SYNOPSIS
OF THE FLAT TAX RATES
IN THE REGION
OF SOUTH EAST EUROPE

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Plovdiv/Belgrade
December 2008

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Introduction

The main purpose of this Brochure: "Synopsis of the Flat Tax Rates in the Region of South East Europe" is to present selected economic information in a simple and comprehensible way to decision-makers of diverse professional background.

This Brochure is focused on reviewing certain economic indicators and, more specifically, the flat tax rates /FTR/ regiments, if any, applied in different states in the region of the South East Europe - SEE. As there is no agreed use of the term "South East Europe" due to different reasons, the countries, which are subject to this brochure, in alphabetical order, are the following: Albania, Bosnia and Herzegovina (BiH), Bulgaria, Croatia, Kosovo, Macedonia, Montenegro, Romania, Serbia, and Slovenia – a total of 10 countries.

The Brochure illustrates in texts, graphs, pictures and tables, certain factual data of economic realities of the ten states, employing a descriptive-analytical approach to investigate some interesting phenomena, related to the application of flat tax rates in these states.

The contents of this Brochure is structured in such a way, that it gives a brief overview of the leaders of FTR introduction on the European continent, and then follows the factual and statistical material, as well as the analysis for each of the ten states.

In most states around the globe, countries use tax systems with sets of "Income Tax Brackets" /ITB/, which, in most cases are, "progressive tax systems" – that is, the greater the level of generated incomes, the higher the level of taxation of these incomes. However, economic advantages for the states to use "flat taxes" instead of progressive taxes may not be so numerous.

In essence, the wording "flat tax" stands to mean that each economic agent – individual or legal entity is taxed at just one rate. For individuals, who generate the so-called "personal income", there is a "Personal Income Tax" /PIT/; and, respectively, for corporations, there is a "Company Income Tax" or "Corporate Income Tax" /CIT/. The economic reasoning, behind applying flat tax to personal incomes, and to corporate proceedings, is to be set such a comparatively low and unified level of taxation, that this level to play the role of a "stimulus" for economic agents to pay their taxes, rather than dodging them. Alternatively interpreted, there is one single "tax bracket" for each economic agent no matter the nature of its business, and the speed of his capital formation, given that all incomes are generated legally.

Broadly speaking, there are three reasons at least, according to which the flat tax system is favorable than the progressive tax system.

Firstly, it is expected that application of a single tax rate will favor state budget proceedings and recover the macroeconomic balance of a state.

Secondly, it is comparatively simple in nature – "one tax bracket fits all", so that it can be an incentive to all tax-payers to fair-play, when it comes to paying taxes, as the cost of legal hiding of taxes becomes more expensive than the cost of paying these dues.

And finally, it is believed, if a greater share of the generated capital in an economy is left to the very economic agents who generate it, they will have rational incentives to either spend it for consumption purposes, or save it, or invest it, according to their own vision and plans. The assumption is that all individuals and legal entities will have legitimate freedom to choose how much to earn, and how much to spend and on what, which is considered to be the “laissez-faire” – “the invisible hand on the market”, which allows people and companies to choose themselves the patterns and volumes of their spending.

At a first glance, the main idea of simplifying methods for tax computing, and equalizing tax burdens for all people, seems to look as a very great one. It is indeed so, as for example, if a 10% flat tax rate is introduced in a country, accounting practices of all entities, including corporate and not-for-profit ones in this country would be much more simplified, and easy to cope with. Another advantage of the flat tax rate system is that it favours businesses, including domestic and foreign, as the greater part of their proceedings remains untaxed, which, basically stands to mean that a greater mass of money flows remains free and hence, it becomes cheaper to use. It is out of any doubt, that a flat tax rate system nurtures business entities and corporations, as this system, essentially, aids companies to grow faster.

Therefore, the two main conclusions, which could be drawn, are that a state could be in a better position to implement such kind of a system of taxation; and also, businesses, would readily and willingly accept this system as well, as it allows them to incur more profits. Therefore, these two effects may be considered advantageous both for a state, and its legal entities.

However, on the other hand, the flat tax rate systems have certain characteristics, which may have ambiguous interpretations. For example, such kind of a tax system eliminates, basically, almost all types of tax exemptions and allowances, which normally, are welcomed by the poorer people of a society. In addition to that, the flat tax favors the rich individuals and companies at the expense of the poor due to non-proportional and asymmetrical large amounts of money, which is left after taxation. For example, an applied single FTR to a multi-million turnover of a company, on the one side, and to a salaried worker, on the other, allows the company to have a greater share of disposable incomes than the disposable money of the salaried worker.

It has to be stressed, as well, that such countries as the US, France, Germany, United Kingdom, and others, are considered to be “economically developed”.

On the other hand, the countries, which have introduced first the flat tax system, have been either ex-USSR states, or close allies or satellites to former USSR, and/or have been considered “developing countries” with a few exceptions, such as Hong Kong, and Jersey, for instance. Therefore, the countries, which introduced first the systems of FTR do not have statistical evidence large enough to prove that flat tax systems are “successful”, simply because such kind of tax systems have never been tested before into developed ones, where statistically and data based constructs could be designed. And also, low FTR will allow capitals from shadow sectors of each economy to get into the “statistically observed economy” in a legal way, which may seem good from the viewpoint of macroeconomics and to some economic agents, but it is unpleasant to all those who have struggled with life for numerous years, believing in fair-play, and fair-competition, and fair laws – especially when it comes to millions of people, who were forced to live in socialism, and have been banned to have private property, punished for their entrepreneurial skills and knowledge, and forced to abide to the centrally planned economic rules of their home countries.

And it is here the place to state that a FTR-system has its advantages and disadvantages, when it comes to economic realities of the ten countries in question, because recent studies have shown that according to different theoretical papers on the effects of FTR-systems, but which demonstrate, on the one hand, favouritism on the positive economic effects a FTR-system provides to an economy, and, on the other – negligence on the negative social impact they make.

Leaders of Flat Tax Rates Application

Since tax rates are a key element to each country in order to generate aggregated income on a state level and to compose a balanced budget, a matter of primary importance for each and every state is to apply reasonable policies to adjust tax rates to certain economic indicators. Usually, there are a plethora of taxes, which a state may apply to add value to its economy through implementation of its economic and budget policies. Therefore, it is more than necessary to construct a tax rate system, such as to create benefits for taxpayers, on the one hand, and state, on the other, taking into consideration indicators, which may differ from a state to state.

In 1994 Estonia, followed by Lithuania took the lead, which were joined in 1995 by Latvia in applying flat tax rate systems. In addition to that, in 2001, Russia also introduced a flat tax rate on Personal Income Taxes /PIT/ of 13% and a flat tax rate on Corporate Income Taxes /CIT/.

The implemented tax reforms within the Russian Federation and some of the ex-Soviet republics have been widely trumpeted as successful due to the increases, accumulated in the budgets of these states. Introduction of flat tax rates both for PIT, and CIT dramatically increased tax proceedings in the state budgets of these countries, as it was planned and expected. However, the main accent on majority of findings and reports, such as those of the World Bank, focus primarily on the revenue collection, tax structure, and tax compliance.

Presently, the PIT and CIT for some of the leaders of the flat tax reform, which is already happening on a global level, are presented on Table-1.

STATE	2008	
	PIT	CIT
Estonia	23%	23%
Lithuania	24%	15%
Latvia	25%	15%
Russia	13%	30%
Georgia	12%	20%
Ukraine	15%	25%

Table 1 Flat Tax Rates for 2008 of some ex-Soviet states

Macroeconomic studies do point out and prove the significance of the tax reforms of these states from macroeconomic and state-finances point of view. However, this does not necessarily mean that a simple “copy/paste” technique will be valid for other countries, as well.

A very important fact, which has been omitted about these economies, is that all of them were classified as “socialist centrally planned economies” /SCPEs/ before the political changes in 1989. One of the main characteristics of SCPEs is that all resources were under direct governmental control and, therefore allocated by on central level by “commands” and these SCPEs were also named “pressure economies” in economic jargon. This is so, because a greater share of the factors of production (steel factories, car factories, textile kombinats, and others) changed ownership – from state and municipal type of ownership to private type of ownership, but in essence, these countries have never went through a more significant change of political and economic lifestyles.

What is typical for ex-USSR states, such as Lithuania, Estonia, Latvia, Ukraine, Georgia, and Russia, for example is that they used to have a high degree of economic centralization and from low to severe internal and external macroeconomic imbalances. These macro imbalances in the ex-socialist economies were primarily due to budgetary imbalances and almost none or "faked" constraints and requirements on businesses of their state-owned enterprises.

As most of the mentioned states changed ownership regiments of the most factors of production and privatized to a very great extent their economies, it appeared that businesses are not inclined to pay voluntarily tax dues to the state budgets, which exacerbated their macroeconomic frames. As economic conditions worsened in these states, which directly affected the standard of living of the majority of their citizens, turning them into impoverished individuals unable to pay the very basic needs for daily survival – food, water, and shelter, a good, but untested anywhere else, solution, was to apply such tax rates, which would allow their state budgets to get balanced.

