteristics of public finances, after successful implementation of fiscal consolidation and increase in the amount of public investment, space for improvement of pro-growth impetus remains in several fields: *i)* selection and implementation of public investment projects, *ii)* overhaul of the system of selection, compensation and promotion of civil servants, *iii)* reduction in non-productive subsidies and non-targeted cash transfers, *iv)* improvement of the system of financing of healthcare and education, *v)* reform of local governments financing scheme, *vi)* improvement of efficiency of state-owned enterprises, *vii)* further steps in tackling shadow economy, as well as *viii)* in further reform of the tax system.

Reform of tax policy is not a crucial component of structural reforms, but if implemented in efficient and effective manner, it can yield considerable growth dividend. In that respect, to contribute to achievement of sustainable development goals, tax reform in Serbia should be shaped taking into account three overall objectives: to foster economic growth, to contribute to reduction of economic inequality and to reduce negative environmental footprint of households and companies. In that sense, building on relevant theoretical and empirical arguments and using the benchmark indicators for other European countries, in this paper the main elements of tax reform aimed to foster sustainable development of Serbia have been outlined. First, to foster growth, the tax reform should be done to slightly reduce the overall tax burden, with significant reduction in labour taxes, financed by means of broadening base of environmental taxes, increase in consumption taxes and cut in unproductive government spending. Second, to ensure that growth benefits are fairly distributed, the tax reform should entail changes in the personal income tax, property tax and inheritance tax that would moderately increase overall tax progressivity, notwithstanding the need to control the negative effects on productive behaviour. Third, to be efficient environmental policy should be comprehensive, including both tax and non-tax (regulatory) instruments. In that sense, to contribute to sustainable environment, future tax policy reform in Serbia should also consider

the options to broaden the base for environmental taxes (excise duties on coal and coke, redesign of some forms of pollution taxes and in the future also participation in the European Emission Trading System) and to offer tax incentives for environmental friendly consumption and investments by households.

The described outline of the reform provides for general directions, why concrete decisions on the parametrization of the reform should be built on comprehensive, data-driven and evidence-based estimations of economic and fiscal impact. Conducting such reform of the tax system would also require further investment in tax enforcement and tax collection institutions and mechanisms, with the focus on digitalization and strengthening the human capital component.

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