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COMPREHENSIVE TAX REFORM IN SERBIA AIMED AT ENHANCING GROWTH, EQUITY, AND ENVIRONMENTAL SUSTAINABILITY

Sveobuhvatna poreska reforma u Srbiji u cilju podsticanja rasta, pravičnosti i ekološke održivosti

Abstract

Starting from the fact that Serbia's current tax system was shaped by the 2001 reform in a markedly different economic and social context, as well as from relevant theoretical and empirical insights and the experiences of other European countries, it can be concluded that there is substantial scope for its improvement in support of the sustainable development of Serbian economy and society. A comprehensive tax reform should be oriented toward three key objectives: fostering dynamic economic growth through investment, innovation, and exports; accelerating the green transition; and reducing economic inequalities. These objectives can be achieved through a revenue-neutral reform that entails a significant reduction in the tax burden on labor, an increase in environmental taxes to align with EU policies and mitigate the effects of the CBAM, and an adjustment of consumption taxes in the residual amount necessary to preserve fiscal neutrality. Such a reform would stimulate exports and investment, enhance both horizontal and vertical equity of the tax system, and reduce inequalities, with an additional contribution from reforming inheritance and gift taxation. In parallel, a parametric reform of corporate income taxation, combined with the introduction of incentives for investment in advanced and green technologies – particularly in the small and medium-sized enterprise sector – could contribute to the growth of domestic investment and to long-term technological and environmental progress, provided that improvements in the business environment and the institutional framework are implemented simultaneously. This paper presents estimates and analyses of the economic effects of one modality of such a tax reform.

Keywords: *tax reform, fiscal devaluation, inequality, green transition, economic growth*

Sažetak

Polazeći od činjenice da je postojeći poreski sistem Srbije oblikovan reformom iz 2001. godine u bitno drugačijem ekonomskom i društvenom kontekstu, kao i od relevantnih teorijskih i empirijskih uvida i iskustava drugih evropskih zemalja, može se zaključiti da postoji značajan prostor za njegovo unapređenje u funkciji održivog razvoja srpske privrede i društva. Sveobuhvatna poreska reforma trebalo bi da bude usmerena na tri ključna cilja: podsticanje dinamičnog privrednog rasta kroz investicije, inovacije i izvoz, ubrzanje zelene tranzicije i smanjenje ekonomskih nejednakosti. Ovi ciljevi mogu se ostvariti prihodno neutralnom reformom koja podrazumeva snažno smanjenje poreskog opterećenja rada, povećanje ekoloških poreza radi usklađivanja sa EU politikama i ublažavanja efekata CBAM-a, kao i korekciju poreza na potrošnju u rezidualnom iznosu potrebnom za očuvanje fiskalne neutralnosti. Takva reforma bi podstakla izvoz i investicije, unapredila horizontalnu i vertikalnu pravičnost poreskog sistema i smanjila nejednakosti, uz dodatni doprinos reforme poreza na nasleđe i poklon. Paralelno, parametarska reforma poreza na dobit, uz uvođenje podsticaja za ulaganja u napredne i zelene tehnologije, naročito u sektoru malih i srednjih preduzeća, mogla bi da doprinese rastu domaćih investicija i dugoročnom tehnološkom i ekološkom napretku, pod uslovom unapređenja poslovnog i institucionalnog okvira. U ovom radu predstavljene su procene i analize ekonomskih efekata jednog od mogućih modaliteta takve poreske reforme.

Ključne reči: *poreska reforma, fiskalna devalvacija, nejednakost, zelena tranzicija, privredni rast*

Introduction

Over the past quarter century, Serbia's economy has recorded an average annual growth rate of approximately 3.2%, which was almost a full percentage point higher than the unweighted average growth rate of the EU-27 economies. Nevertheless, Serbia's economic growth rate over the period 2001-2025 was broadly comparable to the unweighted average growth rates of the economies of Central and Eastern Europe (CEE) – around 3.1% – and the Western Balkans – around 3.2%. These results indicate that over the past two and a half decades Serbia has achieved some degree of convergence in terms of economic development relative to the EU average, although the development gap remains substantial. In 2024, GDP per capita in Serbia amounted to only slightly more than half (specifically, 52%) of the EU-27 average (for a more detailed discussion of convergence challenges, see [19]). By contrast, over the same period, Serbia did not reduce its development gap vis-à-vis the CEE countries, despite having entered this period from a significantly lower level of development as a result of the deep and prolonged economic crisis in the 1990s.

