ANALYSIS

Wealth Tax in Bosnia and Herzegovina

A Contribution Towards Equality and Democratization

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- This extensive study of history of taxation and theory of taxation has shown that a wealth tax can be an important component of a tax policy as it is proven that it points to a political concern and orientation towards a system of measures that should facilitate more equal outcomes of capitalism. It can boost a more efficient social policy and entails also a potential to correct the common trend of an increasing accumulation of wealth in the hands of the few.

- The wealth tax may be an important mechanism in reversing wrongdoings of the failed privatization in BiH, illicitly obtained wealth and grey economy. Wealth registries that are necessary for imposing a wealth tax, work towards democratization of capitalism, destigmatize entrepreneurship and capitalists, and correct mistakes of failed privatizations in a very systematic manner.

- Potential introduction of a wealth tax in BiH can provide important source of revenue given estimates of total wealth in BiH amounting to 114 to 218 billion KM using different methodologies, which if taxed at only 1% could yield between 1.14 to 2.18 billion KM in tax revenue.

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Content

Summary of the Study

Traditionally, a right to tax exists and is theoretically justified only after the basic human needs are met. Accordingly, fair taxation implies that the ones who have more wealth, pay more taxes, and thus finance state and public services such as security, education or healthcare. This study shows that throughout history, taxation has changed its form where for instance today, income and spending are increasingly taxed (income tax, VAT, health insurance, social security etc.) because such taxes are better managed and are more efficiently collected. These taxes also have a broader base in that they are applied to a wider tax base i.e. the population (e.g. we pay a 17% tax when purchasing products and services in Bosnia and Herzegovina). To simplify, it is quicker and easier to fill state budgets by taxing a large number of people through salaries or purchases, rather than selectively taxing once it is determined that someone has a surplus of money and should pay more taxes.

This study offers historical proof that systems that have taxed wealth before or are currently taxing it, have reduced inequality in their society. Accordingly, we can conclude that wealth tax in such systems is politically significant, important for equality and implies a more even distribution of national income. In these societies, taxation of wealth was followed by a series of measures such as progressive taxation of income and profit, in order to correct market outcomes of a capitalist model.

If we ask ourselves whether it is possible to achieve a fairer income distribution in a society without taxing wealth, we have to first look at the wealth concentration trend over the past few decades in the developed capitalist countries. Data indicates that 1% of the world's population possesses about 90% of the total wealth. Although we do not have official numbers for the national income distribution for Bosnia and Herzegovina (BiH), except for odd media reports on an increase in the number of millionaires and billionaires in Bosnia, the drastic results of the capitalist model in BiH exist in terms of inequality expanding. As such, available data is a good indicator of inequality being on the rise BiH.

The questions then arise: "Why are the wealthy becoming wealthier and the poor poorer, and how do we correct this dangerous and unjust trend in the society? What are the policies that can make the society more just and the outcomes of economic system better for all citizens?"

Vast room exists for corrective measures in fiscal policy, especially in the area of tax policy. Bosnia and Herzegovina inherited a large portion of the former Yugoslavia's tax policy in which the working class was dominant and where the tax system was created on taxing incomes from which the pension fund, healthcare and other state functions were financed. There was no progressive tax as there were no major disparities in incomes. Profit as capital did not categorically exist, and as such, it was never significantly taxed nor were there progressive types of taxation. Capital belonged to everybody and income tax belonged to the society. Therefore, there was no need for this form of taxation. During transition to the capitalist market economy, Bosnia and Herzegovina did not adopt a tax policy that followed this economic model change. This paper provides an overview of the BiH tax policy where an indirect tax, in the form of VAT (Value Added Tax), is added to the already significantly taxed labor incomes, which tend to mostly burden those with the lowest earnings. VAT is proven to be a very regressive tax which the statistical evidence for BiH shows that VAT tends to burden those with the smallest earnings[1]. This double taxation of the working class that includes a significantly high labor tax, as well as a tax on spending, is unjust and has to be changed in favor of these people and greater tax burden has to be shifted to the ones with greater wealth.

1 It is clear that due to the marginal propensity to consume, higher proportion of income of the poor is spent on goods and services (and there is lower percent saved if any), hence the higher percentage of tax that is paid in regards to their income when compared to those who have higher income. Those studies that claim that VAT is not regressive assume that saving and borrowing are smoothing out these effects, but these assumptions are very questionable as poor people have no savings while borrowing makes them only poorer.

To see the statistical evidence on VAT being regressive, please see *Economisch Statistische Berichten*, where Rens Trimp of the Central Bureau for Statistics and Flip de Kam of Groningen University show that while income taxes in the Netherlands are highly progressive, all the other taxes (VAT, social insurance, excise taxes and so forth) are so regressive that the total burden of taxation is almost flat across all income groups. Everybody pays about 40%. (*The Economist*, December 1, 2011 issue)

This study also demonstrates that room exists for more progressive types of taxation, considering that the countries of the European Union, even the ones that follow a more liberal, Anglo-Saxon capitalist model, have a more progressive income and profit tax, thus there is flexibility in the tax policy which would lead to a more just society in Bosnia and Herzegovina. The following question is then raised: Is it necessary to tax wealth if we choose to progressively tax income and luxury goods? Wealth tax is necessary as a corrective measure, primarily because of systemic errors and earlier privatization that had poor outcomes. This type of taxation is also a more efficient systemic measure, that can fix previously accumulated capital, thus amending amassed injustices that permanently threaten a society and create imbalances. Such is a measure of a more equitable distribution of taxes in a society, which allows those who are wealthier to give back to a society that has enabled them to acquire their wealth in the first place. This study also demonstrates that taxation of wealth is propagated as a systemic corrective measure of outcomes, from the capitalist model set in order to prevent further dangerous accumulation of wealth by a small percentage of the population, which would jeopardize the social balance and survival of the capitalist model itself.

In 2011/2012[2], the Green Party in Germany proposed a wealth tax that would be payable as a one-time tax over a period of several years in order to balance out the fiscal burden that occurred following the economic crisis of 2007/2008 when the government used tax payers' money to protect equity owners. As such, wealth tax can be a remedial that goes beyond the normal fiscal policy, especially in situations where inequity from previous policies is more than visible and where the earlier outcomes are a hindrance to a more just society and democratization of capitalism.

Another question comes up and that is: Is wealth tax used only as a political measure that aims to fix failed privatization and accumulation of capital in the gray economy from the past two decades, or is this policy capable of simulating a better business environment by collecting significant tax revenues in order to reduce labor income taxes and thus increase employment?

This study illustrates potential for taxing wealth through several different methodologies and shows that the total capital in BiH has been assessed to be in the range of 73 to 218 billion KM (Bosnian Convertible Mark). Taxing this amount with a very symbolic rate would result in a 0.5 to 1 billion KM in tax revenue per annum. Taxes collected from these sources, compared to the current structure of tax collection where direct taxes make up around one billion KM, are quite significant and can become a mean for financing other tax reforms set forth in the Reform Agenda, such as unburdening the employment tax, reducing contributions for pension, health insurance and similar.

One important argument for introduction of the wealth tax and direct taxes is the proven[3] positive impact these taxes make on civic consciousness and political activism in terms of promotion of both, as well as how such measures contribute to democratization of a society. In addition to promoting activism and citizens' participation in political processes, establishment of administrative mechanisms such as *wealth registers* and income records of every individual, which would be available to various tax institutions, is an important measure in preventing corruption, gray market and potential tax evasions. Perhaps even more importantly, wealth registers would include a *national (net) wealth register* of a society that would list natural resources (which has been already done long ago by many developed countries) in order to create capability for better public policy planning and especially better economic planning. Public policies in the field of social policy are especially important because wealth registers enable

2 http://www.spiegel.de/international/germany/german-opposition-calls-for-wealth-tax-a-849131.html last accessed on June 30, 2017.

https://www.gruene-bundestag.de/files/beschluesse/vermoegensabgabe.pdf last accessed on June 30, 2017.

3 '…direct taxes calculate the spirit of civic responsibility among the tax payers. As, direct taxes are a way for the tax payers to directly contribute and make them take keen interest in public expenditure, weather the revenue raised is properly utilized or not. In other words, people try to be watchful on how much tax revenue is raised by the government and how it is used. Tax payers become conscious of their rights and obligations. In a democratic country, this civic consciousness checks whether there is waste in public expenditure…' Esmaeel E.S. (2013), 'The Impact of Direct and Indirect Taxation on Consumers', Journal of Engineering, Vol 3, Issue 6, pp 8-13.

social transfers. They also enable targeted social policies based on property status, i.e. the level of wealth of an individual, which will be a significant shift in relation to the current social policy in BiH which is poorly directed and based on acquired rights, rather than on a real need for social welfare.

Is there a way to streamline an introduction of this tax and what are the lessons learned from other countries that have experience with the wealth tax, which BiH can adopt in order to ensure implementation of a new effective and efficient policy? It has been proven that wealth threshold should be set high. It is also necessary to harmonize the progressive income tax rates with the revenue from the wealth tax, so that the effective tax rate would not become too high and would not motivate an outflow of capital from the country. It is also necessary to avoid tax exemptions through different forms of property, as such could motivate a transfer of capital into those assets that are tax exempt. The answer, therefore, is to have as simple of a tax law as possible that applies to those who are the richest. Such module is reminiscent of the simplicity of the *Zakat*, a passive symbolic contribution no longer used in Islamic jurisprudence. Along these lines, the wealth tax ensures that all forms of property are used for the betterment of a society, which the economic theory has also cited as one of the essential reasons for taxing all forms of wealth. In the absence of wealth taxation there is no guarantee that taxes will be put into service, while the wealth tax motivates positive economic activity and prevents the accumulation of wealth that does not contribute to the social good.

Wealth tax is, thus, a measure that achieves a number of socially beneficial goals, such as correcting the injustices of illicitly gained capital and reducing the great inequality that arose from the economic transition. Such taxes secure proceeds which reduce employment taxes and allow those who have less in this society to be free from the heavy rates of income and sales taxes. Therefore, injustice and inequality are reduced and the society becomes more stable. Wealth tax, as a direct tax, encourages activism and political involvement, as citizens care more about how the tax revenues, which are taken from what they have earned, are spent. This tax also has a deeper background in economic theory as it ensures that all production resources in an economy are truly put towards the interest of the society, since the wealth tax i.e. the capital, ensures that it is used for productive purposes so as to not lose value. Wealth tax builds the state and furthers the state's administrative capacity to collect taxes, to distribute social benefits on the basis of real needs and, more importantly, provides basic framework for long-term economic planning and economic policy development.

