

Tax Labor and Labor Will Leave: The Bosnian Example



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The fiscal burden of labor in the Federation of Bosnia and Herzegovina is one of the largest in Europe. Although living among the poorest countries on the continent, workers in Bosnia and Herzegovina pay a lot to a high tax wedge, which is over 40%. In particular, at EUR 100 net salary, the employer gives EUR 73 to the government (at the expense of contributions and income tax).

Although in the last five years there was an attempt to reform the fiscal system under the guidance of international partners, the reforms have failed. The consequences of having the largest fiscal burden on labor are numerous, but the most significant are: a high unemployment rate of over 18%, a gray economy comprising 25% of GDP, and, finally, the departure of over 200,000 workers from Bosnia and Herzegovina in the last 10 years.

If you tax labor, then labor (like capital) will leave as soon as the first opportunity is created. This is what has been happening since 2010, when a visa-free regime was established with most EU countries.

In general, high taxes on labor, in the long run, are forcing labor outside the country, which puts pressure on large social systems (such as pensions and health), which, again, creates the need to maintain high labor taxes or, *ceteris paribus*, introduce new taxes. Reforms are painful but necessary, and the reform of the tax system must be carefully and smartly managed.

FISCAL FRANKENSTEIN

The tax system is a sub-system of the economic system that covers all taxes, contributions, and similar instruments that provide public revenue to cover public expenditures. Bosnia and Herzegovina has a very specific tax system, whose organization

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was inherently a political issue, as is often the case with other countries, and is not rooted merely in financial reasons¹.

It is a system that results from the legal and fiscal legacy of almost 50 years of communism within the former Yugoslavia, obligations made from that period, but also the wartime events of the 1990s, as well as the specific constitutional order stemming from international efforts to stabilize the political and economic situation in the country – the Dayton Peace Agreement. All of this has led to the development of a complicated tax framework, which, according to all relevant global reports – such as the World Bank's *Ease Of Doing Business Index*, the *Index of Economic Freedom* by the Heritage Foundation and the Wall Street Journal, the *Economic Freedom of the World* by Fraser Institute, as well as the *Global Competitiveness Report* by World Economic Forum – is one of the biggest obstacles for

¹ Jusufbašić, E. (2011) *Organization of Fiscal Policy at the Level of Bosnia and Herzegovina*, Fondacija Centar za javno pravo – Analize.

developing the domestic economy. This is why the tax system was in the focus of one of the largest post-war economic reform packages, called the Reform Agenda for Bosnia and Herzegovina (now in the form of a new socio-economic reforms package). There are numerous consequences of such a tax system. First of all, it is necessary to clarify the characteristics of the tax system of Bosnia and Herzegovina, in a simple and precise manner.

OWN IT AND SPEND IT

At first glance, the local tax system in Bosnia and Herzegovina is a paradise – a unique VAT rate of 17%. This implies that the VAT rate, like the one in Kosovo, is not differentiated, which is economically speaking, very effective. Namely, the system is simple; there are no possibilities for fiscal manipulation.

In addition, a uniform rate implies that the same rules apply to everyone, no matter what you produce and what services you offer. Why Bosnia and Herzegovina, apart from Kosovo and Denmark, is the only one in Europe with a unique VAT rate, can be explained by greater international intervention and the presence of international lobbyists and economic experts when certain laws were created. The greatest merit to such a VAT system is due to the actions of Lord Paddy Ashdown², the former leader of Liberal Democrats in the United Kingdom, who held the role of High Representative for Bosnia and Herzegovina from 2002 to 2006. The result of these reforms is that the VAT system is currently the healthiest tissue of the entire tax system and the “golden goose” for budgets at all levels. This kind of VAT is in line with the recommendations



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featured in *Tax by Design*, the latest report prepared by the renowned *Mirrlees Review* – the Bosnian VAT has one single rate, is a well-established system, and offers tax neutrality³.