With regard to the dynamics of economic growth, the past quarter century in Serbia can be divided into three sub-periods: *(i)* 2001-2007, a period of strong growth with an average annual rate of around 6%, broadly in line with the average growth rate of the CEE countries and significantly above the averages of both the EU-27 and the Western Balkans; *(ii)* 2008-2017, a period of sluggish growth, during which the average growth rate amounted to only 0.9%, lagging behind the averages of the CEE countries, the Western Balkans, and the EU-27, as a result of both global factors (the 2008 global financial crisis and the 2011-2013 euro area crisis) and domestic factors (fiscal consolidation, floods, and structural weaknesses in the business environment); and *(iii)* 2018-2025, a period of solid growth, during which Serbia's GDP grew at an average annual rate of 3.6%, exceeding the averages of the CEE countries, the Western Balkans, and the EU-27. Economic growth over the past decade has been driven predominantly by labor force activation and strong inflows of foreign capital, while progress in terms of technological advancement has remained modest [20].

As a result of these developments, according to World Bank data, with a gross national income (GNI) of USD 11,570 per capita, Serbia belonged to the group of upper-middle-income countries in 2024. Transition to the group of high-income countries would require an increase in Serbia's GNI of approximately one-fifth. Although this gap may appear attainable, a significant number of countries remain permanently trapped in the middle-income range – a phenomenon referred to in the literature as the "middle-income trap". The underlying reason lies in the fact that once the scope for extensive growth based on increased use of production factors (labor and capital) is largely exhausted, further progress depends to a great extent on a country's ability to catch up in terms of technological progress, that is, to generate, absorb, and implement innovations in technology and organizational practices.

The determinants of economic growth are inherently complex, as growth is influenced by dozens of often interrelated factors, some of which are policy-controllable – such as economic policy choices and institutional quality – while others are exogenous, including country-specific characteristics and global economic conditions. According to empirical evidence [4], more than half of the variation in GDP growth rates among post-socialist countries in Europe and Central Asia can be attributed to differences in policy quality, with fiscal policy and institutional quality playing a particularly prominent role. Fiscal policy contributes positively to economic growth by ensuring macroeconomic stability, for which moderate levels of fiscal deficits and public debt are key preconditions. In addition, fiscal policy can affect growth through its structural characteristics, including the level and composition of the tax burden, as well as the design and efficiency of public expenditure policies.

Following the implementation of fiscal consolidation in the mid-2010s, fiscal policy in Serbia has largely remained within sustainable bounds, as fiscal deficits have generally been low or moderate. Combined with solid economic growth in recent years, this has ensured that public debt has remained at sustainable levels. Short- and medium-term fiscal plans indicate that fiscal policy in Serbia is expected to remain within sustainable limits in the period ahead with respect to both the fiscal balance and public debt, which constitutes a necessary condition for a positive contribution to economic growth. However, this condition is not sufficient, as the issue of improving the structural characteristics of fiscal policy remains open.

In this context, the design of the tax system plays a particularly important role. For the tax system to contribute positively to business conditions and the development of the economy and society, it must generate sufficient tax revenues to keep fiscal deficits low in the medium and long run, while minimizing the distortionary effects of taxation on economic decisions (regarding labor supply, saving, investment, risk-taking, etc.) and ensuring an equitable distribution of the tax burden. Serbia's current tax system was established through the major tax reform of 2001, when the core tax laws governing the main tax instruments were adopted. Together with the legislation regulating value added tax (VAT), introduced in 2005, and numerous subsequent amendments, these laws still constitute the backbone of the tax system today. Given that the tax system was originally designed under markedly different economic, social, and technological conditions, a comprehensive reform now appears necessary. The parametrization of such a reform should be based on clearly defined objectives derived from a long-term development strategy for the economy and society.