1. Political Economy of Increasing Inequality: The Reason for Taxing Wealth?

Bosnia and Herzegovina has been faced with an increase in social inequality during its transition from a centrally planned economic system to a free market economy. Failed privatization attempts are still perceived as being the primary cause of detriment for many members of the working age population, many of whom feel that their lives have been destroyed. In the eyes of the public, privatization process itself is seen as unsuccessful and corrupt. Inequality, as measured by the Gini coefficient, has increased from 0.24 during the time of the former Yugoslavia to 0.36 (OECD, 2014). This measure alone does not completely capture the general perception that a very small part of the population has actually benefited from the present economic system, (small part of population that has often been able to bend rules and laws for their own profit and benefit) while the general majority has been disadvantaged and deprived of a decent life, future and a right to work.

At the same time, Bosnia and Herzegovina has been going through a severe crisis when it comes to its public finances which reached its peak in 2013 when BiH accepted a conditional loan package from the IMF. Yet, the fiscal position in the country remains unconsolidated and the authorities continue to increasingly rely on credits in order to fund their budgets and cover debts. Since 2016, BiH has undergone two years' worth of continuous discretionary fiscal consolidation.

This process has included cuts to public spending, minor pay cuts and increases in regressive taxes such as excises, as well as slight increases in income taxes. Despite a clear objective of the Bosnian authorities to broaden the tax base, an introduction of a wealth tax has not yet been considered. A wealth tax could be an attractive option in regards to distribution and taxation of the wealthy as it would be an important element for social solidarity, particularly at a time of deteriorating living standards for a large portion of the population. However, in context of failed initial privatization and injustices that stemmed from it, the biggest advantage of the wealth tax, according to Piketty (2014), would be (social) justice that would be achieved faster than any courts would be able to reach it in regards to fixing tribulations made by illicitly obtained wealth, which in BiH was brought on by two decades of an informal economy, lack of rule of law and corruption. Indeed, where judiciary has been slow or where it is no longer possible to act through the judicial system, the wealth tax would provide an economic compensation to society as a systematic measure which counteracts the drastic socio-economic consequences of illegally obtained wealth and subsequent emergence of severely widening socio-economic inequalities.

In the current framework of liberal capitalism, social capitalist democracies have implemented sales and income taxes that are higher than taxes on wealth and capital, which is the case in Bosnia and Herzegovina as well. As such, the aim of a more just society which serves to justify taxation of income and sales taxes, should be revised and viewed from an angle for those for whom it should have brought benefits and welfare in the first place. Large social democratic states have not managed to resist negative effects of globalization stemming from the free flow of capital. This is mainly because national political systems are unable to control big capital as it moves into safe heavens and evasion of taxes, while citizens are burdened with having to finance the welfare state. Such injustices today threaten to destroy social democracy as a political preference due to the unfair outcomes of social capitalism, which are assigned to social democracy as an ideology and political option, while the recovery is sought in protectionism and nationalism--which unfortunately do not offer corrective potential to mend these injustices. As a result, the political sphere in a society then turns towards the populism.

Social capitalist democracy is seen as a political order where politics only enable manipulation of the state for particular interests, which only further deepen the injustices in the economic system. This is especially relevant in Bosnia and Herzegovina, where theoretically we have a big welfare state and have inherited policies of redistribution based on entitlements and populism in its worst shape, that are nowadays used in order to misuse the state and the political system for the benefit of the few. These are the same few who have supported illegal flows of money in order to avoid paying taxes to the state for over two decades now. However, we tend to see free market capitalism as privatization of state assets fueled by particular interests, which is very often done in order to garner big capital.

Finance capitalism has a tendency to favor those who have better access to assets, not just based on collateral which is the privilege of the wealthy most of the time, but also based on political connections. This creates an environment where wealth procreates wealth and such a system reinforces the injustices and inequalities in society that were accumulated over the past two decades in Bosnia and Herzegovina. In other words, as long as an opportunity to increase one's wealth through credit is not democratized, one can argue that wealth should be taxed in order to have an oversight on this tendency of the financial system to strengthen the rights of those who hold most of the capital. The ever-increasing concentration of wealth in the developed world, mostly controlled by the very few, proves that the system is not made to self-correct in order to achieve greater justice and equality, but a wealth tax can serve as a mechanism for correction of the injustices inherent in the system of financial capitalism.

In the current political economy of Bosnia and Herzegovina, tax system reform with an aim of remedying the injustices that were made by the economic system so far, can be considered. These injustices occurred as a result of illegal cash flows and tax evasion that was happening for far too long due to the absence of the rule of law, and resulted in accumulation of wealth in the hands of the few. At the same time, we can consider the injustices of the current tax system that inhibit working-class citizens and work against expanding the labor market and healthy investments. Wealth tax registers, even without raising great sums of money, could offer great advantages both in hindering the grey market and correcting the negative consequences of ill-gotten wealth, in a systematic manner and faster than any court system could, while at the same time they would promote equality, and democratization of capitalism (Piketty, 2014).

Regardless of these arguments, which are based on the political economy and an ideological perspective – and which are supported by historical evidence obtained in Bosnia and Herzegovina – in *Section 2* we examine theoretical background for taxing wealth. *Section 3* offers methodological approaches in assessing the potential impact of an introduction of taxing wealth in Bosnia and Herzegovina. This chapter also offers an analysis of scenarios where similar taxes were implemented in other countries, as well as recommendations that are proposed in regards to designing future potential wealth tax policy in Bosnia and Herzegovina. *Section 4* offers a conclusion with implications and recommendations for policy makers.

2. Theoretical Justification for Taxing Wealth

Theoretical foundation for taxation is ultimately a discussion on the role of the state and the function that the state provides through collection of taxes from its subjects. As such, the amount of taxes that are justified and are to be collected by the state, is determined through a collective agreement made by the citizens of a state. In this respect, classical liberals argue for a small state which is solely taxing its citizens in order to finance the government's limited role in providing security and rule of law. On the other end, in theoretical foundations of social democracy, the ideals of equality, solidarity and fraternity call for a significantly bigger role of the state, where among many other roles, the state should provide access to healthcare, education, and basic human needs for all of its citizens, so financing of these functions calls for higher taxes. The higher amount of taxes in social democracy is also required to perform the redistributive function and to ensure a just distribution of income within a society. In extreme circumstances, the state should also invest in infrastructure, research, and economic development—this would justify the sizable taxation of its subjects.

In economic theory, optimum taxation creates optimum revenues and is most efficient, that is, with the minimum waste of social well-being. Simply stated, taxation is not optimal if it begins to stifle the economy which in turn would result in the amount of tax revenues to decrease. Such a scenario ultimately reduces the welfare, lowers the living standards, creates social imbalance and leads to resentment towards the state and the authorities. Tax incidence in France, before the 1789 revolution, was extremely high and was seen as a mean to finance the lavish lifestyles of the ruling elite, which essentially triggered social unrest at the time. A parallel could be drawn in present day Bosnia and Herzegovina where a heavy tax burden is placed on the citizens who are employed in the formal private sector and are financing the ruling elite who are living well above the average of the society at large. Such an environment can lead to social imbalance and potentially to disintegration of the entire legal and economic order. This ominous side of the political economy of BiH reared its ugly head in February 2014 and prompted a change of direction in the EU policy towards BiH. Nonetheless, we have not seen any major changes since then when it comes to the structure of the economic incentives or the system, including taxation, which would have mended injustices of the present economic order in Bosnia and Herzegovina.

The confusing mishmash of financial liberalization, pursued by both liberal and social capitalisms that protect the capital in relationship to labor income and expenditures, is the framework in which we can talk about the potential introduction of a wealth tax in BiH as a way towards a more just economic and social policy. From this perspective, taxing capital gains that benefit from this system which is created easily by the state through the current financial system and its credit creation mechanism, appears to be very reasonable. However, in order to provide an economic justification for this notion, it is necessary to look back at the history and identify when and why states have stopped taxing wealth and instead started taxing expenditures and incomes.

In theoretical writings, there are three grounds for taxation: 1. Wealth, capital or actual gain; 2. Income; 3. Expenditure. The fourth ground for taxation which Francis A. Walker (1888) advocated so early in the economic history for, is capability, or an inborn or acquired power to produce or create something of value. The key discussion about fairness of ground for taxation over another, lays in the realm of fairness and tax subjects' relative capacity, in relationship to others, to bear the burden of taxation. **At one point in history, it was considered that equal taxation of all wealth was just and that personal income should not be taxed, as personal income should be considered primarily unavailable for taxation until basic human needs have been satisfied. At the same time, wealth was considered to be a good basis for a just assessment of the relative power of the subject in their relationship to others, to pay taxes. Only once the income is turned into wealth, and after basic human needs are satisfied, can we look into the capacity of one subject, in relationship to the others, to bear the burden of financing the state, or broader social goals.** In this context, the present tax systems where personal income and consumption before basic human needs are met, are completely opposite of the theoretical works on taxation.[4]

The reason perhaps lies in the fact that it may be easier to tax income and implement sales tax, as wealth assessment is complicated. Specifically, the question of wealth assessment is complex due to determining value of certain forms of wealth which has been changing in economic systems over time and has been gaining or in losing value. Nevertheless, certain forms of wealth have historically been a good way to assess the ability of individuals to pay taxes if that wealth or property had use or market value. In today's world where financial capitalism prevails, use value of property as a base for taxation and ability to pay taxes, has been complicated as property now is generally acquired through credit and not necessarily by savings, as was the case in the past.

Wealth or property that are acquired through savings, provide a good base for assessment of ability to pay taxes. Ability to save was also an indicator of better living standards and acted as a condition for better education and healthcare. In the past, taxing of wealth or property did not reduce one's motivation to save. In an environment where property, education or healthcare is financed through credits or loans, incentive for savings is reduced or lost, and the net wealth or resources after all credit obligations are subtracted, has to be the basis for assessing the rate of taxes. In theory, it is possible to finance large property value through credit, where the value of that property is the basis for the credit itself. Once the value of the given property declines and the asset bubble bursts, individuals that took out loans are unable to pay them back and are faced with financial difficulties. In the world of loan emissions, the value of property is more volatile now than it used to be in the past. In response to this problem, complex valuation controls are used nowadays as is the example in Norway, in order to determine the value of private homes before they are used as a base for taxation and before wealth tax is charged onto them.