Corporate income tax is another important part of the tax system of Bosnia and Herzegovina. Registered companies pay a 10% tax on all profits, which makes the country extremely competitive with Europe, where the average corporate income tax rate is about 30%. The tax base includes profit, income, and capital gain, in accordance with accounting regulations. This is an entity, not

² N1 Sarajevo (2019) *Head of Bosnia's Islamic Community: We Owe a Lot to Late Lord Paddy Ashdown*. Available [online]: ba.n1info.com/English/NEWS/a377276/Head-of-Bosnia-s-Islamic-Community-We-owe-a-lot-to-late-Lord-Paddy-Ashdown.html

³ Mirrlees J. et al. (2011) *Tax by Design*. Oxford University Press. Available [online]: <https://www.ifs.org.uk/publications/5353>

a state tax, which, again, like VAT, has a flat rate, with no difference between two entities that comprise the country.

There is no progressive taxation, although there are initiatives to do this with an income tax, which is also 10%. However, this has not been done yet, and in any case, corporate taxation would remain the same. Although government officials commonly cite this rate as a valid reason for foreign direct investment in Bosnia and Herzegovina, it does not happen and there are a number of arguments for this. Let us mention only the main ones: unfavorable and uncertain business, legal, and political environment, according to all economic indicators. One of the interesting reasons is the regional fiscal competition – with Montenegro having a corporate income tax of 9%. Why is it ex-

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THE GREATEST MERIT TO SUCH A VAT SYSTEM IS DUE TO THE ACTIONS OF LORD PADDY ASHDOWN, THE FORMER LEADER OF LIBERAL DEMOCRATS IN THE UNITED KINGDOM

actly 9%? Well, because it is 10% in Bosnia and Herzegovina.

What is interesting is that real estate taxes are almost non-existent. In the Federation of Bosnia and Herzegovina, the Real Estate Transfer Tax (RETT) is regulated at the cantonal level and is applicable to transfers of property (land and buildings) with or without compensation. The taxpayer is either the buyer or seller of the property (this varies across the cantons). The taxable base is the agreed price, if not lower, than the market price.

Tax rates are from 5% to 8% (which varies across cantons; for example, the tax rate is set at 5% in the Sarajevo Canton). In the Republic of Srpska (RS) there is no RETT, but RS has a Real Estate Tax (RET), whereby RET is generally payable in respect of real estate used for commercial purposes. RET is in the range of 0.05 to 0.5% of the estimated real estate value in question. It is within the local government's jurisdiction to determine the specific tax rate that has fallen within the aforementioned range⁴. So, as such, real estate taxes are often negligible, non-existent, and do not interfere with conducting business.

There are several reasons why this tax is low and why it will remain so. The biggest is that over two million people were expelled temporarily, or permanently displaced during the war in Bosnia and Herzegovin⁵a. A significant portion of these people did not return to their own land, nor was their legal status resolved. Annex VII to the constitution of Bosnia and Herzegovina

⁴ KPMG (2019) *Bosnia and Herzegovina – Other Taxes and Levies*. Available [online]: <https://home.kpmg/xx/en/home/insights/2015/07/bosnia-and-herzegovina-taxes-and-levies.html>

⁵ Ministarstvo za ljudska prava i izbjeglice (2019) *Najčešća pitanja i odgovori*. Available [online]: www.mhrr.gov.ba/ministarstvo/default.aspx?id=8687&langTag=bs-BA [in Bosnian]



THE VAT SYSTEM IS CURRENTLY THE HEALTHIEST TISSUE OF THE ENTIRE TAX SYSTEM AND THE “GOLDEN GOOSE” FOR BUDGETS AT ALL LEVELS

took particular account of this⁶. Therefore, it would be very controversial to introduce a real estate tax given that many citizens do not use their property.

The second, and more practical reason is the lack of legal and property relations in the society, the cadastres are not settled, and there are many illegally constructed facilities that are the result of internal migration. The effect of a really low real estate tax is that the real estate market is dead. Citizens of Bosnia and Herzegovina tend to own their homes, which implies a malfunctioning market mechanism – small price fluctuations, property overestimation, small number of transactions, and the like. Some of the dynamism was brought by Arab real

estate investments, especially in the Sarajevo Canton. Recent data shows that the 160 companies owned by Arabs account for about 15.3 million of square meters of land⁷.

If we look at the three bases for taxation – consumption, capital, and property – then the tax system of Bosnia and Herzegovina is a paradise on Earth for both domestic and foreign companies. But there is a catch. We have forgotten the fourth base of every tax system, which is labor.