For example, since the introduction of the flat-tax rates in Estonia in 1994 until 2006, it happened this country to become the biggest recipient of foreign investments per capita in Europe. The economic growth of this country for the period 2000-2006 was more than 11% per year, and it is projected to grow by about another 8% per year. Latvia experienced almost the same 11% annual growth for the same period, according to its macroeconomic indicators. And all states, which introduced flat tax rate regiments, enjoyed for the first two years increase in tax proceedings of more than 30% per annum.

For example, in the case with Russia, it is widely stated that this country introduced a FTR of 13%. However, when it comes to increases of tax revenues, it is omitted the fact that Russian economy is also growing up in time, which logically, results in more taxes paid.

And also, Russian administrative reform of its Tax Office continuously marks a strong progress, which results in a higher level of paid taxes to the budget. Therefore, the FTR itself may not serve as a sound argument to prove that all the economy of a state can do better only after a FTR-system is applied.

As there is a great motion to ask all SEE states to have equalized their tax burdens, so that speed of their individual economic development, and speed of the regional development may be normalized, has much sense. This will make State Treasuries increase tax revenues, and generation of a greater mass of cash flows could be used to level up wages in the public sector, or invested into economic development of the countries.

In addition, businesses could use a greater part of their incomes on the legal market, instead of nurturing shadow economy, and spending lump sums for complex accounting practices to minimize the "visible part" of their incomes to Tax Authorities.

One of the greatest concerns with flat tax rates introduction is that this will speed up the process of capital formation of business entities, but leave behind the boat a greater number of ordinary people.

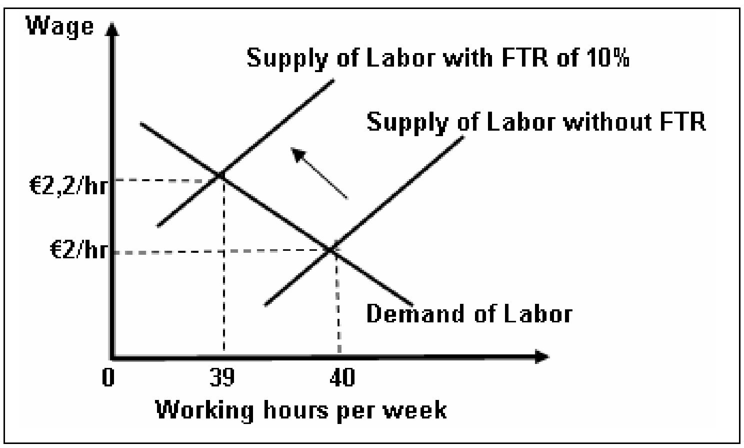
As the case with Bulgaria is, about 5% of the population of the country hold in the form of legal entities, 100% of the production capital of the state, and more than 90% of the economic enterprises are privately owned. Basically, the state of Bulgaria will definitely economically tolerate the richer part of Bulgarian society, and create hardships for salaried employees, who total to about 3,5 million people. This was just the case with Romania, and it is already happening there.

The problem with the money in the shadow part of each economy of SEE is a very “painful” one, due to the size of these shadow economies.

If there is an idealized situation on the labor market, where the curve, illustrating the “Demand of Labor” crosses the curve, illustrating the “Supply of Labor without flat tax rate” applied at a wage of €2 per working hour at a 40-hour working week, this point may be considered the equilibrium point on the market.

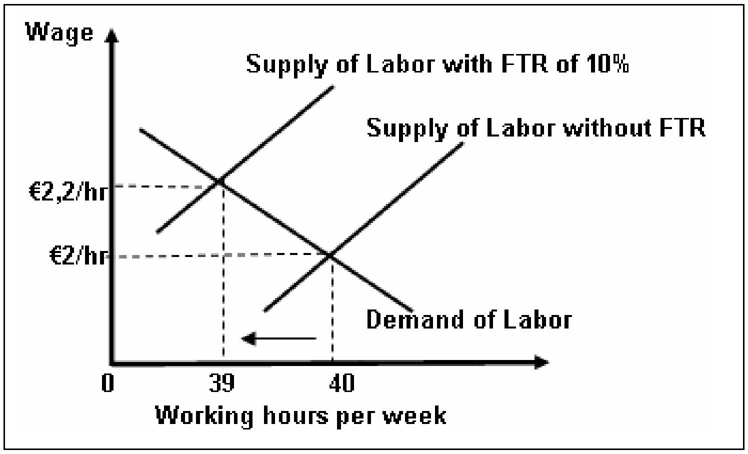
However, if a certain tax rate (it is valid to any rate) is applied to the aggregate supply of labor, it will make labor supply more expensive to all those who demand it.

Therefore, the Supply of Labor curve will shift left, as it is shown on Graph-1. In this case, it is applied a 10% tax rate on incomes of labor.



Graph 1 Shift of the Supply of Labor curve

That is how, if labor costs €2 per hour, since introducing a 10% tax rate, it gets to €2,2 per hour. However, as there is a shift of the whole curve to the left, then the amount of working hours gets from 40 to 39, as it is illustrated on Graph-2.



Graph 2 Decrease of Demand of Labor

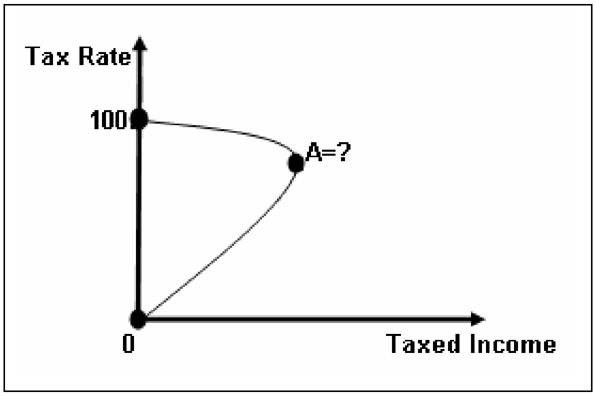
Then, if the two consequences of the discussed situation are taken in mind altogether, as illustrated on Graph-1 and Graph-2, one could observe, that if an employee is hired to work for €2 per hour for 40 hours per week, this will cost the employer an amount of €80 per week. And if there is a certain tax on labor, this will make labor supply more expensive.

As it is illustrated, the price to hire an employee becomes €2,20 per hour for 39 hours per week, which amounts to €85,80 per week. Or if an employer wants to buy the same amount of labor as he needed before, the cost will go even further, as €2,20 per hour for 40 hours per week will total to €88 per week.

This illustrates the idea that the greater the tax on labor, the higher the cost of hiring workers, and vice versa. Therefore, exact adjustment of tax rate has not only a macroeconomic effect materializing into greater budget proceedings in the national budgets, but also has microeconomic effects directly on demand of labor, and triggers the costs of production of goods and supply of services up. Hence, two things may be deducted here: first, tax rates cannot be very high, as they will increase the overall cost of production, and, second, tax rates should not be unified so as a single FTR be introduced, because businesses differ in nature, capitalize on their assets with different speed, and increase of costs of their products/services may place them directly out of the business.

In addition to the above reasoning, it is known, conceptually, that tax rates influence business activities of an individual/legal entity, because a certain portion of incomes generated, are taxed, which constitute the so-called “taxed income”. And, if economic agents enjoy a tax rate of 0%, no taxed income will be collected by the state.

The other extreme point, as illustrated on Graph-3, is the situation, when economic agents are subject to 100% tax rate – in this case there will be no economic agents to work, or, in practice, no economic agents will declare their incomes.



Graph 3 Tax Rate & Taxed Income Extreme Points

Therefore, it is logical the tax rate to be in between the interval 0% and 100%, which necessitates finding the answer of what tax rate will Point-A on Graph-3 equal to. That is how the marginal tax rate turns into an important indicator in this case.

The economic phenomenon in taxation – the so-called "marginal tax rate" /MTR/ can be explained, as such a tax rate on certain level of income generation that tax-burden becomes so heavy, that companies and/or individuals prefer to stay in the lower tax bracket and have a greater share of disposable incomes rather than generate more capital and get onto higher tax brackets and be subjects to a higher level of taxation, respectively.

It is known that MTR equals to "changes in tax code", divided to "changes in taxed income". For example, if an individual generates €100 more per month and its taxable income increases by €2 more, then MTR will equal 2% (MTR=2/100). With the flat tax system, such a marginal rate of taxation, in practice, does not exist, which is favorable to those, who have greater value of their wealth, investments, or incomes, and is unfavorable to those with comparatively lesser value of their economic wealth.

Based on the supply and demand of labor, which is related to MTR, there is another concept – the idea of "tax incidence", that is, the way the tax burden in a state is shared by its economic agents (both consumers, and producers).

For instance, when there is a "planned deficit" in a budget of a state, an "expansive fiscal policy" is followed, due to comparatively inactive economic agents. And when there is a comparatively high level of economic activities in a state, a budget surplus is formed due to the "restricted fiscal policy", which is observed. Therefore, states, which follow a restricted fiscal policy may form huge amounts of budget surpluses, as it is the case with Russia, Lithuania, Estonia, and others. Consequently, formation of budget surpluses can be expected with the state budgets of the SEE-countries due to the mentioned reasons.