Despite the complexity of calculating net wealth due to issues with valorization and loan liabilities against the wealth, the argument for taxing wealth is found in the very trends on wealth concentration over time. Data on wealth concentration indicates that the predisposition of members of a society to attain greater wealth has not changed and the argument that the motivation for saving does not exist is refuted by the very fact of concentration of enormous wealth in the hands of the few. In

4 This argumentation has received modern-age support through advocacy of Milton Friedman for the so-called negative taxes. In other words, not collecting taxes from individuals below a certain level of income, with money transfers or additional income up to the minimum necessary for a respectful life. Friedman, Milton (1987). Leube, Kurt, ed. "The Case for the Negative Income Tax." *The Essence of Friedman.* Hoover Institution Press: 57–68.

fact, the trends indicate that only a few percent of the population possess more than 90% of the total wealth in the developed capitalist democracies. As such, argument that wealth tax cannot be used any longer as a base for taxation is refuted, as wealth is accumulated and reproduced in a way that inequality today is on an increase more than it was the case in the past. In this context, introduction of a wealth tax makes even more sense from an economic and a social perspective.

In the context of wealth concentration and mechanism in a capitalist society[5], we could say that the majority of people might be less inclined to save (or their ability to save is reduced) and that savings are the privilege of the wealthy in a society. This then raises the question that should be answered of what is political power and what influences public policy rather than justifies the taxation of wealth (Piketty, 2014). In fact, high concentration of wealth stipulates for easier administration of the wealth tax with higher threshold levels. The system which relied on the argument that it was cheaper and more efficient to tax all income and spending rather than to tax net wealth, and which requires assessment of the ability to pay taxes, has failed- as this system has enabled tremendous accumulation of wealth in the hands of the few, while creating a high tax burden on labor income and spending. In the end, such a system is without a doubt wrong in taxing labor income or any income before basic human needs have been satisfied.

There is also the theoretical question on the use of capital and policies which are designed in order to ensure that capital is put to the best social and economic use. In this sense, we can argue that a wealth tax is a desirable policy to ensure that the owner of the capital puts it to a greater social use. In the former Yugoslavia, wealth or capital was put into economic use while belonging to a whole society, and it was assumed that its use to create economic value, belonged to everyone. In its socialist character, this wealth was exempted from taxes as the person or the entity that held this wealth was only a representative of the others. This argument in extreme cases can become justification for the state to take away wealth or to nationalize it, so that it can carry out the economic activity for the sake of the greater social good. However, such an approach does not have a foundation either in equality nor does it have an economic justification, as we can never be sure whether the individual or the state indeed invested the capital or the accumulated wealth in order to boost economic activity and thus contribute to the greater social good. This is rather obvious to us now who are witnessing many state resources not being properly used nor are they directed towards boosting the economic activity in Bosnia and Herzegovina. If there was a wealth or a capital tax implemented, it would force its owners (whether they are individuals or the state) to use it and we would see less waste of resources in the present economic system.

In this context, where it is impossible to guarantee that capital is going to be used to foster economic activity and create value, tax on wealth can serve as a tool which "pushes" capital from being passive, or rather it pushes its owners to bring wealth and capital into economic use so that it does not lose value. A wealth tax is therefore necessary to ensure that the owner of the wealth and capital, even if it is the state, puts it into economic use and boosts activity, so that it benefits the society. Wealth tax, therefore, serves as a mean to ensure greater justice and protect the economic interests of the society as a whole. This same reasoning is mentioned in the Islamic law when justifying *Zakat*, which is the tax on passive wealth of individuals. *Zakat* is a tax which is meant to motivate Muslims to put their wealth into a productive use.

In a narrower, more technical sense, optimum taxation is the one which achieves the greatest benefit for the consumers. **The outcomes of theoretical work on this topic indicate that the most efficient taxes are flat-rate taxes which depend on the ability, or take into account inequality of the ability of the tax subjects, to pay taxes. In this context, flat rates are almost ideal. However, understanding the ability to pay taxes is crucial**

5 Another proof that there is a need for reconsideration of the present day tax policy is the proposal to tax robots in the new economy (see *The Economist,* February 27, 2017) and the idea to introduce the Robin Hood tax on financial transactions, which was considered in the EU. This was done in order to get under control the socially negative consequences of excessive financial transactions that destabilize the financial system and that don't have a positive social function (see *The Guardian,* 18 February, 2017).

for the policy makers' design of a given tax policy. What N.G. Mankiw (2009) concludes while reviewing theories on optimum taxation is that the best way to tax, while taking into account the challenges of dynamic economic environment, is to make personal taxes in any year subject to income history. This is, in fact, close to the argument that taxing wealth as income accumulated throughout a year should represent wealth. Even Mankiw (2009:26) warns that to define wealth, we would have to take into account possession of all forms of wealth, including expensive movable property and luxury items. Not taxing these would penalize those who save in other forms of wealth.

Henceforth, the common denominator of various arguments is that a just taxation system requires an assessment of the subject's capacity to contribute towards the broader social good after they have satisfied their basic needs, and that they are taxed based on that estimate. Therefore, the first step for Bosnia and Herzegovina in creating a more just tax system would require an establishment of a wealth register, something that developed capitalist democracies have already done for hundreds of years. Also, in states where the tax base is lesser due to an active grey economy, the unavoidable need is to rely more on regressive indirect taxes like VAT. This should also be followed by a fall of investments and lower rates of economic growth where a reform of the tax system in such societies is considered as a necessary first step towards a healthier economy.

Finally, a tax system reform in BiH should steer the way towards a more just system of taxation that would take into account the broader global context which draws attention to the inequality created from relying on income and sales taxes, while the capital is exempt from aiding the state that has helped in its establishment[6] in the first place. Reform of the tax system and policy in BiH is even more important in the sense that it would cure injustices that have resulted from a weak governance and an established low tax base. Furthermore, it would address the slow institutional development which was necessary for a successful transition into a functional democratic capitalism that could be viewed as Bosnian type of a social capitalism.

There are four standard goals of taxation when we look at the existing literature on taxes, and those are: 1) an increase in revenue; 2) a reduction of excessive earnings and wealth inequalities; 3) political considerations and 4) the right to use taxes in order to stimulate economic performance on private markets. In this case, a wealth tax would serve the second goal while at the same time it would take on political considerations of taxing away the unjustified privatization opportunities, making it the strongest argument for introducing a wealth tax. Another important goal of taxation is its influence on economic patterns when it comes to private markets. In private market economies, taxes alter economic behavior due to the fact that they add on costs and consequently shift relative prices of goods and services on the market. This in turn affects the supply and demand, thereby allowing changes in prices to emerge out of taxation. A tax on wealth (wealth, property, buildings, fixed assets etc.) adds costs to all forms of capital that are not utilized in the process of production and hence should motivate movement of assets towards production. However, such tax also increases the effective average tax rate on income and as such it could conflict with the goal of economic efficiency due to ensuing high tax rates on income. This is the reason why the society itself should decide between taxing progressively both labor and capital income or taxing saved income in the form of a wealth tax, but not both, as this would be unfair and would create tax evasion trends.

As past accumulation of capital is the primary political motivation for taxing wealth in the presence of income taxes which are very low, Bosnia and Herzegovina can opt to tax wealth and to not introduce progressive income taxes. It could also, as an interim solution, choose to introduce a onetime flat rate tax in proportion to one's wealth and later on present more progressive income taxes. Such taxes were introduced in Germany following World

6 The state aids capital through the financial system as taxpayers' money is used to finance last resort credits or act as the final solution for the financial system, thus aiding in the development of moral fallout. In this system, the rich collect winnings, while the taxpayers foot the bill in case of market flops.

War II in the form of the so-called *Equalization of Burdens Law*, which included a wealth tax of 50% of net wealth to be paid out in up to 120 quarterly payments or over a 30-year period. In combination with inflation and high growth rate, the tax was not too imposing and was easily collected. Revenues were then used to support and compensate those who had suffered the most during and after the war. In BiH, such revenue could be used to support those families that suffered the most over the past two decades, but more importantly they could also finance an intergenerational fund to support vertical mobility by educating children from low income families and by providing the minimum income. A similar proposal for Germany was made by the German Green Party during their 2013 election campaign. They proposed introducing a 15% tax on net wealth as of January 1, 2012 payable in ten annual installments in order to balance out the fiscal burden of the financial measures that had preserved the wealth of the wealthiest following the financial and economic crisis of 2007/2008, but which had at the same time increased the public debt. The tax would be implemented on net wealth of above 1 million Euros with some special provisions for business. As such, Bosnia and Herzegovina could reflect on the political consequences of a weak state over these past two decades, as well as outcomes of privatization and the active gray economy, and should propose a corrective one-time measure to rectify these shortcomings. Imposing a tax on those who have a net wealth of 1 million KM and above could be a politically feasible move, but on the day this is to occur, the government would need to have a wealth registry set in place first. Consequently, a wealth registry is a requirement in order for this policy to take place and a strong argument exists for a need to build a fiscal capacity of the country whether to introduce the wealth tax or to introduce a corrective one time, lump-sum tax in proportion to one's assets.

In this paper, we argue that income tax rates in BiH are almost nonexistent in comparison to other countries and show that there is plenty of room for improvement in order to achieve the goal of equality when it comes to taxation. In section 3.1, different types of the present fiscal system in BiH are described and an argument for the necessity on policy adjustment in the sphere of taxation when the equity goal is concerned is necessary. Section 3.2 illustrates the growing inequality as measured through the Gini coefficient and indicates wealth tax features of the tax policy of a group of countries. The historical existence of a wealth tax is examined in order to show its prevalence in countries where redistribution caused a serious political concern, and where it reflects the presence of other important measures that exist as well. A historical assessment on existing wealth taxes in OECD countries is provided in Section 3.3. Furthermore, a macroeconomic approach in estimating wealth tax effects in BiH is outlined in section 3.4 in order to give an idea of wealth accumulation and to promote a discussion on the potentials of a wealth tax introduction or an introduction of a tax in proportion to wealth. Section 3.5 provides data on categories of wealth that are presently available in secondary sources and that could form the basis for a wealth register in BiH, while Section 3.6 gives a general macroeconomic approach to estimating wealth in BiH. Section 3.7 provides final policy considerations and examines potential issues with design of the fiscal policy in order to achieve equity and democratization of capitalism in BiH.