DON'T WORK

Bosnia and Herzegovina, in addition to relatively modest rates of consumption taxes (VAT, plus other indirect taxes – such as excise duties on fuel, cigarettes, etc.), place the greatest fiscal burden on labor. These taxes consist of social contributions and the aforementioned income tax. The contributions relate to pension and disability social insurance, health and unemployment insurance. There is also a child protection contribution in the RS entity. These contributions differ, depending on the administrative structure of Bosnia and Herzegovina – two entities (Federation of Bosnia and Herzegovina and Republic of Srpska, and Brčko District as a third separate administrative unit). In the Federation of Bosnia and Herzegovina, the following types and rates of contribution on gross wage (41.5% in total) apply⁸:

- Contribution for pension and disability insurance at the expense of the insured – 17%;

⁶ Klix (2018) *U BiH blizu 98 hiljada interno raseljenih osoba, RS ukida Ministarstvo za izbjeglice*. Available [online]: <https://www.klix.ba/vijesti/bih/u-bih-blizu-98-hiljada-interno-raseljenih-osoba-rs-ukida-ministarstvo-za-izbjeglice/181127008> [in Bosnian]

⁷ Večernji list (2019) *Arapi na području Sarajeva kupili 15 milijuna četvornih metara zemljišta*. Available [online]: <https://www.vecernji.ba/vijesti/arapi-na-podrucju-sarajeva-kupili-15-milijuna-cetvornih-metara-zemljista-1377781> [in Bosnian]

⁸ Chronos (2019) *Pregled poreznog sistema u BiH*. Available [online]: <https://chronos.ba/pregled-poreznog-sistema-bih/> [in Bosnian]



REAL ESTATE TAXES ARE ALMOST NON-EXISTENT

- Employer pension and disability insurance contribution – 6%;
- Contribution to health insurance at the expense of the insured – 12.5%;
- Employer Health Insurance Contribution – 4%;
- Unemployment insurance contribution at the expense of the insured – 1.5%;
- Employer Unemployment Insurance Contribution – 0.5%.

In RS, the following types and rates of contribution (cumulative 33%) apply:

- Pension and disability insurance contribution – 18%;
- Health Insurance Contribution – 12.5%;
- Unemployment insurance contribution – 1%;
- Childcare contribution – 1.5%.

In Brčko District, the following types and rates of contribution apply:

- Contribution for pension and disability insurance – the employee decides in which fund the contribution of PIO is paid and the rate is applied (24% in Federation or 18% in RS);
- Health Insurance Contribution – 12%;
- Unemployment insurance contribution – 1.5%.

Working in the Federation of Bosnia and Herzegovina, thanks to tax policy, is an economically unreasonable thing to do. On the net salary, the employer is obliged to pay

about 72% of the amount in the name of the employee for taxes and contributions. The Federation has the highest cumulative contribution rate in the region, amounting to as much as 41.5% of gross salary, while in the Republika Srpska the cumulative contribution rate is only 33%. In Montenegro, this rate is 32.5%, in Serbia 37.8%, and in Croatia 37.2%⁹.

When it comes to the overall fiscal burden on labor, two factors determine it – high social contribution rates plus income taxes. These two create the tax wedge as a difference between the cost of labor and what the worker receives on hand, expressed as a share of the total cost of labor¹⁰. The current tax wedge on salaries in the Federation, for a worker who receives an average gross wage is 41.9% without tax-free benefits. Considering that the majority of the population of Bosnia and Herzegovina lives in the Federation of Bosnia and Herzegovina, around 63%¹¹, and even more work there because of larger development, then it is clear that a significant proportion of workers pay one of the highest contributions not only in the region, but in Europe and the world¹². This discourages workers from getting employed, and employers from employing.

⁹ CPU (2019) *Zašto nam je neophodno manje oporezivanje rada*. Available [online]: www.cpu.org.ba/blog-bih/post/2019/zasto-nam-je-neophodno-manje-oporezivanje-rada/ [in Bosnian]

¹⁰ CPU (2019) *Klik se klinom izbija: šta donosi novi prijedlog oporezivanja rada u BiH*. Available [online]: www.cpu.org.ba/blog-bih/post/2019/klik-se-klinom-izbija-sta-donosi-novi-prijedlog-oporezivanja-rada-u-bih/ [in Bosnian]