In this regard, a reform of Serbia's tax system aimed at supporting sustainable development should pursue three main objectives: *(i)* fostering economic growth based on investment, innovation/technological progress, and exports; *(ii)* improving the equity of the tax system and its contribution to reducing economic inequality, so that the benefits of economic growth are more evenly and inclusively distributed; and *(iii)* contributing to Serbia's green transition and environmental protection. In addition, since certain segments of tax policy are subject to EU guidelines that are binding for member states, the design of tax reform must take into account both the opportunities and constraints arising from these guidelines, given that Serbia is in the process of negotiating EU accession.

Accordingly, this paper presents one possible option for a comprehensive tax reform in Serbia, derived from the objectives outlined above. While maintaining the overall tax burden at its current level, such a reform would encompass: *(i)* reform of the personal income taxation, aimed at a substantial reduction in the tax burden on labor and improvements in horizontal and vertical tax equity, to be achieved through the abolition of health insurance contributions, the equalization of marginal tax rates across all income sources, a significant increase in the tax-free personal allowance, and the introduction of family allowances for dependent household members; *(ii)* an increase in environmental and health-related taxes – such as carbon taxes and other green taxes – to levels that would, over time, internalize the effects of EU environmental border charges (CBAM) and preserve fiscal proceeds in the Serbian budget, the introduction of excise duties on coal and coke as envisaged by EU guidelines, and increases in existing tobacco excises to align with current and forthcoming EU excise policy; and *(iii)* a compensatory increase in the general consumption tax (VAT), which would render the tax reform revenue-neutral. In addition to these three core components, the tax reform could also include changes to inheritance and gift taxation aimed at enhancing progressivity by replacing the current general exemption with a tax-free inheritance allowance, as well as reform of corporate income taxation through the introduction of safeguard mechanisms related to the global minimum corporate tax. Potential additional revenues from these sources could be used to finance further corporate income tax incentives for small and medium-sized enterprises investing in technologically advanced and green projects, as well as to provide additional protection for vulnerable population groups through improved coverage and generosity of means-tested social assistance programs [11].

Reducing the tax burden on labor would stimulate labor force participation and formal employment, while improving cost and price competitiveness of the domestic economy – effects that would be particularly beneficial for export-oriented and labor-intensive sectors. At the same time, re-parametrization of personal income taxation would enhance both horizontal and vertical equity. By contrast, increases in consumption taxes would primarily affect import-oriented firms rather than export-oriented sectors, while discouraging consumption and encouraging saving, which represents an important precondition for the growth of domestic private investment. Finally, reform of environmental taxes would contribute to improvements in environmental quality without additional adverse effects on the export competitiveness of Serbia's economy oriented toward EU markets, as payments of environmental border charges to EU budgets would be replaced by tax payments to the Serbian budget.

The issue of comprehensive reform of Serbia's tax system in the direction of fiscal devaluation and the creation of drivers of sustainable growth and development has been raised repeatedly over the past decade and a half ([3], [22]). In addition to a detailed elaboration of the parametrization of such a tax reform – taking into account previously proposed approaches ([3], [22]) – this paper presents the results of simulation analyses of changes in the tax burden, as well as corresponding ex-ante assessments of the economic effects of the reform.

The remainder of the paper is organized as follows. Section 2 provides a review of the empirical literature on tax reforms, with a focus on recent trends in tax reforms in EU countries. Section 3 presents and discusses the concept and parametrization of the proposed tax reform, while Section 4 analyzes its economic effects. Section 5 offers concluding remarks.

Review of Relevant Tax Reform Literature

The impact of the tax system on economic growth and development has long attracted the attention of economists and policymakers. Empirical research indicates that labor and capital costs – and, indirectly, the manner in which these factors of production are taxed – are of particular importance for fostering growth, strengthening competitiveness, and supporting long-term development. Over recent decades, tax systems have undergone multiple phases of reform in response to shifting economic priorities and social objectives. While in some periods the emphasis was placed on revenue mobilization and fiscal sustainability, in others the focus shifted toward efficiency, equity, or the promotion of investment and employment. These changes have resulted in gradual adjustments to tax structures, including modifications of tax rates, broadening or narrowing of tax bases, and the introduction of various tax incentives.