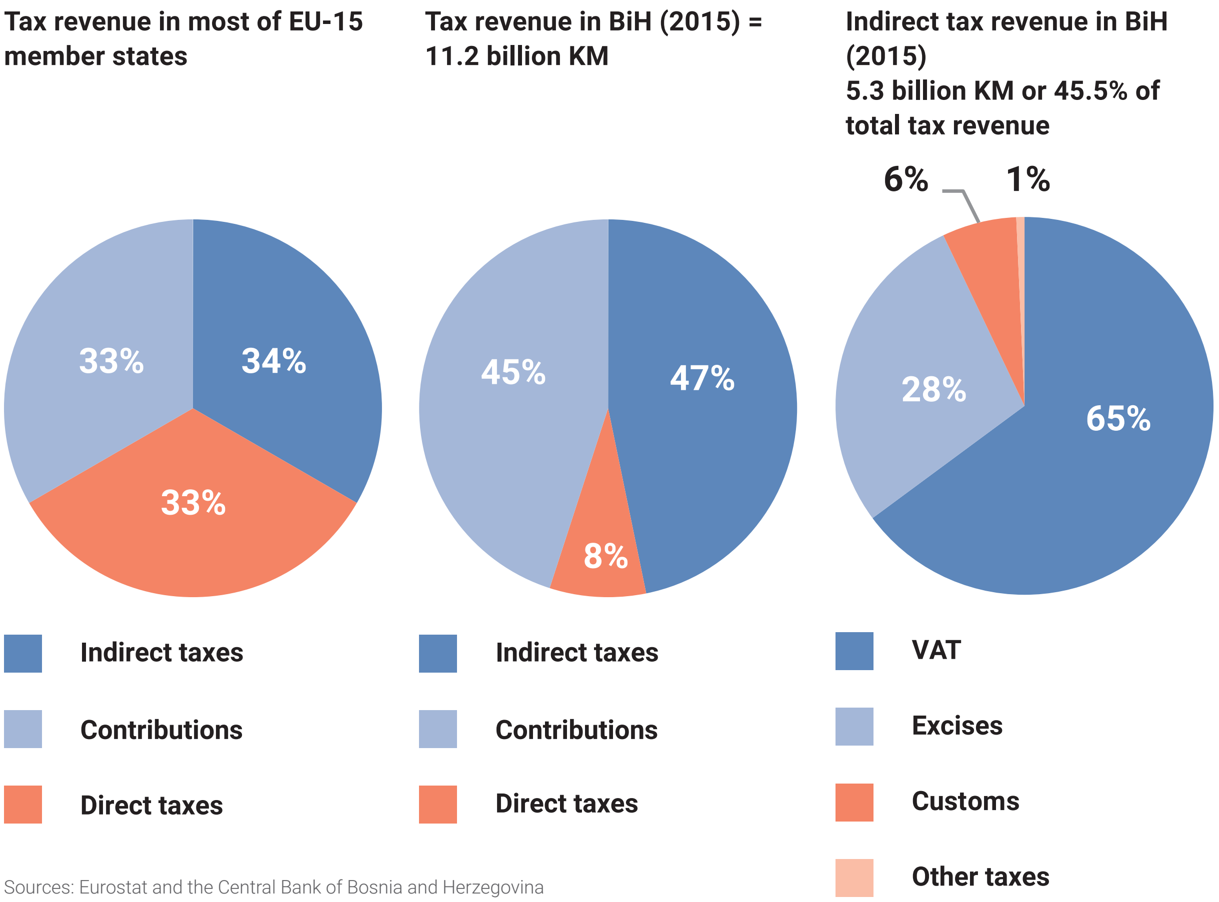
3. Estimating an Introduction of Wealth Tax in BiH

3.1 Evaluation Of The Current Tax System In BiH – Room For Major Redesign

In order to compare the tax policy in BiH with some of the other countries in the region, we will provide an overview of the current tax system in relationship to some of the other countries: the structure of tax revenue generated by indirect and direct taxes, as well as contributions.

Tax revenue in BiH and its entities in 2015 totaled 11,245.1 million KM, out of which indirect taxes amounted up to a total of 5,258.7 million KM, from which 3,255.9 million KM was collected through VAT, 1,408.1 million KM was collected through excise taxes, 239.9 million KM was collected through customs, 319.8 million KM through tolls and 35.1

Figure 1. Composition of tax revenue (EU and BiH)



Sources: Eurostat and the Central Bank of Bosnia and Herzegovina

million KM through collection of other types of taxes. The total tax burden in BiH amounts to 40% of the GDP. This is close to the adjusted EU average of 38.8% of the GDP. However, when compared to the Eurozone, the composition of the tax burden is quite different.

In the Federation of BiH (FBiH), direct tax revenues amounted to only 9.3% of the total tax revenue, while social contributions amounted to 45.2% of all tax revenues. Indirect taxes, therefore, contributed 45.5% to the total tax revenue. In most of the EU-15 member states, direct taxes, indirect taxes and social contributions contributed about a third or 33.33% towards the total tax revenue.

Such a setup shows the small amount of direct taxes that are collected in the Federation of BiH. Furthermore, the data shown in *Figure 2* indicates that the tax rate on capital income is very low in BiH compared to other countries, and that it is not particularly progressive. Comparison of income tax rates on labor income and corporate income, presented in *Figure 2,* reveals how much BiH and the region are behind when compared to the developed capitalist democracies in utilizing tax policy towards a more just and fairer capitalism. Hence, the time is now for the tax policy to be revisited and redesigned in order to achieve greater social cohesion. The alternate scenario in reforming the tax system towards greater social good would be a more progressive tax on income and profit.

Table 1. Where does the burden fall: comparing Implicit Tax Rates (ITR)

	Spending (2011)	Labor (2011)	Capital (2010)
Ireland	22.1%	28.0%	14.0%
UK	19.5%	26.0%	34.9%
EU (weighted average)	20.1%	35.8%	27.4%
Bosnia and Herzegovina	17%	36%	10% (12%)
Bosnia's ITR compared to the percent of European Union ITR	84.6%	101%	36.5%

Source: Eurostat (2012 and 2013), Taxation Trends in the European Union (author's own calculation for BiH)

If we examine the tax incidence on personal income, we can conclude that this incidence is very high and every KM of income is taxable through a number of levies, which are about 69% of the personal income[7] when contributions are added to income taxes. When we take into account that the employees must also pay VAT every time they purchase something, it is obvious that citizens who live from personal income are highly taxed. Furthermore, VAT is a regressive tax meaning that those with smaller incomes carry a higher tax burden. Tax on capital gains is very low and is not progressive enough. As such, we can conclude that personal income is definitely taxed more. This trend creates a downward spiral towards inequality in a society and when the questionable capital gains in post-war BiH is also taken into account, due to the underdeveloped institutional capacity, weakened rule of law and grey market, this system seems to be only in the service of the capital.

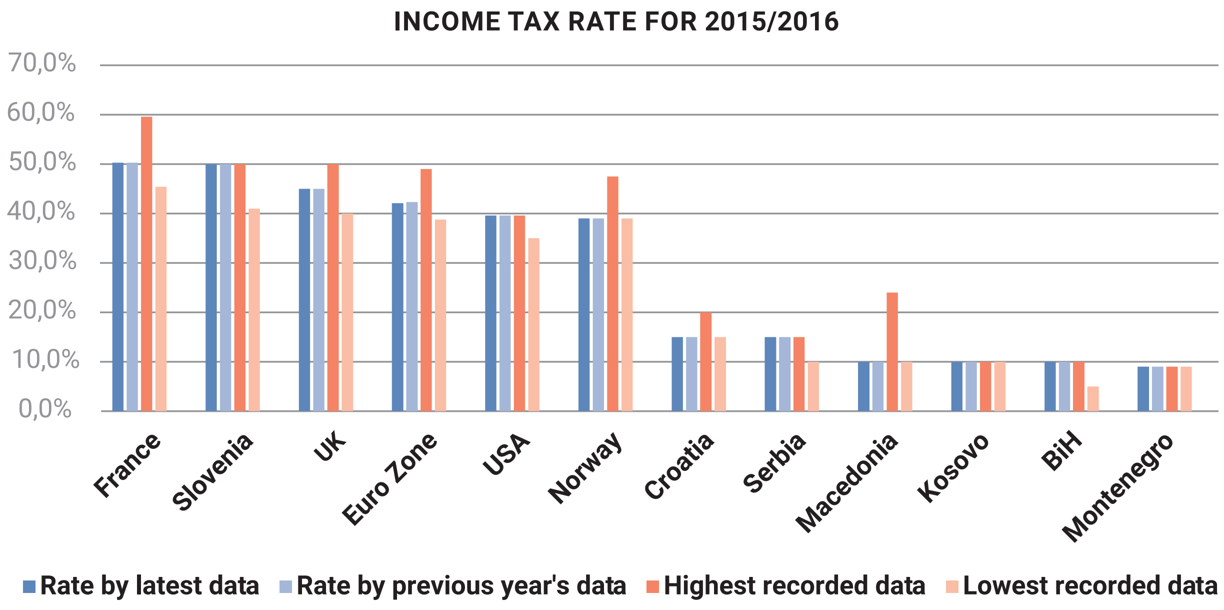
Table 1. shows the ITR (*Implied Tax Rate*) for consumption, labor and capital for Bosnia, the UK and the EU. Bosnia treats its capital tax base (ITR=10%), which is a lot leaner than either its consumption tax base (ITR=17%) or its labor tax base (ITR=36%). France has the highest ITR on capital at 44.4%, while Latvia has the lowest ITR on capital at 5.5%. Bosnia taxes sales less severely than the EU average. Bosnia's ITR on sales is 85% of the weighted EU average in 2011. On the other hand, Bosnia taxes income more heavily than the respective European average. Taxes on capital as proportion to the GDP are relatively low in comparison to the weighted EU average of 2.6% of the GDP.