¹¹ Tportal (2016) *Konačno se zna koliko u BiH ima Bošnjaka, Srba i Hrvata*. Available [online]: <https://www.tportal.hr/vijesti/clanak/konacno-se-zna-koliko-u-bih-ima-bosnjaka-srba-i-hrvata-20160630> [in Bosnian]

¹² Dnevni list (2019) *Imamo najveće stope doprinosa u Europi a njihovo smanjenje dovelo bi do rasta plaća i investicija*. Available [online]: <https://www.dnevni-list.ba/imamo-najvece-stope-doprinosa-u-europi-a-njihovo-smanjenje-dovelo-bi-do-rasta-placa-i-investicija/> [in Bosnian]



REAL ESTATE TAXES ARE OFTEN NEGLIGIBLE, NON-EXISTENT, AND DO NOT INTERFERE WITH CONDUCTING BUSINESS

What is also important to the state is that the outcomes of these contributions are very uncertain and inefficient. Namely, through the contribution system the employee mostly finances pension insurance and health insurance. The state of these two large social systems is catastrophic, so the minimum paid pension in the Federation is EUR 190, while in the Republika Srpska it is even lower – EUR 103¹³. Because of financial difficulties, both of pension schemes have switched to the treasury business mode, i.e. budget (although, in theory, they should have remained standalone, earmarked funds).

The second major contributory social system is health care. Here, there are also a number of structural problems – large queues, inadequate health care service, lack of medical supplies, but also an in-depth debt of these funds to different parties.

Taxation of labor, as opposed to the VAT system, is very selective and, therefore, unsuccessful. Thus, the largest debtors in terms of these taxes are protected public companies such as railways, Sarajevo public carrier – GRAS, coal mines, and the like¹⁴. Workers have not been paid contributions in these companies for years, which has created not only a number of problems for the social systems themselves, but also for tax administrations, politicians, and ultimately for the workers, who are to become pensioners someday.

SUMMA SUMMARUM

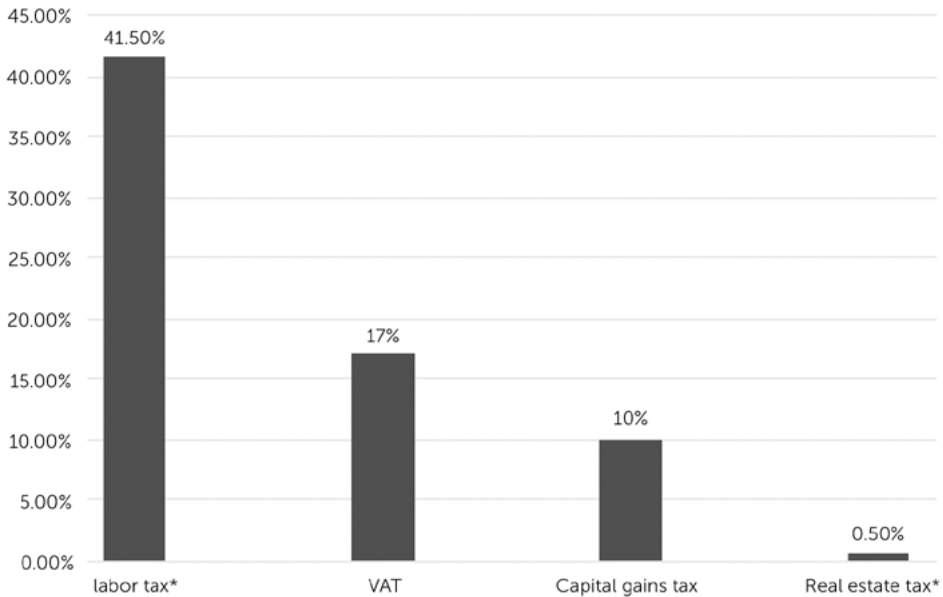
In this light, and understanding that every tax system in the world exists on several pillars, it can be concluded that in Bosnia and Herzegovina the fiscal system places the greatest burden on labor, followed by consumption, and then finally capital and, in minimal amounts, real estate. If we were to simplify this, and only compare rates, then Figure 1 shows the main characteristic of the tax system of Bosnia and Herzegovina.