However, there are certain economic mechanisms, which are called "automatic stabilizers" of the fiscal system of a state, which are designed to shape the state budget directly into deficit or surplus, without changing the macroeconomic policy of the state.

There are at least three very important automatic stabilizers in the fiscal system of a state.

The first is compensations and allowances, which a distributed by a state in times of unemployment of individuals. These compensations are designed to help people in economic difficulties, and also to prevent dumping of prices on the labor market.

The second stabilizer is tax rates on companies' profits, which tax rates are usually designed to be progressive. This is so, because companies' profits increase in times of economic booms, and decrease in times of economic depressions. On the one hand, if companies pay higher taxes in periods of economic boom, this will prevent the local economy from "heating" and "price sky-rocketing". On the other hand, if companies pay less taxes in times of economic depression, this will result as a remedy to "cooling factors" of the economy, and allow companies to stay on the safer side of the tax brackets.

The third factor is the tax bracket schemes for individuals due to the MTR-phenomenon.

If an individual earns €1,000 per month, and this is taxed at 5% tax rate, and he his chances to get €1,500 the next month, which will be taxed at 8%, and can increase his income to €2,000, which will be affected by a tax of 14%, then, his disposable income would be €950 in the first case, €1,380 in the second case, and €1,720 in the third case.

However, if a single 10% FTR-system is used for all the three levels of income, then the disposable income of this individual will be €900 in the first case, €1,350 in the second case, and €1,800 in the third case. This simple example proves how FTR-system tolerates individuals and companies with comparatively high levels of incomes, and places into unfavorable conditions people with lower levels of income.

Tax administrations of states, which already introduced a FTR-system, are primarily concerned with the "compliance of the state budget" rather than the equal income distribution in their societies. From the standpoint of macroeconomics, there are "good numbers" in the reports, but from the standpoint of social welfare and wealth distribution into societies, the gap between the poor and the rich in these societies is widening, and in a due course of time it will get wider and wider.

In addition to the ambivalence of the effects of a system with a single FTR, one must bring evidence to either support or reject factual interpretation, according to a set of predefined indicators, which may serve as benchmarks in international comparisons.

As factual economic reality of the economy of a state may nurture different interpretations, it is absolutely necessary to bring enough evidence to state that, most probably, a single tax effect rate may not be the best possible solution for a government to apply on the market. In support of this viewpoint, it has to be pointed out that even the International Monetary Fund /IMF/ has failed to collect enough evidence to maintain the popular rhetoric predominating opinion that a flat tax rate system is a better system than the existing ones in these SEE-states.

I. Albania

Albania is comparatively small country with a population of almost 3,2 million people in 2007 and the Gross Domestic Product /GDP/ for the very same year of about € 8 billion.

Picture 1 Albania

The GDP per capita in terms of Purchasing Power Parity /PPP/ is about €5,370 for 2007 and the gross wage of salaried workers is €280 per month. In Albania, at the end of 2007, there are about 140,000 registered individuals as unemployed and the annual unemployment varies from 13% to 15%. The overall labor force is estimated to 1,1 million people. Therefore, taking into account the unemployment rate, it can be computed that the employed are about 1 million people.

If the overall GDP of Albania is computed not per capita, but per a working individual, it appears that this figure is €8,000 per annum which is about €3,400 higher than the statistically observed and declared GDP. It basically means that about 40% to 45% of Albanian GDP is channeled either through the tax system or the shadow economy, or through both in different proportions. Although gross salaries of employed in different sectors vary to certain extent, aggregated level of gross wages in Albanian official economy is about at €3,4 billion for the Year-2007 (one million salaried workers, multiplied by average monthly salary multiplied by twelve months in a year). As a percent share, this is 40% from the GDP of Albania.

Albania introduced effectively on January 1st, 2007 a flat tax rate /FTR/ for individuals of 10%. In addition to that Albania adopted a single Company Tax Rate /CTR/ of 10%, as well, from January 1st, 2008.

It may be concluded that Albania has strong desire to introduce such FTR-system with a single rate of taxation, equalizing the corporate tax rate to personal tax rate.

II. Bosnia and Herzegovina (BiH)*

The country of Bosnia and Herzegovina (BiH) is a federation and its population is about 3,8 million people. BiH's GDP accounts to about €11 billion, and its GDP per capita totals to about €6,300.

Picture 2 Bosnia and Herzegovina (BiH)

In BiH the tax administration in charge of collecting taxes is organized on entity, cantonal, and municipal levels. In the Federation of BiH (FBiH), personal income tax is levied at cantonal level, while in Republica Srpska (RS) it is regulated at entity level. Brko District has its Law on Personal Income Tax that regulates this type of tax for the District. On the state level, the Indirect Taxation Authority (ITA) is in charge of collecting value added tax, customs, and excises on the entire territory of BiH, as well as coordinating fiscal policy issues in general on the state level. Basic taxation categories in BiH include: Corporate Income Tax /CIT/, Personal Income Tax /PIT/, Value Added Tax /VAT/, Wages Tax, and Property Tax, Social security contributions paid by employers and employees, and Excise Taxes.

Value added tax (VAT) in BiH was introduced on January 1st, 2006, replacing sales tax on goods and services. It was introduced at a flat rate of 17%. The Indirect Taxation Authority is in charge of calculation and collection of VAT. Value added tax is a comprehensive tax on consumption, assessed based on the value added to goods and services. This is a general tax applied to all commercial activities, including manufacturing and distribution of goods and providing services. Revenues from indirect taxes in BiH, including VAT, exceeded expectations. In 2006 total indirect tax revenue collected in BiH amounted to €2.1 billion, which is 26.1% higher than in 2005. The Indirect Tax Authority (ITA) collected 94.5% (€2.07 billion) while the rest (€119.3 million) was collected by the Entity Tax Authorities. Value-Added Tax accounted for 57% of all indirect taxes in 2006. Other indirect taxes included: excise, customs, sales, and toll taxes.

Revenues in 2006 were 17.45% higher than projected by the Indirect Tax Authority projected. The revenue collected from indirect taxes, including VAT, continued to increase in 2007. In the 3rd quarter of 2007, total indirect taxes collected in BiH was €0.65 billion, which was more than in the same period of 2006. Total VAT revenue in the 3rd quarter of 2007 was €400 million, an increase of 14.5% compared to the same period in 2006. The number of registered tax payers also increased. Based on the statistics provided by the entity tax administrations there were expected to be 20,000 taxpayers. But, to date the ITA has registered more than 37,000 VAT taxpayers (17,000 more than expected. Since the first accounting period and up to the present 97% of VAT taxpayers submitted their VAT reports on time.

Bosnia and Herzegovina (BiH) is comparatively young state, but the average net salary approximates at €366 per month (April/2008) and the gross average pay is €480. The Labor Force of BiH is about 1 million people, 30% of whom are considered unemployed.

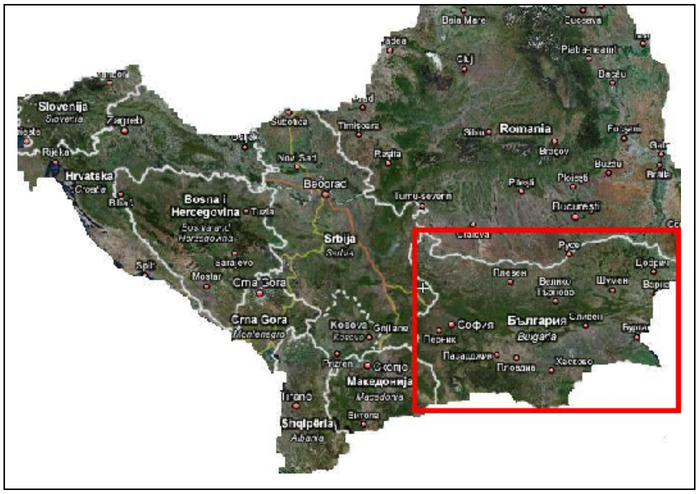
Corporate income tax /CIT/ rate is 10% in all parts of BiH. However, there are some differences across entities regarding tax exemptions. For, example, the Federation of BiH (FBiH) Law on the CIT enables taxpayers, who in the year for which the corporate income tax was determined, achieved 30% of their total revenue from export to be exempted from the tax payment for that year. Tax exemptions are also provided for the tax payers who in the period of five consequent years invested into production a minimum of €10 million. Similarly, taxpayers which employ workers, categorized as "disabled persons" and/or "persons with special needs" for a period, longer than one year, are exempted from CIT the year, at which more than 50% of this disabled persons and persons with special needs were employed.