7 See 'Analysis of the taxation model for all labor-related compensation in Federation of Bosnia and Herzegovina' (2016) Federal Development Planning Institute, Federation of Bosnia and Herzegovina.

Figure 2. Direct tax rates in BiH vs. selected countries

a) Corporate tax rates BiH vs. selected countries

b) Income tax rates BiH vs. selected countries



Source: OECD database

A basic analysis through comparison of tax revenues collected across different tax bases, reveals that Bosnia collects, through contributions (burden on personal income), much more than the EU average, while it also through direct taxes, collects three times lesser the amount in relationship to its GDP. Among different tax mechanisms, we see a similarity in the sense that capital gain is taxed, however in Bosnia, tax rates on income from capital are a lot smaller when compared to the more developed capitalist countries. We can also observe that even though wealth is not taxed in BiH, there are different taxes on property as one form of capital, which in the Republika Srpska entity is taxed at 0.2% in relationship to the determined value, while in Federation of BiH symbolic per square meter charges exist. This is very different when compared to the developed capitalist economies, which tax property at progressive rates and not just as income from the property, as can be seen in Table 2. Therefore, a simple overview of differences in the tax system of BiH in relation to a few other developed capitalist economies, indicates that BiH has significantly lower tax rates on gains from capital. BiH also has an inconsistent rule when it comes to property taxes (as one form of capital), where these taxes come at a very low rate in RS while in the FBiH, they are not at all proportional to the value of the property. These major inconsistencies raise the question on whether BiH has lagged in development of a tax system which would be a pre-requirement for more just outcomes in the BiH capitalist economy.

Table 2. Comparison of property taxes in France, UK and BiH[8]

Property taxes in France	
Property value	Tax rate
€800,000 or less	0%
€800,001 up to €1,300,000	0.5%
€1,300,001 up to €2,570,000	0.7%
€2,570,001 up to €5,000,000	1.0%
€5,000,001 up to €10,000,000	1.25%
€10,000,001 or more	1.5%
Property taxes in the UK	
Property value	Tax rate
£125,000 or less	0%
£125,001 up to £250,000	1%
£250,001 up to £500,000	3%
£500,001 up to £1,000,000	4%
£1,000,001 up to £2,000,000	5%
£2,000,001 or more	7%
Property taxes in FBiH (Canton Sarajevo)	
Up to 150 square meters	3 KM per square meter
Over 150 square meters	5 KM per square meter
Property taxes in RS	
Immovable property	0,2%
Immovable property in which productive activity is taking place	0,1%
Note: Municipalities and towns determine the above rates every year	

Source: Lawton and Reed (2013), Law on Property Tax Canton Sarajevo; Law on Immovable Property Taxes of Republika Srpska

The existing research on personal income tax structure shows that in order to increase revenue and reduce inequality in income tax deduction, BiH should apply more progressive income tax rates. Kramer et.al. (2016) illustrate that applying personal income tax structure of Slovenia (also a former Yugoslav country) to the Federation of Bosnia and Herzegovina (FBiH), we would have a reduction of 7.97% to the Gini coefficient on the income tax deduction and would thus reduce the inequality on taxable income. By applying the Slovenian model to FBiH, we would achieve a 3.54 times higher Kakwani index of progressivity in social intervention. This indicates that FBiH but also RS, due to its similarities, lingers behind in regards to using personal income tax rates in order to achieve uniformity in taxation. Progressive tax rates would increase personal income tax revenue by 3.14 times in FBiH and would significantly impact the set tax revenue goals when compared to the current situation. It is also not surprising that the progressive tax rates of Slovenia have resulted in a larger redistributive effect. In actuality, the personal income tax structure in Slovenia resulted in a five times bigger overall redistributive effect when compared to the FBiH. The structure of tax incentives that was used in the stated research included all tax allowances that are available in both countries except certain allowances and untaxable income such as pensions, but which are major sources of income for an important part of the population in both countries. Nevertheless, the existing research shows how significant differences in results can be made in a short period of time between two countries that, fairly recently, shared a common socio-economic history.

In terms of social security benefits and their impact on equality and move towards redistribution of income that it should work towards, BiH lags behind in functioning when compared to its neighbors. The IMF Country Report on BiH (2016) indicates that social security spending is low when compared to the rest of the region. At the same time, spending on benefits is poorly conceptualized by the regional and European standards as estimated by the World Bank. In BiH, the poorest 20% of the population benefit from only 36.8% of the total social welfare budget, when compared to Albania, Kosovo and Montenegro, where they receive 60%. Even more worrying is the fact that the richest quantile of the population in BiH receives a disproportionally high share of social assistance benefits.

We, therefore, conclude that the more progressive income taxes and better directed social as-

8 Law on Property Tax Canton of Sarajevo; Law on Immovable Property Taxes of Republika Srpska

sistance are necessary in order to create fairness when it comes to the tax policy in BiH. In fact, there is no justification for BiH to remain on this path unless the goal of the policy is to promote regressive taxes such as VAT and protect the interests of the wealthiest part of the population. Preferably, BiH should move towards implementing a more direct progressive tax, as there is proof in studies[9] that such taxes do increase civic awareness—a potentially very beneficial outcome from the tax system that BiH should surely pursue in its early stages of democracy.

3.2 Equity And Tax Policy – Wealth Tax And Execution Of Inequality

Unequal distribution of wealth is a growing problem in a transitioning country such as Bosnia and Herzegovina. This phenomenon is constant in the observed increase in inequality of the transitioning economies of Central and Eastern Europe following the fall of Communism and the establishment of free market economies. In such nations, the average Gini coefficient of disposable income increased from 24 to 33 in just nine years and an increase in the dispersion of Gini coefficients could also be noted (Milanovic, 1998). Today, the situation is likely worse rather than better and one of the challenges is a lack of available data in this domain.

From an economic perspective, income inequality has damaging effects on a country as it increases economic inefficiency, in that, a smaller number of people can qualify for credit since the rich tend to own the majority of assets which serves as collateral for taking out loans (Todaro and Smith, 2009). Income inequality also increases socio-political instability since people become dissatisfied with the state of their country (Park, 1996), which can be observed in the case of social unrest (that eventually turned violent) of February 2014 in Tuzla and Sarajevo. Furthermore, income inequality can facilitate rent-seeking behavior as well as cronyism (Samanta and Heyse, 2006). This theory is relevant in the case of Bosnia and Herzegovina, where recent bank failures in Republika Srpska – due to their inability to meet their obligations and failure to return credits – were attributed to clientelism and corruption.

In the framework of growing inequality and the problems that arise from such a phenomenon in a country, many studies have attempted to provide insight into the factors that impact income inequality, in order to better understand relationships that are important in transition economies. If we strive to improve the economic, political, and social situation in transition economies by finding the best policies that would result in decreased income inequality, then we need to take a multifunctional approach.

Privatization has been proven to be an important factor in explaining increased inequality in Central and Eastern Europe (Rose and Viju, 2014; Bandelj and Mahutga, 2010; Grimalda et al., 2010). In addition to an increase in inequality, privatization has been labeled as unsuccessful in bringing on a functioning market economy in a transitioning BiH, which to a great extent was unlawful. Consequently, the society is faced with not just vast inequality for which official statistics are unavailable, but also with clear signs and proof of examples of failed privatization and which help to shape the public opinion on current model of capitalism in BiH. This opinion has also been shaped through daily media reports of workers protesting due to their unresolved status of health and pension funds in companies where privatization has undoubtedly failed. If privatization is associated with an increase in social inequality, and if the problem of inequality in property ownership results in further inefficiencies due to a lack of loans for many people, then procedures for addressing this inequality should be sought in countries where the capitalist model has been successful and inequality was reduced despite the free market capitalism.

Recently, certain authors like Piketty (2014) have called for a global tax on wealth in order to combat growing societal inequality and achieve greater social cohesion. In our case, however, such a tax would indeed be a firmer way than any courts in amending wrongdoings that arose from illegally obtained capital and would also help to address the

9 See Nayeem Abdullah M. and Parvez K. (2012), Effect Of VAT and Taxes On Economy: An Analysis in the Context Of Bangladesh, *Research Journal of Finance and Accounting,* Vol.3, No. 7., pp. 64-70.

growing dissatisfaction with our existing economic model. Such a measure could be seen as a rectification of the failed privatization policies. In BiH where one could over the past two decades, via the informal economy, profit significantly without contributing to the society, the question on redistribution of wealth is important in regards to the social and welfare policy. This interpretation is supported by Mkandawire (2005) who argued that there is a functional relationship between universalist social policies and redistributive policies in other areas, in that "there is an elective affinity between the preference for universalism and other measures, such as high progressive taxes." (Mkandawire, 2005:6) Progressive taxation is therefore one of the potential solutions that could be assessed as an alternative policy in order to reduce inequality and improve outcomes of the capitalist model in Bosnia and Herzegovina.

Mkandawire (2005:6) assumes that **possibly non-distribution in transfers is more than compensated for by redistribution in taxes. Regardless of whether it is universalist or not, social policy coupled with the redistributive role of taxation has played a crucial role in capitalist economies that are doing well in terms of lowering inequality. Hence, the absence of a desired system of taxation could have caused failure in transitioning economies in terms of social justice and equity. This would have substantial implications for BiH, but also for other transitioning economies, as social policy should be viewed in the context of tax policy failure to perform a redistributive role which was required for the free market economy model to prevent growing inequality.** Compared to the former socialist model where most of the existing tax policies were designed and where inequality was not considered an issue, or where it was an oxymoron due to the socialist economy of equality promoting the 'working classes', the Bosnian model of capitalism did not seriously consider the issue despite the obvious growing inequality.

In order to achieve greater social cohesion, data on citizens' wealth would be required (even if only available for the policy makers), as this is the key precondition for fair taxation. It would also create room for more successful social policies, even if they remain universalist and are not made based on status of one's wealth. However, **in countries that are transitioning towards functioning institutions and market economy, this extended view of functional relationship between the tax and social laws is a pre-requirement for more just policies in particularly regarding social welfare policies. The question of a capital and/or wealth tax or net personal assets could therefore become one of the most important instruments of redistribution in the BiH society, defining our economic model and model of capitalism, as well as to lead towards better outcomes in social policy.** A symbolic wealth tax would serve as a step towards a development of a database and it would enable better policies to curb informal economy, which is currently undermining the sustainability of the social protection in BiH and public spending in general. While the currently pursued reforms foreseen by the Reform Agenda soon to be implemented, does not problematize the tax system in general, it does stress the need for a better focused social welfare policy. However, such policies cannot be created if the system does not have adequate records on the wealth of each individual citizen (even if it is on the other end of the spectrum of low level of means).