This figure simplifies the entire tax system, as it excludes other consumption taxes – such as excise taxes, as well as hundreds of para-fiscal levies that are present across the country. Also, labor tax rate is used for the Federation, where the majority of the population lives. Whereas for real estate taxes, the rate in the Republic of Srpska is used, primarily because the federal rate is absolutely negligible and determined by the cantons. However, based on this simple illustration, it can be concluded that the fiscal system stimulates consumption, capital investment, and real estate ownership, while, on the other hand, it discourages labor. The consequences of all this are catastrophic.

¹³ BN (2020) *Za 170 KM manja najniža penzija u RS nego u F BiH*. Available [online]: <https://www.rtvbn.com/3976648/za-170-km-manja-najniza-penzija-u-rs-nego-u-fbih> [in Bosnian]

¹⁴ Porezna uprava Federacije BiH (2016) *Nismo svi jednaki pred zakonom*. Available [online]: www.pufbih.ba/v1/novosti/774/nismo-svi-jednaki-pred-zakonom [in Bosnian]

Figure 1: Tax system of Bosnia and Herzegovina



Source: Own elaboration

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The first obvious result of such a system is unemployment. Officially, the unemployment rate in Bosnia and Herzegovina, according to the Labor Force Survey for 2019, was 15.7%, but the *de facto* registered unemployment rate for the same period was 32.6%. This is an extremely high unemployment rate compared to the countries in the region (Croatia, Serbia, Slovenia, Northern Macedonia, Montenegro), and especially other European countries.

As a result, employers do not have the incentive to hire workers due to high labor contributions, while workers remain passive job seekers in the labor market for a long time because they do not have the incentive to work for low wages (the minimum wage is about EUR 200, while the average wage is about EUR 450 per month) in formal economy.



A SIGNIFICANT PROPORTION OF WORKERS PAY ONE OF THE HIGHEST CONTRIBUTIONS NOT ONLY IN THE REGION, BUT IN EUROPE AND THE WORLD

In order to avoid paying high levies to the state, employers and workers often look for “more creative” solutions in the gray economy zone, which can be seen from the data. Noteworthy, almost one-fourth of the economy exists within the gray economy¹⁵. All of the above applies mostly to micro employers who employ up to 9 workers – there are about 74.6% of these in the economy¹⁶. Such employers usually do not have enough turnover to pay all workers, fulfill their obligations, and ultimately provide entrepreneurial profit. In particular, it is known that labor inspections generally place the greatest focus on micro-employers,

¹⁵ Aljazeera (2018) *Siva ekonomija je zamka iz koje je teško izaći*. Available [online]: balkans.aljazeera.net/vijesti/siva-ekonomija-je-zamka-iz-koje-je-tesko-izaci [in Bosnian]

¹⁶ Capital (2019) *UBiH najviše registrovanih mikro preduze a, najmanje velikih*. Available [online]: <https://www.cap-ital.ba/u-bih-najvise-registrovanih-mikro-preduzeca-najmanje-velikih/> [in Bosnian]

seeking to compensate the debt made by large state-owned enterprises.

Low wages are certainly a significant effect of this kind of tax system. Lower net wages mean a lower purchasing power of citizens, which is reflected in quality of life, level of consumption, and ultimately in economic growth. Lower wages also mean that workers are not motivated to work, especially certain low-paying jobs.

Another problem in this regard is that there is a huge gap between the public and private sector wages, as recently noted in a comprehensive report by the representatives of the International Monetary Fund (IMF) in Bosnia and Herzegovina. As the private sector is not able to pay high wages due to high contributions, most talent still goes to the public sector, where wages and working conditions are significantly better. Public companies are, as several times stated in the article, exceptional debtors and burdens on social systems. The reason for this is that they have political protection and rationally expect the government as a last resort in terms of support (as debt write-off or subsidies).

Also, a significant level of tax evasion is due to, among other things, the tendency of the private sector to maintain competitiveness, but also for workers to bring as much money as possible to their families in such a tax system. There are numerous cases of undeclared work and registering workers for a minimum wage, with the payment of an additional amount “on-hand”, usually through corporate profits, which are significantly less taxed, and part-time employee engagement for many years (part-time contracts)¹⁷.