The New Law on the Corporate Income Tax /CIT/ in FBIH came into force on January 1st, 2008. However, some articles of the previous Law on the Corporate Income Tax, which regulate lowering of the tax obligation, did not cease to apply, until the period for which the tax exemptions could be used, elapses. In Repulic of Srpska, for a taxpayer making an investment into machinery and equipment, at the territory of Republic of Srpska, and which is attributable to performance of own registered production activity, the tax base shall be reduced for the amount of the respective investment. Also in this entity, the tax base reduction for the amount of investment shall be valid until December 31, 2008.

There are also differences in salary taxes across entities in BiH. For example, in FBiH salary tax rate of 5% is levied on net salary regardless of the amount of salary, but there is a new law underway that will change it. In RS income tax is levied on the tax base that includes net salary and allowances, except transport allowance. In this entity there are three income tax rates (0%, 10%, and 15%) depending on the taxable amount.

III. Bulgaria

Bulgaria is a country of about 7,7 million people with a GDP of about €28 billion, which is about €9,500 per capita, if the PPP-computation is employed.



Picture 3 Bulgaria

Bulgaria introduced on January 1st, 2007 a single PTR of 10%, and a single CTR of 10% on January 1st,2008.

Employed Bulgarians in the public sector are unable to evade taxes, due to electronic remittances of wage settlements and most of them change their public jobs with private ones, as the real level of wages in the private sector approximates at € 750 per month, while the nominal level of wages of the public sector approximates at € 340 per month.

Recent studies for the shadow economy of Bulgaria urge readers to believe that shadow economy has never been greater than 25% to 30% of the GDP of country, having in mind that GDP for Year-2007 was about € 28 billion.

In Bulgaria, legal entities /company tax-payers/ and citizens /individual tax-payers/ are expected to pay in taxes for Tax Year-2008 about € 1,1 bln. each of these tax-payer groups, at 10% FTR. However, at approximately 3,5 million employed persons in Bulgaria at a population of almost 7,7 million individuals, it appears that one employed supports two citizens of Bulgaria, thankfully to being tax-obliged. Simple computations prove that GDP per capita per month in Bulgaria for 2008 approximates at € 340, while, if GDP is computed per employed per month for the very same 2008, this number would approximate to € 750.

If introduced, a FTR-system should come along with a set of other economic and budget measures, as it would definitely favour "the successful" and harm the poorer.

For example, "a successful" businessman in Bulgaria could put his costs for gas, lunches, papers & pencils, hotel charges et cetera, as expenses of his company, and this would basically not affect his lifestyle, and his company's success, unlike, the poorer – who at the moment, which they go out of home, they should have enough money to meet the rising price of the bus/metro/train ticket, to cover the ever-increasing gas prices, to commute to the place they work, to pay extra money for a burger with a beer for lunch, to pay more for water and electricity, and so on, and so forth.

This is a serious argument, as the consumer basket of an average Bulgarian household consists of: above 50% just for food and bills for housing; transportation, communications, and healthcare add another 17% to the spending pattern of an average Bulgarian household.

Another sad fact is that Bulgarians spend on buying clothes & footwear about 3% of their income, and for durable goods another 3%. The question with financing these purchases is as a “Sword of Damocles”, and people prefer to get credits to finance their daily needs, instead of getting into criminal activities.

The other way economic agents employ to obtain certain financing is to go into the shadow economy and do their own “small business games”, such as to be paid in cash, to get social deductions on minimum rates of deductions, to sign two contracts – one for them, and one to show to the Tax Office, and so on.

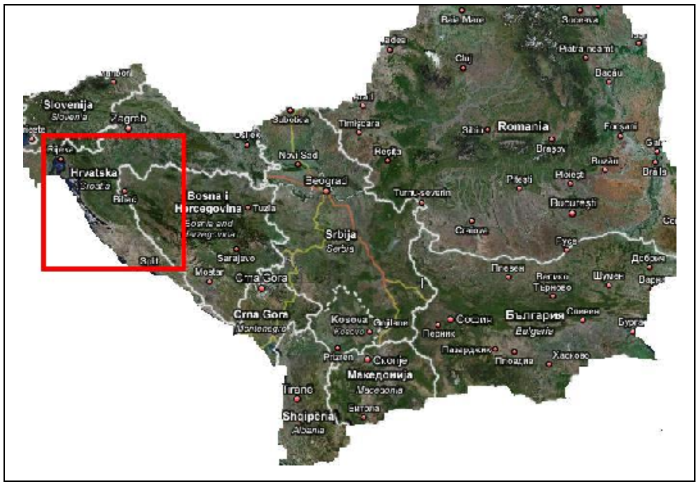
In Bulgaria, according to official statistical data, tax proceedings due to corporate taxes /CTR-proceedings/ and to income taxes /PTR-proceedings/ are at very close levels:

- FY-2006; Due to CIT – €0,667bln.; Due to PIT – €0,660bln.;
- FY-2007; Due to CIT – €0,915bln.; Due to PIT – 0,905bln.;
- FY-2008; Due to CIT – €1,13bln.; Due to PIT – €1,10bln./estimates for 2008/;

Therefore, it may be clearly stated that in Bulgaria the FTR-system is favourable to companies, and unfavourable to individuals, because according to this tax system, disposable income of individuals in absolute numbers decreased, while disposable income in absolute numbers of companies increased in real terms.

IV. Croatia

The state of Croatia has a population of about 4,5 million people with a GDP of €37,5 billion and a GDP per capita of €13,500 (2007).



Picture 4 Croatia

The net monthly wage per person in Croatia has been measured at about €700, while the gross monthly wage has been estimated at about €1,000 (2008). The minimum wage is fixed at €364 until June/2009.

The economically active population /labor force/ of Croatia is estimated at 1,8 million people, but the actual number of employed people is 1,5 million(2007). The unemployment in Croatia approximates ate 10%-12% per year. Therefore, the gross amount of wages generated in the Croatian economy per year is estimated at about €18 billion (2008), which is about 48% of the GDP of the country. The net amount of wages is estimated at about €13billion, if the official statistics is followed.

Croatia uses a methodology, called “National Classification of Activities”, designed in 2002 (NKD-2002) and synchronized with the one of the EU to observe and register all legal business entities. The latest statistics is from Dec/2006 and according to NKD-2002, there are 239,131 legal business entities, registered in Croatia.

Croatia used to have in 1997 a two-bracket system of personal income taxation, and the rates were 20% and 35%, respectively. In 2001 Croatia introduced a three-bracket system of taxation of individuals – 15%, 25%, and 35%. And, the last reformation of taxation of individuals’ incomes was in 2003, when Croatia introduced a four-bracket system of taxation- it added another rate of 45%.

The Corporate Income Tax /CIT/ in Croatia is 20%, but a recent study of the Institute of Public Finance (July/2008) reveals that the overall number of tax-payments, which a legal entity has to make is 28, and the total tax rates accrues to 32,5%, where the components of this figure are as it follows: 11,4% for profit taxes, 19,4% for contributions, and 1,7% for other taxes.

The state of Croatia is an example of a country from the SEE-region, which is not inclined to introduce a flat tax rate, but just vice versa. Croatia is gradually modernizing its tax-system and the Ministry of Finance regularly updates all the information and improvements of the whole tax system of Croatia.

In conclusion, Croatia has never demonstrated willingness to introduce a FTR-system on personal incomes, and it has engaged itself in constant adjustments of its corporate taxes.

V. Kosovo

Kosovo is the newest state in the region of South East Europe and it has 30 municipalities. This tiny country has a population of about 2 million people (2007) with a GDP of €2,7 billion, measured by the PPP-mechanism, which is about €1,350 per capita per year, or approximately €113 per month.

Picture 5 Kosovo

Kosovo used to be the poorest province of the Former Republic of Yugoslavia, and presently is the poorest country in the region, if GDP is taken into account. It is known, that about 25% of Kosovo's GDP is due to individual remittances from Albanians outside Kosovo.

Foreign assistance to Kosovo forms approximately one-third (35%) of its GDP. With these facts in mind, it is more than evident, that basically, there is no economy existing in the state of Kosovo in the way modern and civilized societies imagine and know it.

There are certain estimates, according to which about one million Kosovars are under age of 25, which is about half of the population of the state. And, the labor force of Kosovo is estimated at about 830,000 individuals (2007), of whom 40% are considered unemployed. Therefore, the state of Kosovo may rely on about 0,5 million workers with an average pay of about one-third of the average pay-rate in Albania, or roughly €90 per month. These figures indicate that on average the cash flow to compensate salaried workers is estimated at €0,54 billion per year. There is, virtually, no labor market, although cash flows, remittances, bank transfers and other payments do exist in one or another semi-formalized way. The official currency is the euro and almost all state institutions abide, in practice, to the rules and regulations imposed by international institutions.

The World Bank recommended in 2006 to this state to introduce a FTR-system. Presently, more than 70% of the budget of the state is formed through collecting VAT, custom duties, and excise duties. There is certain statistics, which show that those who pay regularly taxes to the state are not about 30% of the tax-payers in the state.

There are certain estimates for Year-2006 that the property taxes collected from all municipalities totaled to about €3,5 million.