This is the reason why we argue that a wealth tax could play an important role in developed capitalist societies that do perform well in terms of social cohesion and lower inequality, as an important attribute that was present in such cases. Progressive tax and an introduction of a wealth tax could be important lessons for post-transition and transitioning economies which are on their path towards a functioning form of capitalism. Such measures can shift these societies away from social and economic disequilibrium and towards a greater social cohesion. In *Figure 3* we present a simple analysis on capitalist countries where free market mechanisms are combined with different wealth tax policies. The countries are sorted into the best and worst according to their performance in terms of inequality of wealth distribution, as measured by the Gini coefficient. The OECD database is used to obtain the measure of the Gini coefficient.

We demonstrate that countries with a history of wealth tax policies perform better than those that have never had a wealth tax. This indicates that wealth tax policy is at least a good sign that redistribution was a serious political concern, which likely mirror other important measures of redistribution that take place. Further analysis is necessary in order to specify whether this is a pure connection if wealth tax registers are associated with other policies that bring about better performance in terms of equality, or whether it points to a certain degree to a causality relationship. Yet, it is certainly probable that tax policy or information on taxable resources, could act as mechanism for democratization of capitalism and towards greater social cohesion and lower inequality, especially if combined with other measures such as more targeted social assistance and progressive income taxes.[10]

This data supports our argument that post-transition or still transitioning countries have to seriously consider measures that have brought on social capitalism in Western Europe. One of these policies, that seems to be the most indicative of a society's ability to respond to inequality, the wealth tax or net worth tax, where the primary advantage would be the transparency of data and the ability of policy makers to better tailor policies that promote social cohesion. **Yet nowadays, the wealth tax is faced with a main obstacle in the global and free flow of capital where capital seeks places outside of the country and in such cases only a global wealth tax would be able to overcome this issue.[11] However, in order to enable the society to support the growing need for data collection and to curb the grey market, an introduction of tax registers which would aim to provide information on all taxable resources would have potentially positive implications against "savage capitalism."** This is where the *post-revolutionary* measures of introducing wealth registers, tax registers, and databases of this nature, which were pursued in the developed Western European capitalist societies, might be recognized as a measure that is needed in the new free market capitalist societies of the Western Balkan region.

The potential benefits of a wealth tax in regards to social welfare policies in Bosnia are multiple and significant. A need for targeting the welfare policy in the context of history of social policy has been seen by some authors as a result of shifts in ideologies where neoliberalism won against universalism. However, failures of universalism in Bosnia, as well as other countries in the region, is the main reason why a "big state" is perceived as a tool for the very few to gain personal interest, while the majority suffer. In this context, the aim is to cure social problems that have resulted from manipulation of the universalist politics and populisms in a chronic capitalist society. **Furthermore, while discussions on universalism versus targeted policies prevail in which one will garner better results and which one has more redistributive effects, universalism that is seen in Bosnia has obviously failed. It did not fail due to universalist policies' inaptitude but due to the absence of a redistributive tax system which needs to accompany such policies, while it also should provide more transparency that would resolve the problem of misuse of universalism by bureaucracy and particular interests.** Consequently, the social policy question is certainly a question of political economy and the current burdens of social disequilibrium call for more targeting. Yet, this is too narrow of a view, given the extent of failures of the system. A broader functional view is necessary in order to assess the social policy in regards to redistribution.

While administrative and transaction costs of policies that aim for greater wealth status are high, and where many argue that only wealthy states can afford such policies, it is obvious that this is a question of political economy too. A new effective social policy that truly facilitates a more just society and social cohesion would not only require a targeted policy based on wealth status but a broader functional view that recognizes that universalist policies have succeeded due to their tendency for progressive tax systems. This would entail a set of policies that would combat, not just growing inequality, but would also resolve problems that originated from a weak rule of law and initial capital accumula-

10 See Omerbegovic, Arapovic A. and Arapovic A (2016) for an econometric analysis of correlation between tax policies and equality measures in OECD countries, with control of different standards of these countries that could have affected the performance of a particular country in terms of equality.

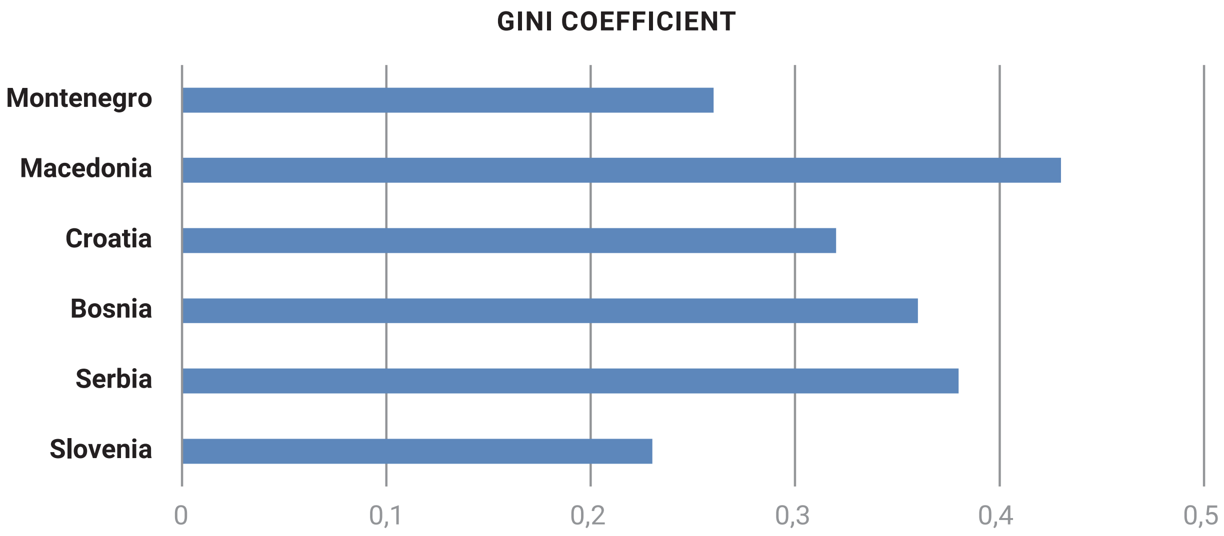
11 In this context, greater progressive tax on all forms of income or luxury spending could be a substitute for wealth tax and further study should include all aspects of tax policy and its relationship with inequality.

tion that resulted from privatization. This socio-economic effect of building institutions, rule of law and a more just society, is a potential method of increasing social cohesion in societies where free market and capitalism are now stigmatized against, due to many failures of the given model and the abuse of the universalist social policy inherited from the regime of the former Yugoslavia.

The current letdowns of social policies of universalism in BiH, which is the basis for the argument of better targeted social policies, should not be considered separately from broader purposes and other policies that relate to the society. Evidence that universalist policies in capitalist societies do better in terms of equality, and that they are related progressive taxes, is further examined. We have shown that the wealth tax and database on wealth of citizens, as well as specified progressive tax system, have the potential to bring about a more just and efficient social policy in BiH. Thus, we conclude that measures such as introduction of wealth registers and a wealth tax, even a symbolic one, can result in multiple benefits for Bosnia. In particular, in regards to destigmatizing wealth and free market capitalism, which so far is deficient in the domain of social justice and social cohesion. **In the end, social policy question is in fact a question of political economy and mobilization in political pressure will finally determine how reassignment of wealth will be conducted in Bosnian version of capitalism. In this process, it is crucial that social policy is not considered single-handedly, as history shows that social policy alone cannot result in desired redistribution that is required for social cohesion in post-transitional and transitioning societies. The question is not in universalism or targeted policies, but is instead in regard to the design of a comprehensive mix of policies that would remedy the issues of misuse of universalism and would overcome errors created by other policies that are needed from the capitalist model in regards to fostering equality and social cohesion, like progressive taxation and net wealth tax.**

Figure 3. Gini coefficient: OECD (2014) best and worst performers in terms of inequality and wealth tax

Figure 4. Gini coefficient: Countries of the former Yugoslavia (2014, OECD database)



3.3 Historic Perspective and Wealth Tax Experiences Of The Organization for Economic Co-operation and Development

In this section, in order to lay ground for a comparison with Bosnia's potential to introduce a wealth tax, we review experiences of the existing countries of the Organization for Economic Co-operation and Development (OECD) which still have some form of a net wealth tax implemented.

Treatment of wealth for taxation purposes varies widely from country to country and a 'direct comparison between countries can be misleading due to different legal, economic and overall tax systems as well as institutional setups.' (McDonnel, 2013:20) In 2010, twenty-three out of the thirty-six OECD member states had wealth transfer taxes. In countries where wealth taxes exist, they are generally focused on the individual and tend to, in practice, operate as supplements to income tax. There is an obvious relationship between income tax and wealth tax because in almost all cases, wealth tax is paid out of the taxpayer's income. As such, many countries with net wealth taxes have used ceiling provisions in order to cap the combined total amount of net wealth and income tax to the maximum percentage of income. This relationship could only be disregarded in tax systems where income is not taxed. However, benefits could be found by taxing net wealth of individuals with a check of the personal income and capital obtained in a particular year, as capacity to pay taxes is going to be related to income of households (McDonnel, 2013).

Taxes on net wealth were once common in the OECD, but in recent decades the number of countries taxing wealth has declined. The most likely reason for this is the increased mobility of capital. As of 2010, occasional periodic net wealth taxes in OECD existed in only the following countries: France, Norway and Switzerland. Situation is similar outside of the OECD too. Reintroduction of a net wealth tax has been proposed by the main social democratic parties in Austria and Germany, while the Netherlands introduced a *de facto* wealth tax within its income tax system. Under the Dutch tax system, a 4% refund is established on financial and physical capital, and this profit is then taxed at a 30% single rate (Schnellenback, 2012).