¹⁷ CPU (2019) *Zašto nam je neophodno manje oporezivanje rada*. Available [online]: www.cpu.org.ba/blog-bih/post/2019/zasto-nam-je-neophodno-manje-oporezivanje-rada/ [in Bosnian]

Such practices are widespread and have significant long-term social and economic implications. First of all, they created unfavorable working conditions for employed workers who do not have a lot of work experience, have no legal protection, have a low pension base, live and work in fear of being caught in illegal work, and in the case of an injury at work, they are left without existential means. These practices, one of the key results of the current tax policy, have significantly impaired the fiscal discipline of businesses, impacted the tax morale of the population, reduced the stability of funds, and discouraged investment in human capital, which contributed to the poor image of the private sector and businesses.

Another important effect relates to the lack of competitiveness of the economy. The Bosnian economy (especially manufacturing companies operating under regulations) is less competitive, as the cost of labor has to be calculated into the final price of the product, so domestic products often cannot be more favorable than the products imported from countries in the region, which prevents them from taking a significant market share.

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High taxation of labor has other manifestations; companies do not have the resources to invest in marketing, design, research and development, which further reduce the competitiveness of domestic products on trade shelves. All this directly affects their market growth, financial and investment strength, and in many cases, survival in the market¹⁸. The competitiveness rate is very low according to the Global Competitiveness Report 2019 – Bosnia and Herzegovina held the 92nd place¹⁹.

TAX THE LABOR AND THE LABOR WILL GO AWAY

However, all things considered, the biggest visible result of the tax system punishing labor is the departure of labor from Bosnia and Herzegovina. This is a process that began with the opening of borders to EU countries in 2013. A visa-free regime was then introduced for most EU countries, enabling hundreds of thousands of indigent workers to decide to seek happiness elsewhere.

Until then, it was considered that capital is too scared – if you tax it too much, it will cross borders and flee to another country. After the borders were opened, the same formula proved true for labor – modern workers have less and less patience to wait for major reform moves and change of the state. Instead, they use the first opportunity to try and work somewhere else.

High unemployment rates, low wages, social insecurity, and low living standards are all among the leading reasons why dozens of families leave Bosnia and Herzegovina every day. Although there are no clear estimates of how many citizens have left so far, the data shows that it may be as high as

¹⁸ Ibid.

¹⁹ Schwab, K. (2019) *The Global Competitiveness Report*, World Economic Forum.

half of the population in total – being partly a result of the 2013 migration wave. This means that, at the moment, there are only about 500,000 people left in the country²⁰.

What is clear is that this has become a “herd of effect”, which means that leaving Bosnia is openly talked about, and young people are increasingly seeking their prosperity outside of the country. The worst-case scenario is that somewhere down the road, Bosnia and Herzegovina might be left with no population at all. The biggest culprit for all of this is the tax system that terrorizes workers. This only worsened this year after Germany further liberalized opportunities for assimilation of Bosnian workers²¹. Germany is otherwise the largest importer of labor from Bosnia and Herzegovina, but the question is how to compete with wages that are five to ten times higher, the Western European social systems, and a better quality of life in general. Deterministically, it is imminent for Bosnia and Herzegovina to share the fate of other countries of the Western Balkans, Eastern Europe, and the Baltics. One part of the population simply has to move out, which later, through good mechanisms and strategies, can be compensated through the economic benefits of the newly formed diaspora – foreign direct investment, partnerships, and know-how transfer.

AVERTING THE CRISIS

What to do? Understanding that the tendencies to leave cannot be stopped, it should be noted that it is possible to mitigate these trends and retain domestic workers, and

²⁰ Oslobodenje (2019) *Evo koliko je ljudi napustilo BiH u posljednjih šest godina*. Available [online]: <https://mojabih.oslobodenje.ba/b-v-logovi/evo-koliko-je-ljudi-napustilo-bih-u-posljednjih-est-godina/1269> [in Bosnian]

²¹ Njemačka ambasada Sarajevo (2019) *Njemačka otvara tržište rada za kvalifikovanu radnu snagu iz zemalja izvan EU*. Available [online]: <https://sarajewo.diplo.de/ba-sh> [in Bosnian]



AS THE PRIVATE SECTOR IS NOT ABLE TO PAY HIGH WAGES DUE TO HIGH CONTRIBUTIONS, MOST TALENT STILL GOES TO THE PUBLIC SECTOR, WHERE WAGES AND WORKING CONDITIONS ARE SIGNIFICANTLY BETTER

thus strengthen the economy. This can be done primarily through reforms to the fiscal system, which has already been advocated by the international partners of Bosnia and Herzegovina, and concretized in the form of the Reform Agenda.