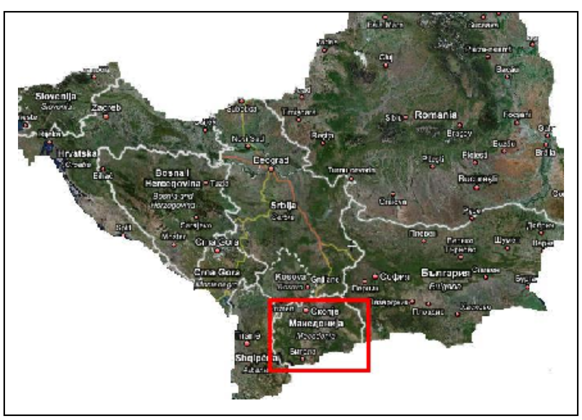
The American Chamber of Commerce has suggested in 2006 to Kosovo authorities to introduce a single CTR of 7% to 10% from the present 20% company tax rate, and a single PTR of about 7%, which, in practice, are suggestions for introducing a FTR-system in the state. Hence, if this 7% is applied as a PTR in Kosovo, it might be expected that the state budget of Kosovo may get about €40 million from individual tax-payers.

There are certain reports of The Ministry of Economy of Kosovo, according to which the budget of this state for the FY-2006 was €700 million. This stands to mean, that individual tax-payers of Kosovo bring about 6% of Kosovo's budget.

In practice, the state administration of Kosovo has the enormous task to rely on about €700 million budget to construct its social policies, which have to be designed in such a way, so that the state has to help to about 2 million individuals, of whom 40% live below the poverty line.

VI. Macedonia

The population of the state of Macedonia is about 2,1 million people and its GDP approximates at €5,5 billion, and its GDP per capita is about €7,300 (2007).



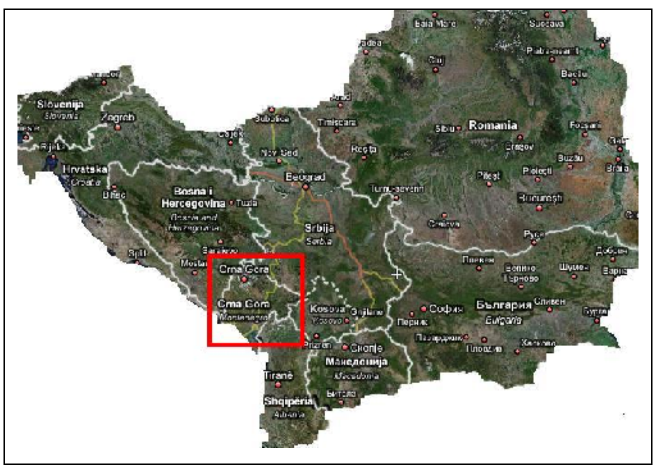
Picture 6 Macedonia

The Labor Force of Macedonia is estimated at about 900,000 people of whom 30% are unemployed, and of those who are employed get a gross salary of about €400 per month. Therefore, the legal gross cash flow of the employed per one year (2007) is estimated at €3 billion, which accounts at about 55% of the GDP of Macedonia. Hence, it may be concluded that this economy is extremely primitive, as it relies on its labor force, mainly, rather than on technologies, mechanization, automatization, computerization, et cetera. The poverty level here is very high – about 30% (2007), and more than two-thirds of the poor families are headed by a person who has no primary education or some primary education. This means that roughly 600,000 Macedonians are poor and about 400,000 are illiterate. Macedonia is among the countries, which introduced a FTR-system on personal income with a rate of 10%, since January 1st, 2008. Until this date Macedonia used a three-bracket tax system for personal incomes – 15%, 18%, and 24%. In addition to tax changes, regarding the PIT, Macedonia also decreased the CIT to 10% and dropped to zero the taxes, if profits are re-invested for a period of 10 years. The Tax Office of Macedonia has planned to collect revenues for Budget-2008 of approximately €2,1 billion. It is planned €140 million to be collected through PIT (6,7% of budget proceedings), and €90 million (4,3% of budget proceedings) to come from company income taxes /CIT/. Therefore, the state of Macedonia has planned for the Tax Year-2008 to collect on average about €22 from each one of the 630,000 employed individuals in the country.

Macedonia also designed another tax advantage for all (individuals and businesses), who draw a decision to invest in technological parks. Such economic agents will be levied with a tax rate of 5% for a period of five years. Thus, it may be concluded that the state of Macedonia is heading towards minimizing tax rates for individuals and companies, as most of the SEE-countries do.

VII. Montenegro

Montenegro is perhaps, the smallest country in the region with a population of about 0,63 million people and a GDP of about €2,5 billion with a GDP per capita of about €9,000 (2007).



Picture 7 Montenegro

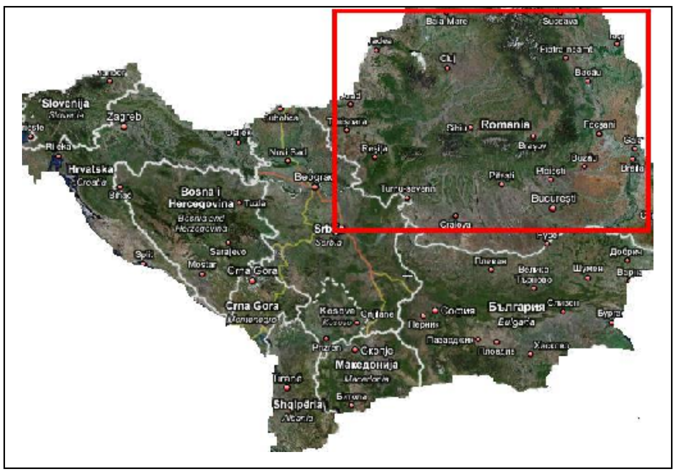
Montenegro is also comparatively young state. It joined the World Bank and the International Monetary Fund /IMF/ in January/2007. There were about 156,000 employed in 2007 and the unemployment rate for the last year was 15%. The average gross wage for the same year was calculated at €500 monthly. Therefore, the statistically observable cash flow in the forms of wage payments in the state of Montenegro totalled to about €1 billion in 2007, which is about 40% of the GDP of this economy.

Montenegro introduced a flat tax rate of 15% for personal incomes on January 1st, 2007. The state plans to drop this rate at 12% in January/2009. In addition to that the state also schedules to equalize this rate with the corporate tax rate to a single FTR of 9% from the beginning of 2010. Estimations, based on the Budget-2007 of Montenegro, show that about €30 million were collected from PIT.

The state authorities plan to decrease the tax rates in time, thus joining the general trend in the SEE-region of lowering tax burden of economic agents and unifying tax rates.

VIII. Romania

The state of Romania is comparatively large state as its population is estimated at about 22 million people and its GDP is estimated at €121 billion, and the GDP per capita is about €10,000 in 2007.



Picture 8 Romania

Romanian economy is constantly growing and its labor force of 9,5 million people, of which 4% to 5% are unemployed (2007) get on average a gross salary of €450 per month. Thus, the cash flow in salaries, based on the average gross salary in the country is estimated to €50 billion per year.

Although the economy is growing the share of the credits is growing by 50% each year for the last five years. The VAT in Romania is 19%, but VAT on medicines, hotel services, newspapers, books, movie tickets and museum fees is set to 5%.

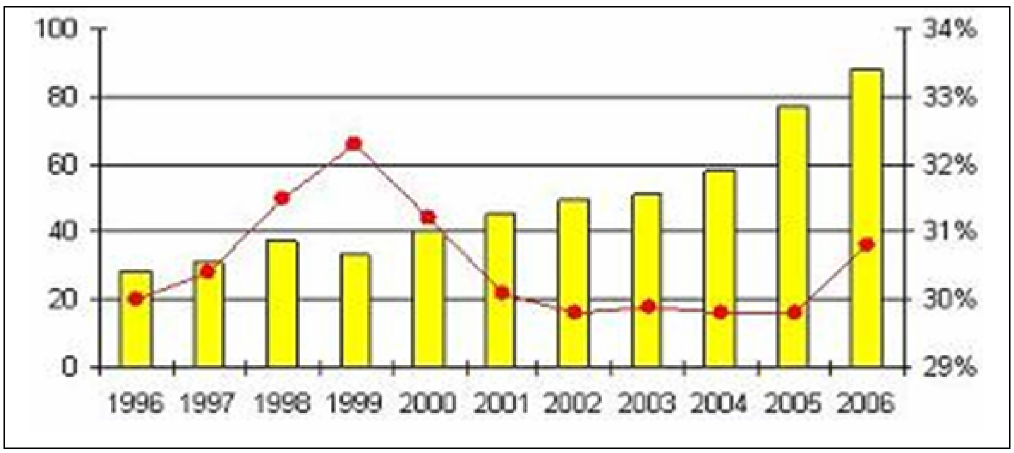
Since January 1st, 2005 all property transactions are subject to a single tax of 10%, payable by all local companies. There is no taxation on incomes due to interests received and investments made. There are no taxes on gifts and on property inheritance.

Romania decreased by 6% the dues on social security since the beginning of 2008, because the security burden is approximately 46% from the salary of a worker.