Wealth tax in France or the "solidarity tax on wealth," applies to natural persons and is paid by those with a net taxable asset that exceeds 1.3 million Euros. A wide range of benefits and exemptions does exist. There is a provision set in place to ensure that individuals do not have to pay more than 75% of income tax. Around 1% of taxpayers pay the solidarity tax on wealth and the total revenue of the tax collected represented 0.2% of France's GDP in 2011. As of 2013, standards presented in Table 3 are applied for net wealth tax in France, the UK and Norway (McDonnel, 2013: 21-22).

These examples indicate that taxing net wealth can be done as is the case in the Netherlands where revenue is collected from physical and financial wealth, or by applying a wealth tax rate (flat or progressive) on net wealth (or ranges of net wealth) above a certain threshold applicable locally, such as in France and the UK. Considering that the aim of this paper is not to provide a concrete technical solution nor a particular design for a wealth tax in BiH, and is instead to offer general guidelines and arguments for an introduction of such a tax, in Section 3.7 we only briefly discuss design challenges and leave this question to be answered at the point when wealth data will be available. In fact, as the first step, this paper advocates a setup of a wealth register that would be accessible to policymakers as a necessity on the path towards a more effective fiscal policy in regards to its redistributive role.

Table 3. Basic structure of the French solidarity tax on wealth (ISF) (2013)

Net Assets (€, 000s)	Applicable ISF rate	Net Assets (€, 000s)	Applicable ISF rate
0 – 800	0%	2,570 – 5,000	1.0%
800 – 1,300	0.5%	5,000 – 10,000	1.25%
1,300 – 2,570	0.7%	above 10,000	1.5%

Only those with net wealth that exceeds €1.3 million are liable for the tax; the effective rate average is 0.5% of taxable net assets for those who are liable for the tax.

Source: McDonnel (2013)

Table 4. United Kingdom property tax brackets (2012-2013)

Net Assets	Tax Rate
<€139,922	0%
€139,923 - €279,845	1%
€279,846 - €559,691	3%
€559,692 - €1,119,383	4%
€1,119,384 - €2,238,767	5%
€2,238,768+	7%

Source: Lawton and Reed (2013)

Table 5. Norway wealth tax (2016)

Paid to	Total Wealth	Tax Rate
State	€0 - €156,218	0%
State	€156,219+	0.15%
Municipality	€0 - €156,218	0%
Municipality	€156,219+	0.70%

Source: The Norwegian Tax Administration (www.skatteetaten.no)

3.4 Macroeconomic Approach IN Assessing The Impact of A Wealth Tax Introduction in BiH

National capital or national wealth is the sum of public and private capital. Public capital is defined as the difference between assets and liabilities of a country (including public agencies), while private capital is defined as the difference between assets and liabilities of private individuals. For the public and the private sector, capital is always defined as net worth or the difference between the market value of what is owed (liabilities or debt).

In his study on capital in the 21st century, Piketty (2014) concludes that throughout history, composition of state wealth (capital) has seen different shares of public versus private wealth, but in general the largest part of national wealth was actually private. In France, the net public wealth *grosso modo* ranged between + 100% and -100% of national income (usually between + 50% and -50%), and remained limited compared to significant levels of private wealth (up to 700% - 800% of national income).

Table 6. Public and private wealth in France in 2012

	Capital value (in % of the national income)		Capital value (in % of the national capital)	
National capital (public + private capital)		605%		100%
Public capital (net public wealth: the difference between assets and debt in the hands of the state and other public institutions)		31%		5%
	Assets	Liabilities	Assets	Liabilities
	145%	114%	24%	19%
Private capital (net private wealth: the difference between assets and debt in the hands of private persons / households)		574%		95%
	Assets	Liabilities	Assets	Liabilities
	646%	72%	107%	12%

Legend: In 2012, the total value of national capital in France amounted to 605% of its national income (6.05 annual national income), out of which 31% is public capital (which is 5% of total capital) and 574% is private capital (95% total capital). Source: piketty.pse.ens.fr/capital21c.

In early 2010, the total value of public assets (non-financial and financial) was estimated to have been at approximately a little less than one and a half years' worth of the national income in France. This means that the net national wealth, i.e. the national capital, is at around 0. According to the latest official estimates of the statistical institute and the central bank of France, the net public capital is barely 30% of its national income (or it is twenty times less than the total national capital; *Table 6*). (Piketty, 2014)

Piketty (2014) further stresses the difficulties that the national accounting faces and how it is not and will never be an exact science. Estimating public debt is not difficult when compared to assessing the true market value of public buildings, transport, infrastructure etc. Norway is one of the countries that applies model estimations in order to determine the value of private property. The most important conclusion is that 95% of national wealth is in fact private wealth.

A historical analysis of national wealth, introduced by Piketty (2014), offers important lessons for Bosnia and Herzegovina as we can only assume that the increasing public debt in BiH has contributed significantly to the accumulation of private wealth in this country. Additionally, historical lessons on wealth that are applicable to Bosnia are the following: increasing public debt increases private wealth and that even though we do not have data on private and public wealth for Bosnia and Herzegovina, we can presume that the increasing public debt has amplified private wealth quite significantly. Following the privatization processes, we should evaluate the relationship of private versus public wealth, as private capital constitutes the majority of capital in France and the UK for which data is available and which is the basis of Piketty's (2014) argument. Piketty argued that history of capital indicates that private capital has always dominated and has been present in the majority of developed capitalist countries. Therefore, we can conclude that this accumulation of private capital in BiH has occurred following privatization and also due to the increasing public debt in the country.

3.5 Wealth Categories And Assessing Impacts Of Introduction Of A Wealth Tax In BiH

Wealth can take on many forms and an individual's or a household's wealth can be made up of a mix of different types of assets or property. Property is typically divided into real and financial. It can also be decomposed into transferable and non-

Table 7. Composition of gross assets in the Eurozone according to the main types, %

		% real assets	% financial assets	% gross assets
Assets	Real assets	100		85
	Financial assets		100	15
	Residential property	60.8		51.7
	Other real estate	22.7		19.3
	Self-employed business	11.5		9.8
Financial assets	Deposits		42.9	6.4
	Insurance Tech. Res.		26.3	3.9
	Mutual funds		8.7	1.3
	Shares		7.9	1.2
	Bonds		6.6	1.0

Source: Euro system Household Finance and Consumption Survey (ECB, April, 2013)

transferable, as well as movable and immovable categories. Property includes, but is not limited to: land, houses and other real estate (residential and commercial property), business equity, agricultural assets including livestock, machinery, money, bank accounts and deposits, actuarial reserves, pension fund equity, securities (e.g. stocks, bonds derivatives and promissory notes), human capital, goodwill, intellectual and personal property such as jewelry, antiques, furniture, collections and works of art.

Asset benefits for the owner can come in the form of monetary income such as through interests, dividends, rent and royalties. However, other benefits for the asset holder can exist including increased capital value, financial security, partaking in the society, status, access, power and influence, economic freedom and psychological benefits. (McDonnel, 2013)

HFCS estimates that the mean value of net wealth of households in the Eurozone in 2013 was 109,200 EUR and the average net wealth stood at 230,800 EUR. This data indicates that there is an uneven distribution of wealth, as the wealthiest 10% of households control over half (50.4%) of the total net wealth in the Eurozone (European Central Bank, 2013). The composition and distribution of gross household assets in Bosnia will undoubtedly differ from that of the Eurozone. Nevertheless, the HFCS data from 2013 provides some indicators for the potential tax base if an annual net wealth tax was to be introduced in BiH.

Wealth tax information found in wealth registers could be modeled after the Norwegian model and would encompass different forms of wealth according to the structure presented below:

Using these categories of wealth and data obtained from the official statistical institutions in BiH, as well as public records, we have estimated the size of national wealth in BiH. Data on stockpiles of financial wealth are estimated based upon quantities and comparable value of assets obtained through previous studies done on land and forest land in Europe. **Our wealth estimate, based on wealth categories adopted from the Norwegian wealth registry, reveals an approximate amount of 114 billion KM net wealth in Bosnia and Herzegovina, which is approximately 400% of the GDP. Yet, this is a conservative figure compared to Piketty's (2014:124) assessment of 500% to 700% of wealth of nations compared to the GDP in the developed world. Taxing this wealth at 1% would result in 1,14 billion KM in tax revenue.**

The total amount of financial wealth alone in BiH amounts to around 25 billion KM. Based upon the 15% share of financial wealth of the total wealth

Table 8. Overview of wealth concepts and proposed future administrative data sources for household wealth in BiH

Wealth Concept	Administrative Register	Approximate value in BiH in 2015, showed in KM
Non-financial wealth		
Private homes/apartments	Estimated values based on a model	KM 59,761,036,000
Holiday cottages	Tax return register	Included in private homes for this purpose
Boats, cars and other vehicles	Tax return register	Not estimated
Forests, farms, land and other real capital		KM 52,529,755,050
Machinery and equipment	Tax return register	Not available
House contents and movables	Tax return register	Not estimated
Real property owned abroad	Tax return register	Not estimated
Self-employed or private business	Estimate based on a model	KM10,956,000,000
Financial wealth		
Bank deposits and cash	Tax return register	KM 16,483,500,000
Share of unit trusts	Tax return register	
Bonds and other securities	Tax return register	KM1,780,190,184
Private pension funds and value of repurchase of life insurance policy	Tax return register	KM 562,110,867
Outstanding debts	Tax return register	-
Bank deposits in foreign banks	Tax return register	-
Liabilities	Tax return register	KM 16,866,000,000
Total debt	Tax return register	
Student loans	The State Educational Loan Fund	NA
Debt to foreign banks	Tax return register	-
TOTAL		KM 114,250,592,101

Note: Author's own calculations. Value of private homes is calculated using the census data and estimated value per square meter. Forests, farms and plots are taken from the available census data at values used by the European valuation model. Bank deposits and cash as well as liabilities, are taken from the Central Bank of BiH. Bonds and other securities are determined at value traded through stock exchanges as of 2015. Private pension funds and value of repurchases of life insurance are from the report from insurance companies. Value of privately owned businesses is approximate given the assumed percentage of wealth in relation to the total wealth of households.

of the Eurozone as presented above, **financial wealth taken at this percent share of the total wealth would amount to 166 billion KM in BiH,** which is consistent with our macroeconomic assessment assuming a rate of return on capital is 6.8%, which is a realistic assumption.