Specifically, it is necessary to lower the cumulative contribution rate. At the start, the total rate can be lowered from 41.5% to 33% of the gross wage. Later, this can be lowered even more – to 25%. This would significantly relieve employers and increase the possibility of raising wages. Employers prefer to pay their workers rather than the state. Also, a significant portion

of employers understands that material compensation has an impact on higher productivity. Otherwise, productivity in the region is very low, as shown by a current World Bank report²².

The next question, after this intervention, is how the stability of large social systems will be maintained. The answer to the above is reflected in the constant increase of indirect tax revenues – consumption. This revenue grows annually up to 6%, which is significantly higher than the economic growth rate of about 3% annually. So, using this positive trend, which may continue if some black swan does not occur in the form of global, European, or regional recessions, Bosnia and Herzegovina can lower the tax burden on work, reduce the tax wedge, and at the same time stabilize large social systems – by redirecting surplus revenue from indirect taxes to the partial financing of these systems.

There is another important assumption to consider, which is that by reducing the social security contributions to labor (specifically health insurance and pension and disability insurance contributions), the government will increase the consumption potential of workers. Employment will also increase, as employers will be more motivated to hire additional workforce. This will also increase total consumption, and consequently also revenues from VAT and other indirect consumption taxes. However, along with a tax reform, it is necessary to continue with the reforms that will increase the efficiency (rationalization) of the social protection system and public services, and affect the expenditure side, i.e. reduce the “losses” caused by inefficiencies. This would further strengthen their stability, as

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well as improve the safety of the workers themselves and the rest of the population.

At the same time, several reforms must be conducted: reducing the contribution rate, shifting indirect tax revenues to social systems, and ultimately reforming social systems to improve their efficiency. Ideally, all of them can be further strengthened through the complete or partial privatization of promising state-owned enterprises (such as BH Telecom), for which an in-depth analysis is already underway to assess its value. Privatization money could be used to guard the entity budgets against potential turbulence in these major fiscal reforms.

Of course, it should be noted that there is a plan B, which is an increase in the VAT rate – an idea that has been cautiously announced by international circles. This plan is far more realistic in the context of political will, but, on the other hand, it must imply a strong guarantee, a commitment to truly reduce contributions to labor.

The worst option is to increase VAT and keep contributions the same – It would push Bosnia and Herzegovina’s recession in the wrong direction, and reduce any chance of developing its economy. However, should

²² World Bank (2020) *Global Economic Prospects – Slow Growth, Policy Challenges*, Washington: World Bank Group.

the VAT rate really increase to, for example, 21%, without differentiation, with a reduction in the rate of contribution to gross wages to 25%, then it would be a strong message for domestic workers, employers, and the entire economy. Psychologically, an individual prefers to have a higher wage, with a slightly higher price of products and services, than a lower wage, with slightly lower prices of products and services. The difference is in the choice or the possibility for the individual to decide what to do with their money, which is Milton Friedman's argument, and is why plan B can also be presented as a liberal solution.

INSTEAD OF A CONCLUSION

There are a number of internal contradictions that prevent Bosnia and Herzegovina's tax system from moving forward and prospering. The good thing is that the international community, especially the European Union, still heavily influences the country. True, Brexit is not in favor of countries like Bosnia and Herzegovina because it throws out the liberal British/Anglo-Saxon approach to central authority politics in Brussels. However, international efforts sometimes produce results.

The only thing that is giving results relates to the carrot-and-stick principle, best expressed through international aid and credits to Bosnia and Herzegovina. The IMF and the World Bank have done this for years. Otherwise, there is no indication that the system will reform itself, but rather that it will remain *status quo*, implying that the wave of emigration will continue.

Although the citizens of Bosnia and Herzegovina are witnessing these scenes on a daily basis – loss of their neighbors, their immediate family members, watching tears on television and in the media – there is still no democratic consciousness to translate emotions into a concrete voice in elections

for change. The general population is prone to economic populism, such as the differentiated VAT rate, the introduction of progressive taxation in income tax, and the like. However, if something is not done soon, this kind of a fiscal system will stifle and reduce the nation, so that, in the end, only a few will remain to finally turn off the light and leave Bosnia and Herzegovina in the dark.



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