There was a tax reform initiated in 2005 in Romania, which altered the progressive tax system on personal incomes from a two-bracket system – 18% and 40%, respectively, to a FTR of 16% for all individuals. The CIT was decreased from 25% to 16%. In essence, the PIT and CIT in Romania are equalized to a single a tax rate of 16%.

Since the very introduction of the new FTR-system the Romanian government was worried about budget revenues, but in this specific case, Romania was able to increase its budget revenues due to this new system of taxation.

For Tax Year-2005 Romania collected revenues from taxes at 29,8%, if they are computed as a share of the GDP. For TY-2006 this figure increased by 1% to 30,8%.



Graph 4 GDP and Government proceedings as % of GDP of Romania

On the above Graph-4 is illustrated the period from 1996 to 2006 and the GDP of Romania in billions of Euro is constantly increasing /left-scale; yellow blocks/. And also, the graph illustrates the government proceedings as % of the GDP /right-scale; trend line/.

Although the new tax system is considered as a successful one by the official authorities, it has some "loopholes". Firstly, there is a preferential tax regiment for the small enterprises, which, in reality, means "tax evasion". Another loophole is that Romanian farmers and those engaged in agricultural sector are merely taxed. There are certain estimates, according to which 30% to 35% of the population is not subject to taxation due to the loopholes of the system, which resembles the situation in the poorest economy in the SEE-region, namely, the economy of Kosovo.

There is a study of the Romanian Academic Society /SAR/, which shows that if the FTR-system has a wider tax base, that is all economic agents subject to equal conditions, then the budget proceedings could approximate to 33% of the GDP of the country.

According to the European Central Bank /ECB/, the governmental expenses of Romania total to about 33% of its GDP. Therefore, Romania could have the chance to balance its budget with this FTR-system. This figure of 33% of Romanian budget expenses as a percent of its GDP is comparable to the budget expenses of Ireland, which has the very same figure as a percent of its own GDP.

IX. Serbia

The state of Serbia is considered as a comparatively big country in the region of SEE. The population of Serbia is about 7,4 million people; its GDP is estimated at €30 billion, and its GDP per capita is €8,700 for the year 2007.

Picture 9 Serbia

The labor force of Serbia is estimated to 3 million people with unemployment rate of about 20%, with an average gross salary of €480 per month. Hence, the total legal gross, but averaged cash flow of the salaries in Serbia approximates to €14 billion, which is 47% as a share of the GDP.

It was January 1st, 2003, when Serbia introduced a FTR-regiment on personal incomes with a tax rate of 14%, which exchanged the three-bracket tax system of 10%, 15%, and 20%. Serbia also altered its CTR from 20% to 14%, thus joining the countries of SEE, which have planned and implemented such flat tax withholding on corporate and personal incomes.

It is has been reported that the Budget-2007 of Serbia has a budget surplus of €165 million and the total revenues for that year are about €7,4 billion. The share of taxes due to collection of personal income is about €800 million, which is about 11% of the state budget proceedings. Therefore, this €800 million, collected by the Serbian government in form of personal income taxes represent 14% of the income generated and declared to Serbian Tax Offices by individuals. Hence, the declared by the population total level of incomes for tax purposes approximates to about €5,7 billion for the TY-2007. This number is 2,5 times less than the statistically declared average salary in Serbia. Hence, this gap may be explained with the fact that, perhaps, there are some other taxes, which remain hidden, or the share of hidden economy is a great number.

In conclusion, Serbia is not a member of the EU, and it hopes to join the Union, perhaps, by attracting more international attention and businesses on its soil through this tax reform.

X. Slovenia

Slovenia is also a small country with a population of about 2 million people and a GDP of €33 billion, and GDP per capita of €22,500 in 2007. Slovenia is considered to be the economic leader of the countries from the SEE-region.

Picture 10 Slovenia

The labor force of Slovenia is estimated at 900,000 individuals, of whom 5% are considered unemployed. The average gross monthly wage in Slovenia is estimated at €1,300., while the minimum wage is €538. Hence, the gross statistically averaged cash flow of salaries in Slovenia is about €13,3 billion, which is 39% of its GDP.

All persons in Slovenia pay monthly personal tax income, and each working individual in Slovenia is assigned a unique number for tax purposes.

Slovenia has a VAT of 20%, although there is also a reduced rate of 8,5%. The proceedings in the state budget due to VAT-collections total to 9% of its GDP. Slovenia's VAT totals to 22% of all revenues of the state budget for TY-2007.

Presently, Slovenia has a three-bracket tax system for levying personal incomes – 16%, 27%, and 41%, while the CIT of Slovenia is 22%.

In its efforts to stimulate the economy, Slovenia taxes all enterprises, which invest in its business zones by 10%, and the intention of the country is to decrease the CIT from 22% to 20% to 2010.

Evidently, Slovenia also demonstrated certain intentions to decrease taxation on corporate profits, but is has not declared any plans to substitute its progressive tax system with a flat tax system, when the personal income taxes are subject to discussions. And also, Slovenia has not expressed any wish up to that moment, to equalize CIT and PIT in any near future.

General Conclusions

Each one of the ten countries from the SEE has its specific economic and political characteristics, so that drawing general conclusions for all of them, may seem irrelevant and inadequate. For instance, there is a great discussion about whether Kosovo is a state, at a first place, and then comes the question about its tax system. Another example is Croatia, which has better economic indicators than most of the other countries, but it is not a member of the EU, yet and does not have the privileges, which Bulgaria and Romania are granted for example. Romania is maybe the only one country, which has some detailed data about application and real effect of the FTR-system on the economy and its citizens. Other countries, such as Albania, Macedonia, Bulgaria do not have reliable statistical data yet.

That is why, here is the place to stress on the fact that experienced budget systems, such as the French, the British, the German ones, for example, and other “capitalism-based” economies are not inclined to adopt the flat tax rate system in their countries, However, there is a wave inspired among inexperienced economies, such as Bulgaria, Macedonia, BIH, and others, to employ in full a single flat tax rate system.

Therefore, the first argument against such a FTR-system is the argument that introducing FTR-systems in developing countries, only, but not in the developed countries in the EU, may be inconsistent to the common policies of the European Central Bank. A popular argument against introduction of a single flat tax rate system to SEE-states is that the so-called “economically developed” countries are placing great efforts to convince “the developing ones” to test something, which has never been tested in their own economies. For example, flat tax rate introduction in Ukraine failed to stop the ongoing tax evasion, and tax fraud practices in the country. There is no guarantee that this may not happen in some or all of the SEE-countries.

Secondly, these inexperienced SEE-economies are also economies in transition, which suffer to a great extent from the consequences of the command-administrative system of economic governance. For example, the case with the Czech economy proves that there is no evidence between the application of a flat tax rate system and economic growth. Contrary to a great number of economic expectations, Czech Republic employs an escalating tax rates system, which allows the country to have a twice greater economic size than the average in the Eurozone.

The third argument against the FTR-system is that two of the most influencing US economists: Robert Hall and Alvin Rabushka, admit themselves that: “it is a mathematical law that lower taxes on the successful will have to made up by higher taxes on average people”.

On the fourth place, comes the argument that progressive tax rates are actually designed in such a way that they are considered “automatic stabilizers” of the fiscal system of a state.

Thus, changing them into a single tax rate, this will create “disturbances” in the very fiscal policy of the state, as there will be no counter-measures against “heating” or “cooling” of economic progress of a state.

Another argument against introduction the FTR-system into the SEE-states is that introduction of a single flat tax rate by itself may not help economic agents of the state as a whole. In support of this, Table-2 illustrates some statistical facts about the number of tax payments, which exist in the discussed economies of the SEE, without Kosovo.

Tax Payments (number per year) - 2007				
Economy	Total tax payments	Profit tax payments	Labor tax payments	Other tax payments
Albania	42	13	12	17
Bosnia and Herzegovina	73	12	36	25
Bulgaria	27	4	12	11
Croatia	39	1	24	14
Macedonia, FYR	54	12	24	18
Montenegro	75	12	48	15
Romania	89	4	60	25
Serbia	41	12	12	17
Slovenia	34	1	24	9

Table 2 Tax Payments (number per year) - 2007

It may be observed that the overall number of “labor tax payments”, that is, the payments, which individuals pay on their earned income, are actually 60 for Romania, 48 for Montenegro and so on. And, businesses for example, in Albania, which is not a member of the EU, make 13 tax payments to settle their dues with the state budget, while for Croatia, which is also not a member of the EU, there is only 1 such payment.

Therefore, application of a single tax rate into these economies does not necessarily mean there are no other tax payments, which actually may neutralize or exacerbate the effect of a flat tax rate.

Another alarming issue is the total number of hours to comply with the tax laws and filling all necessary tax forms, and provide all information needed by Tax Offices. Table-3 illustrates for each of the SEE-countries the number of hours needed to comply with different taxes.