3.6 Assessment Of Wealth In Bosnia and Herzegovina Using Macroeconomic Identities

In order to assess the approximate sum of wealth in BiH in relationship to the GDP, we will rely on the relationship of income from capital and income from labor in BiH obtained from the GDP statistics. In 2015 revenue from capital gains in the GDP of BiH was 40%, while share of income from labor was at around 60%. The 40% revenue from capital of Bosnia's total economy (GDP) is the biggest share of capital compared to developed liberal capitalist states, where share of capital gains in the 21st century stands at 30% (Piketty, 2014). In this sense, BiH compares to Europe in the 19th century when the share of income from labor stood at around 60%.

Keeping in mind that this capital revenue share, in relationship to the GDP, is obtained from stockpiles of capital that earns some rate of return, so that:

$$A = r * B$$

Where,

A is share of income from capital in relationship to GDP,

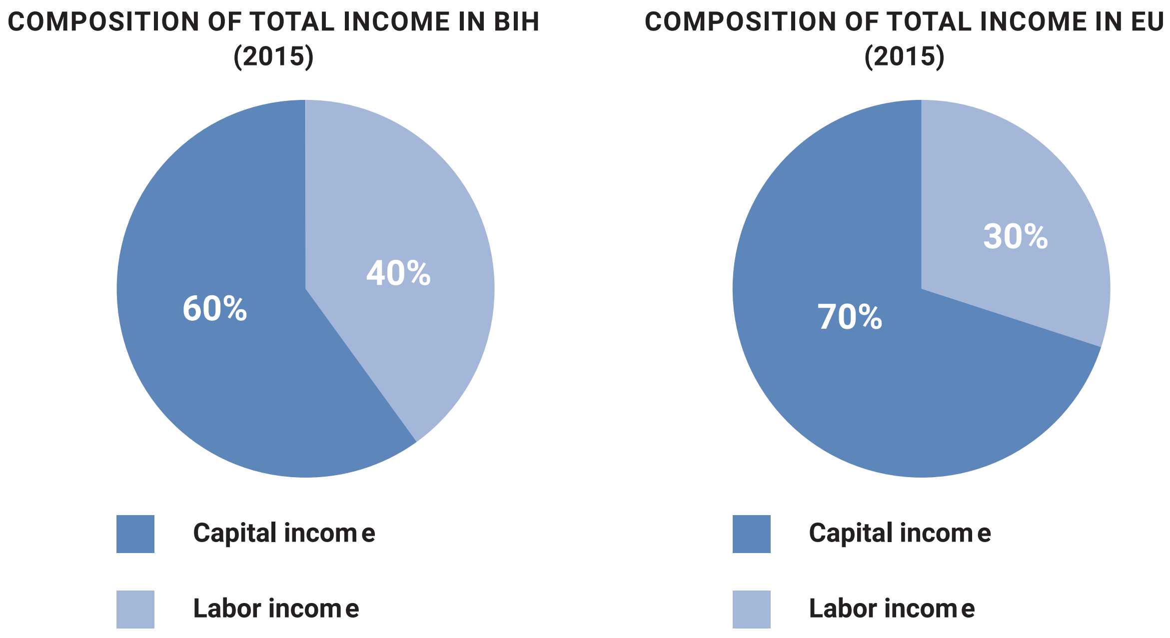
r is the average rate of return on capital,

B is relationship between the stockpiles of capital and the GDP.

If we understand that the rate of return on capital varies from 5 % to 15%, we get a reserve of capital B in BiH which amounts to 800% of the GDP or 218 billion KM, to 267% of GDP or 73 billion KM.

Taxing this amount of wealth with a very symbolic rate of 1% would amount to 2 billion KM in tax revenue, which would enable the government to reduce income taxes, at least for the lowest income bracket where certain lower incomes can be completely exempted from the tax. Exempting lowest incomes from taxation, while at the same time introducing a VAT system based on differential rates for different goods and services, would lead to a more just tax system. Given that the VAT gap is greater than 20% (or percentage of uncollected VAT is still large), tax reform has to be supported by legislation and enforcement of much greater penalties for tax evasion should be implemented in order to broaden the tax base. This is perhaps the most important first step in tax reform as evasion destroys motivation in economic system. Also, we have to move in the direction of reforms which will enable taxes to be paid based on relative ability to pay them, as the current system of income taxation is not pro-

Figure 5. Share of personal income and capital in GDP – BiH 2015 vs. the EU average



Source: Agency for Statistics BiH, Eurostat (author's calculations) gressive and lags behind the developed capitalist societies. The ability to assess the capability of tax subjects to pay taxes should go along the line of the Norwegian model which taxes all forms of wealth and functions based on relative ability of subjects to pay taxes and is based on information kept in the so-called wealth registry. This registry is made up of wealth categories presented in *Table 8* and offers a solution for BiH legislators, naturally in case they were to move towards an introduction of the wealth tax.

3.7 Policy considerations and Tax Design issues

Previous studies have discussed various complications of tax design and have considered issues that include the establishment of a tax base and a tax rate, thresholds, exemptions and subsidies, administration and valuation issues, as well as investment and capital flight (McDonnel (2013), Figari (2013)). While this study assesses the macroeconomic and political economy considerations of the introduction of a wealth tax, our goal is not to discuss design issues but only to note that previous work has already established very important general direction for effective wealth tax policies. The importance of setting high ceilings and the low flat-rate marginal tax has been pointed out in order to increase the effectiveness and reduce costs of administrating of this tax. A benefit of having wealth registries that are administered by the tax authorities increases the ability of these same authorities to check their data from income taxes and cross check the information which would help curb the grey market. Another must for policy makers is to take care of the effective income tax rate once a wealth tax is imposed. Yet, if the threshold is set too high, these administrative and design issues can be simplified.

Potential income and tax rates

Net wealth taxes have generally yielded less than 1% of the total tax revenue for OECD countries that have used them. The lowest marginal rates have commonly varied between 0.2 and 1.5%, while the top marginal rates have varied between 0.5 and 2.5%. Following experiences of the countries that have administered such taxes, the preferred structure for a net wealth tax is one based on a relatively high threshold of liability and with minimum exemptions and reliefs (McDonnel, 2013).

According to data collected by the 2013 census in BiH, the top 5% of households represent 58,169 tax units, while the top 1% of households represents 11,634 tax units. Considering the estimate of 43 billion KM of wealth belonging to the top 5% of households, the average wealth of the top 5% of households possessed an average of 740,000 KM per household. If we are to guess the distribution of wealth in the Eurozone, 1% of households hold 10.4% of wealth, meaning that the average wealth of the top 1% of households would be 1,203,369 KM of net wealth per household. The scale of potential revenue depends on the set upper limit, the rate and higher revenue can be obtained by lowering the threshold and increasing the rate. We, therefore, did basic calculations simply to demonstrate the potential of wealth tax policy in Bosnia and the desired tax revenue that is subject to much debate and depends on a number of factors. In fact, a very symbolic rate and a high threshold will reduce resentment and increase public support for this policy. In turn, this would increase benefits that have been presented throughout this paper and would improve social justice, democratization of capitalism and equality.

In order to collect 1 billion KM in revenue from the top 5% of households, we would need an average liability per household to be 17,191 KM or a rate of 17,191/740,000, which is 2.3%. At an assumed rate of return of 5%, income tax in this scenario is 2.3/5=46%. Finally, we should be aware that the set tax threshold and distribution of wealth among the population, as well as concentration of wealth in the top 1-2% of households, will have a huge impact on tax revenue. (McDonnel, 2013: 62)

The aim of this paper is not to discuss details of design and various scenarios that could emerge depending on assumptions on wealth distribution. However, at this stage, it is clear that a wealth tax could potentially offer significant revenue even when the threshold is set high and with a low tax rate on wealth.

4. Conclusion

Tax policy in general needs to be re-assessed in order to fulfill its role on redistribution, as well as to create more just and equal results of the free market capitalism in BiH. A wealth tax can be an important component of a tax policy as it:

a) is proven that it points to a political concern and orientation towards a system of measures that should facilitate more equal outcomes of capitalism;

b) can boost a more efficient social policy;

c) also entails a potential to correct the common trend of an increasing accumulation of wealth in the hands of the few;

d) may be an important mechanism in reversing wrongdoings of the failed privatization in BiH, illicitly obtained wealth and grey economy.

Furthermore, wealth registries that are necessary for imposing a wealth tax, work towards democratization of capitalism, destigmatize entrepreneurship and capitalists, and correct mistakes of failed privatizations in a very systematic manner.

Social policy alone cannot produce more social cohesion as the redistributive role of tax policy is the most important tool for better outcomes in social capitalism. We have demonstrated that the redistributive role of tax policy in BiH could be improved by a more progressive tax on income, both individual and corporate. However, a wealth tax would still be important – even at a symbolic level – in order to register the enormous amounts of wealth that is not taxed. This should also be done in order to break the cycle of self-reinforcing unequal outcomes from a system that resulted after an initial accumulation of capital that was potentially unlawful and was lingering outside of the legal economic flow. Even if a recurrent wealth tax is seen as a too drastic of a first step, history shows that there is a potential alternative solution in the form of a lump-sum tax on wealth to equalize the burden.

If the available information on the concentration of wealth is confirmed to be true, a wealth tax can also raise substantial revenues (around 1 billion KM with a threshold set at 300,000 KM and a rate of 1%), which can be used towards restructuring the tax system by relieving those who earn minimal income from the high tax burden that is currently applied. Idleness, built on the assertion that this is a comparatively expensive tax to implement, is not a sufficient solution, as there are many benefits to gain from the wealth register alone. These benefits include a whole range of socially desirable outcomes in the sense of democratization of capitalism and a greater social cohesion.

Finally, just as an important argument from Besley and Persson (2013) goes, state capacity determines the fiscal capacity, as a strong state is a requirement for fiscal capacity. This is perhaps also the strongest argument for building fiscal capacity through implementation of a wealth tax registry, considering that an establishment of a wealth tax registry would also contribute towards building of a strong state of Bosnia and Herzegovina, as this is a two-way relationship. A strong Bosnian state means a stronger the rule of law and a stronger fight against corruption, which would bring on many immediate benefits that are hard to measure but nonetheless very important, such as improving the image of BiH. This in turn could bring in new investments and generally improve the economic and market efficiency in BiH.

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