The question of the optimal tax structure from a competitiveness perspective has been studied more intensively since the 1980s, particularly in the context of increasing globalization and growing mobility of capital and labor. Within the European context, many countries have sought to alleviate the tax burden on labor in order to stimulate employment and reduce business costs. At the same time, in order to preserve existing levels of public expenditure and the quality of public services, governments have turned to alternative sources of revenue, such as higher taxation of consumption (e.g. VAT), broadening of tax bases, or strengthening the taxation of property and certain forms of capital income. Such reforms are often part of a broader concept of so-called tax shifting, whereby the tax burden is moved away from labor toward other, economically less distortionary forms of taxation.

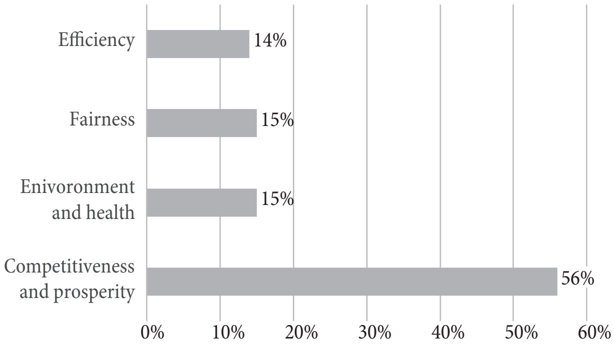
The idea of using environmental taxes as a means of reducing more distortionary taxes was among the first articulated by Pearce [18] under the concept of the "double dividend." The central premise of this hypothesis is that environmental taxes not only contribute to the reduction of pollution but may also generate favorable economic effects – primarily by enabling reductions in other more distortionary taxes, without jeopardizing the overall fiscal sustainability ([13], [14]). In practice, such reforms were first implemented by the Nordic countries (Finland, Norway, Sweden, and Denmark), which introduced carbon taxes to reduce greenhouse gas emissions while simultaneously using the resulting fiscal space to lower labor taxes, thereby improving the overall efficiency of their tax systems. Nevertheless, empirical evidence shows that the double dividend hypothesis does not necessarily hold across all countries and under all economic conditions [13], requiring country-specific analysis.

In parallel, policy discussions have increasingly focused on the possibility of shifting the tax burden from labor to consumption through so-called "fiscal devaluation". By reducing taxes on wages and social security contributions while simultaneously increasing consumption taxes such as VAT, the aim is to enhance economic competitiveness and stimulate employment.

Research by the Organisation for Economic Co-operation and Development – OECD ([15], [16]) suggests that such a shift can have a positive impact on long-term economic growth. Likewise, simulations conducted by the European Commission confirm improvements in economic performance in both the short and medium run [7]. Early examples of fiscal devaluation measures in practice include Denmark (1988), Sweden (2003), and Germany (2006). Following the outbreak of the euro area crisis in 2010, the potential beneficial effects of fiscal devaluation gained prominence [10]. In the post-crisis period, fiscal devaluation measures – implemented to varying degrees – were adopted, among others, by France, the Netherlands, and Croatia (2012). A particularly notable case is Hungary, which initially raised its VAT rate sharply from 20% to 25% in 2009 and further to 27% in 2012 in order to stabilize public finances. After fiscal conditions had been stabilized, however, VAT rates were not reduced to their previous levels; instead, Hungary opted for fiscal relief through a substantial reduction in taxes and social contributions on labor after 2017 [8].

An OECD study [17] indicates that over the past decade, international practice was dominated with reforms of labor taxation, environmental taxes, and health-related taxes. An analysis by the European Commission shows that tax reforms implemented in EU simultaneously addressing broader social and environmental objectives [6]. As illustrated in Figure 1, as much as 56% of implemented tax measures were aimed at enhancing competitiveness and economic growth, including increasing public revenues, stimulating investment, boosting employment, and improving overall economic performance. In addition to competitiveness and growth, a significant share of tax measures and reforms targeted environmental protection, public health, and the promotion of green investment (15%), as well as the reduction of social inequality and the enhancement of tax equity (15%), and improvements in tax system efficiency through the simplification of administrative procedures and the streamlining of legal provisions (14%). This structure of tax reforms points to a dominant economic focus, while also reflecting an increasing tendency to use tax policy as an instrument for advancing a broader social and sustainable development agenda.