Time to comply (hours per year) - 2007				
Economy	Total	Profit tax	Labor tax	Consumption tax
Albania	240	120	96	24
Bosnia and Herzegovina	100	25	40	35
Bulgaria	616	40	288	288
Croatia	196	60	96	40
Macedonia, FYR	96	30	36	30
Montenegro	208	16	96	96
Romania	198	42	96	60
Serbia	168	48	60	60
Slovenia	272	80	96	96

Table 3 Time to comply (hours per year) – 2007

Here, one may see that an individual from Bulgaria will need 288 hours to fill all his tax forms and settle his communications and dues with Bulgarian Tax Office Authorities. If cross-country comparisons are employed, it is observable that individuals from Croatia, Albania, Montenegro, Romania, and Slovenia do need the very same amount of hours to comply with the requirements of their Tax Office Authorities.

The undisputable leader in this ranking, in terms of the amount of time businesses need to comply with declaring and paying taxes on the profits they make, is Albania with 120 hours, which is a period of exactly half a month for a company to settle its tax relations with the state of Albania.

There is also, another ranking, which classifies the SEE-states in terms of the total tax rate burden, decomposed on four main sections: profit tax burden, labor tax burden, other taxes burden, and statutory profit tax burden, as it is shown on Table-4.

Tax rate (% of commercial profits) - 2007					
Economy	Total tax rate	Profit tax	Labor tax	Other taxes	Statutory profit tax rate
Albania	55,8%	16,1%	35,6%	4,0%	23%
Bosnia and Herzegovina	50,4%	26,2%	17,7%	6,5%	30%
Bulgaria	40,7%	7,4%	31,4%	1,9%	15%
Croatia	37,1%	15,4%	20,3%	1,3%	20%
Macedonia, FYR	43,5%	11,5%	30,0%	2,0%	15%
Montenegro	33,9%	7,1%	19,8%	7,0%	9%
Romania	48,9%	9,3%	38,6%	1,1%	16%
Serbia	38,9%	14,2%	20,8%	3,9%	10%
Slovenia	39,4%	15,6%	19,3%	4,5%	25%

Table 4 Tax Rate (% of commercial profits) - 2007

Table-4 illustrates in details the situation with the overall tax burden, which an economic agent may face in the discussed SEE-countries. For example, although Bulgaria introduced a flat tax rate of 10% in 2007 on personal income, the overall burden for an individual was 31,4%, because of the dues on social security, pension fund deductions, health care deductions and others. This is the very same case with Serbia, which announced a single 14% tax rate on personal incomes, but it actually deducts almost 21% from the salary of a worker. The situation in Romania is the same, or maybe worse. Romania has announced a 16% single flat tax rate for all individuals, but actually the overall tax burden on incomes from labor was 38,6%.

Therefore, a single flat tax rate on personal incomes is not a panacea by itself. A more complex solution should be searched for – a solution, which takes into consideration all deductions for social, healthcare, and other accounts along with a formula for comparatively equal distribution of national wealth among economic agents of a state.

If the focus is placed on the corporate tax rate, then the case with Albania shows that Albania announced a CIT of 10%, but the overall tax burden on a company's profits is 16,1%. The case with the state of Bosnia and Herzegovina (BiH) is the same. The state announced a CIT of 10%, but the actual tax burden on profits is 26,2%.

As a final conclusion, it should be stated that this problem – introduction of a flat tax rate on levying payroll earnings and a flat tax rate on companies' proceedings, and especially introduction of a single FTR-system into inexperienced economies, will be rather similar to a jump into the "emptiness" than a powerful impetus to transitional economies. This is an alarming issue of societal importance, which has to be analyzed with due diligence as economic tests on impoverished societies happen to be unsuccessful most of the times.

TRADE UNION STRATEGIES *by Prof. Krastyo Petkov*

Preparation of the present Brochure was preceded by field researches and debates on fiscal innovations in transition economies in the region of South East Europe /SEE/ and on the link of these innovations with the institutional social dialogue.

As a party in this dialogue, regional trade unions are amongst the first receivers of information of intentions of the national governments to make a radical turn in the tax policy decision making process, that is to drop out the progressive tax system, which typically is employed by the traditional EU states as well as by the developed countries and to implement a single flat tax system. In such a privileged position are also the organizations of employers. However, unlike the last, which as a rule, accept with a great share of enthusiasm and favor the single flat tax rate system, trade unions are precautious, and tend to demonstrate reserves to the fiscal experiments.

Does this mean that trade unions are the conservative party in the national dialogue and do they risk to be blamed of being the obstacle to the progress of economic and social reforms? Is it enough trade unions to be just critical to the national governments and organizations of employers, which seemingly, shape an active and motivated “alliance of promoters” of the flat tax in the region, and also try to systematically pressure the weaker representatives of the waged labor and the individual tax-payers?

To answer these questions, it is essential to firstly take a look at the new processes, which occur in the transitional economies, to look at what actually happens to the European Social/Market Model, and to pay attention to the convergence /diversification-respectively/ of the national economic systems.

Global trends

From geographical point of view, the analysis of this Brochure shows that SEE is experiencing a real boom in the spread of the flat tax rate system. According to the data as of 2008, 30% of the states, which employ fiscal innovations, are located in this region. And, if the “first wave” of the states, which introduced flat tax rate systems in the early 90s /the Baltic states and Russia, and Slovakia/, is added to this percent, it becomes clear that for a period of 15 year, the Eastern European region has turned into a compact test-field for testing the pros and cons of the new global fiscal models.

The paradox here is that the country of origin of this tax system – the US, and to that country we add all the rest economically developed Western European countries, one could see that the single flat tax rate is not applied. Moreover, the EU does not have demonstrated any intentions to debate on this issue of changing the predominant progressive tax rate system with the flat tax rate one.

Consequently, there are some more, still undeclared reasons for the application of this new tax philosophy and the recent trends in the Eastern European style of tax reforms. Researches in the region show for the last 10 years that the global leading factor of changes, which happen right now is the *undisputable hegemony of the neo-liberal model of the economic transition.*

Protagonists of this model are known – namely the International Financial Institutions /IFIs/, which define the strategy and control the tactical schemes of the reforms in the Eastern Europe. At the same time, these IFIs strictly follow the logic and timing of the so-called Washington Consensus.

However, the specific reasons are hidden in the weakness and fragmentation of syndicate movement in the region, as well as in the deficit of joint actions from the side of the individual tax-payers.

The Exceptions

In this particular case, the exceptions confirm the rule, that strategic decisions for fiscal reforms are initiated from outside. Exceptions can be found in the national strategies of Slovenia and Hungary. The former Yugoslavian republic is the first and was the one until recently country, which opposed the IFIs for transfer of the flat tax on its territory – and this was not an isolated act, for Slovenia a decade ago firmly decided not to follow the monetary model of reforms, imposed by the IMF and the World Bank in the region.

Organizers of the opposition of applying the flat tax rate system in the period 2005-2006 were the Slovenian trade-unions, who walked through the whole cycle of actions: from the negotiations point to organizing national protests. And, finally, they won the battle.

The strategy of Hungarian trade unions in 2007-2008 is a little bit different. They play with the tools of professional debate, they organize lobbying campaigns to engage the decision-makers in the Government and Parliament. As a result of this strategy, in the summer of 2008, the Hungarian Government declared that it drops its intentions to implement the flat tax rate system.

In Romania and Bulgaria trade unions an active role in providing expert analyses, criticizing primarily the social consequences, which the flat tax rate system would draw, but trade unions of these two countries never go further to organize effective protests.

Tax Dualism and Dumping

Is there a lasting economic effect due to the implementation of a low single flat tax rate, which effect would result into a growth of Foreign Direct Investments /FDIs/? As it is underlined in the prologue of the Brochure, in different states, such as Russia and Bulgaria, this trend does exist, but still it is in a very beginning phase.

Fiscal change by itself may not solve the problem of overcoming the lack of “fresh” capital on the emerging markets through attracting strategic foreign investors. Foreign investors are more influenced by the elements of the business environment, such as modern infrastructure, effective communication, low corruption rate, effective administrative services, qualified labor force, et cetera.

The sharp turn in the fiscal policy of a whole bunch of countries-members of the EU, or applicants for membership in the EU, puts the social partners in a situation of choice between two models of social development.]

The first choice is the traditional one. This is the “continental” choice, which favors tax proceedings, collected through progressive tax system, for this mode of tax collection creates stable financial basis for state-level initiatives and responsibilities in the social policy, such as social protection, social aids, poverty relieves, and others.

The second choice is the neo-liberal “Anglo-Saxon” model, which favors the low tax rates and social security deductions. This model helps businesses first, because of the expectation that the economic growth of businesses will automatically produce welfare for the majority of citizens. However, sound proof of this hypothesis has never been demonstrated.

Today’s geographical division of tax models in the EU is as it follows: low tax rates on the East and significantly higher /progressively growing/ tax rates on the West.

As it is known, EU supports the newly entered members of the Union and the applicant countries for membership in the Union through different types of funds and programs. This is the way it is, in order for EU to make easier the economic and social adaptation of these states to the levels of quality of life in the Community.

Tax dualism is playing as a set-back to the system of wealth transfer, and sooner or later the issues of who is using the money of the tax-payers from the developed European states, and how this money is used. Moreover, intentional fixing of corporate and income taxes at low levels in the economies from the Eastern European zone, along with significantly lower salary rates are actually an *unhidden form of dumping*, that is a form of unfair competition in the efforts of attracting FDIs.

This strategy in its order prevents from organizing joint pan-European trade union initiatives, and also it collides employees from same or identical industry branches or sectors of services. The most recent case is the example with the decision of NOKIA to relocate from Germany to Romania. This is a classic proof for the forthcoming conflict of interests.

What specific steps trade unions may implement to defend the states, which are directly and/or indirectly affected by the fiscal experiments? Obviously, the successful examples are few and specific to each and every country. For instance, in Slovenia, social partnership has traditions and consensus is the searched solution in situations of strategic choices. It seems that direct transfer of effective strategies is not possible, especially in states in a formal or interrupted social dialogue. However, on the basis of comparative analysis and the leading experience of partners, one could point out *a packet of actions*, which may be useful for all trade unions in the region of South East Europe.

Parallel Expertise

Arguments of protagonists of flat tax rate system are not enough sound, nor proven by the financial practices. Trade unions should establish their own network of experts, employing independent specialists from the Universities, who are not institutionally dependent by the promoters of the flat tax rates. Special attention to pay on deserves the problem of unproved or ambivalent effects of the new flat tax rate system on the FDI, on the utilization of growing proceedings of the businesses for investment purposes, on the national budget proceedings after the implementation of the flat tax, on the simplification of tax code and tax practices, and so on, and so forth.

Alternative Computations

Trade unions should do their own computations on the dynamics of tax proceedings, on the incomes of individuals, on the capital proceedings of businesses, on social disequilibrium, and on other key indicators. More specifically, trade unions should have comment on problems, such as growing societal disequilibrium due to not levying profitable businesses and the rich part of the society, in practice, when the progressive tax system is not in force. It is worth paying more attention to the influence of other factors on the growth of tax proceedings in the state budget, which factors may be the inflation rate, the Consumer Price Index /CPI/, excise duties, and others. Also, a special attention has to be paid on the relatively higher tax burden, imposed on the lower-level income individuals.

Partnership Building

Potential strategic ally to trade unions are individual tax-payers, consumer societies, associations of small- and medium-size enterprises, and self-employed. These groups are the most affected by the implementation of the flat tax rate system, and these groups form the layer of the so-called “strategic losers”. In a case, that the pressure on social dialogue to draw changes in the employed fiscal model, which is based on the idea of applying a low flat tax rate may end with no success, trade unions should initiate a national alliance with the public sector, which through a parliamentary pressure or/and elections has to change the situation.

Late actions may be fatal, because of the “no-turning-back point”, at which, a change back: from a flat tax rate system to a progressive tax rate system will have incomparably higher social and political price, which has to be paid by the society.

At last, there is another issue of strategic importance, which has to be commented on. The flat tax rate happens to be just another tool for speeding up the process of social layers’ disparity. To trade unions this is a direct challenge.

Trade unions were in the role of societal “peace-keepers”, and hence guardians of political stability, in the period of economic transitions. Trade unions suffered the consequences of couple of waves of societal division and polarization. According to the property indicator, the Eastern European societies are nowadays deeply divided to a very “thin layer” of property-owners and to a majority of having no material goods individuals.

These societies are divided to winners and losers, as a result of the reforms. These societies are divided into those who have a job, and those who do not have one, and so. However, presently, these consequences are considered, as “publicly explained” in one way or another, and they are now, partly accepted as “inevitable” consequences due to the transition to capitalism-based market. But this is not the case with the flat tax rate system, as it does not fit into this line of ideological reasoning.

Why this is so? It is so, simply because the absolute majority of capitalism-based, market societies /liberal and social/ do not practice this model. The logical reasoning is: the capitalism-based market societies know that the effects of such a model are counter-productive to the concept of democratic capitalism for "admissible inequality". On its turn, the financial-economic global crisis pushed many businesses into bankruptcy, made many people jobless, and created a growing poverty rate. However, this crisis will deepen the social inequality in the developed countries and in the emerging market economies. Consequently, it is time for a strategic global trade union initiative.

Successful may be only a coordinated pan-European initiative of trade unions.

Formation of an EU, as a Community, consisted of two social-economic zones, will be a challenge to the whole European trade union movement.

APPENDIX-I – Wage Flow Estimates in SEE for 2007

Wage Flow Estimates in SEE for 2007

SEE-State	GDP	Population	Employeed Individuals	Gross Average Wage per month	Gross Average Cash Flow of Wages of Employed per year		Flat Tax Rates	
	(in billions €)	(in millions)	(in millions)	(in €)	(in billions)	(as % of GDP)	Current PIT	Current CIT
1.Albania	€ 8,0	3,2	1,0	€ 280	€ 3,4	40%	10%	10%
2.BiH	€ 11,0	3,8	1,0	€ 480	€ 4,0	50%	0%; 10%; 15%	10%
3.Bulgaria	€ 28,0	7,7	3,5	€ 250	€ 10,5	38%	10%	10%
4.Croatia	€ 37,5	4,5	1,5	€ 1 000	€ 18,0	48%	15%;25%;35%;45%	20%
5.Kosovo	€ 2,7	2,0	0,5	€ 90	€ 0,5	20%	n.a. (7%)**	n.a.(10%)**
6.Macedonia	€ 5,5	2,1	0,6	€ 400	€ 3,0	55%	10%	10%
7.Montenegro	€ 2,5	0,6	0,2	€ 500	€ 1,0	40%	15% (9%)***	(9%)***
8.Romania	€ 121,0	22,0	9,5	€ 450	€ 50,0	41%	16%	16%
9.Serbia	€ 30,0	7,4	2,4	€ 480	€ 14,0	47%	14%	14%
10.Slovenia	€ 33,0	2,0	0,9	€ 1 300	€ 13,0	39%	16%;27%;41%	22%
TOTAL	**€ 280,0**	**73,3**	**21,0**		**€ 119,0**	**42,5%***		

* Percent of total GDP of SEE-states;

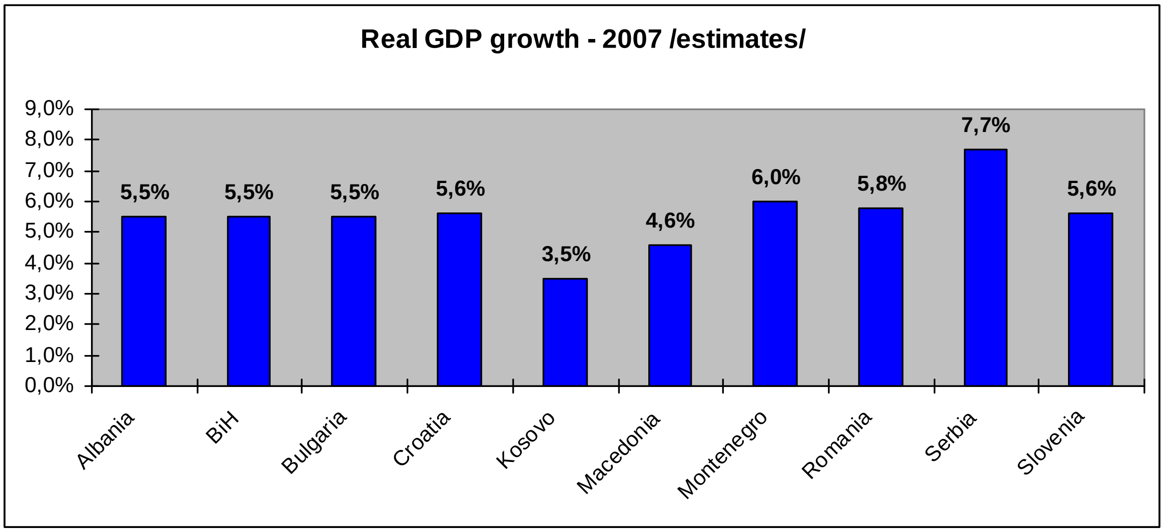
** Official data not available /n.a./; Suggestions by the American Chamber of Commerce

*** A single FTR of 9% for PIT and CIT will be introduced in 2010

The size of SEE-regional economy (the ten states in scope) is estimated at €280 billion for the FY-2007. There about 21 million people employed in this regional economy, which accounts for a little bit over one-fourth of the total population statistics. The gross average cash flow of wages of employed individuals approximates €120 billion, which is about 42,5% of the total GDP of the ten SEE-states. Actually, this is the money in question in the SEE-region in terms of the statistically observable and reported figures, regarding the value of personal incomes.

The last two columns show the personal income tax /PIT/ and company income tax /CIT/ for 2007 by countries.

APPENDIX-II – Real GDP growth – 2007 /estimates/



The graph illustrates the real growth of GDP for 2007 of each of the countries from the SEE-states in question.

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* The section about the State of Bosnia and Herzegovina (BiH) is a contribution of Mr.Suad Muhibic – an expert in UNDP.

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