Figure 1: Tax Reforms in EU-25 Countries by Area of Impact



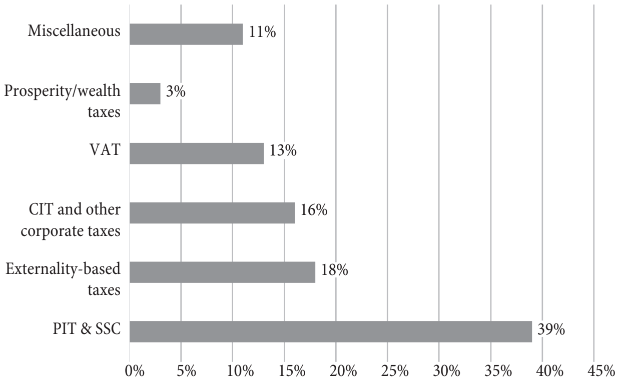
Source: European Commission based on responses to the 2025 joint OECD-European Commission Annual Tax Policy Reform Questionnaires

The most recent available data indicate that the objectives of European tax reforms have been pursued predominantly through reforms of personal income taxation and social security contributions (together accounting for approximately 40% of all reforms), followed by reforms of taxes on externalities (18%) and corporate income taxation (16%), while value-added tax systems and property taxes have been reformed to a lesser extent (Figure 2). Reforms of personal income taxation have primarily taken the form of increased progressivity and greater consideration of taxpayers' socioeconomic characteristics. Specifically, countries such as Estonia and Latvia have raised top marginal personal income tax rates in order to enhance progressivity. Similarly, pursuing more pronounced indirect progressivity and providing additional relief for low-wage earners, several countries – including Germany, Croatia, Latvia, and Lithuania – have increased tax-free income thresholds.

Moreover, tax allowances for families with children have become increasingly prominent. Hungary has announced the gradual doubling of child-related tax allowances, while Croatia has increased tax deductions for children, with more generous adjustments for families with a larger number of dependents [17].

In the domain of environmental taxation, increases in taxes on fossil fuels and carbon emissions have been implemented by countries such as Latvia, Lithuania, the Netherlands, and Denmark. Similarly, in the area of health-related taxation, prevailing trends point to higher excise duties on alcohol, tobacco, and related products across a growing number of countries (e.g., Estonia,

Figure 2: Tax Reforms in EU25 Countries by Tax Type



Source: European Commission based on responses to the 2025 joint OECD-European Commission Annual Tax Policy Reform Questionnaires. France and Romania did not provide input.

Lithuania, Latvia, Slovenia, Bulgaria, Hungary, Slovakia, and Poland) [6].

Taxation trends in the Western Balkan countries broadly follow those observed in the European Union. In this context, Montenegro implemented a radical tax reform in 2022, significantly reducing the fiscal burden on wages with the aim of enhancing competitiveness and stimulating economic growth, while simultaneously increasing the degree of tax progressivity in order to address income inequality [1]. Strengthening the progressivity of tax systems has also been observed in other countries in the region, primarily through greater recognition of taxpayers' differing socioeconomic circumstances and the introduction of tax allowances for children and other dependent household members in Bulgaria, Bosnia and Herzegovina, and Albania. As a result, Serbia, Montenegro, and North Macedonia have remained notable outliers among European countries, as their tax systems do not take into account differences in taxpayers' socioeconomic circumstances and do not provide tax allowances for dependent household members.

Design of the Serbian Tax Reform

Overall tax burden can be measured in several ways, most commonly through the ratio of tax and social contribution revenues to GDP. When measured in this manner, the tax burden in Europe spans a wide range – from around 30% of GDP in countries such as Romania, Albania, and North Macedonia, to approximately 45% of GDP in countries such as France, Denmark, Belgium, and Sweden. This substantial cross-country variation in tax burden reflects differences in efficiency, as well as in the design and structure of public finances, that is, in the scope of goods and services provided by the public sector as opposed to those that, in some countries, are partially or fully delegated to the private sector (such as healthcare or education).

On average, the tax burden in EU countries amounts to approximately 39% of GDP, while this share is somewhat lower in CEE countries, at around 35% of GDP. In Serbia, the tax burden in 2025 amounted to 36.4% of GDP, which is below the European average and median, yet still slightly higher than the average observed in comparable CEE countries. If Serbia's public sector is expected to continue providing a range of goods and services similar to the current one – broadly comparable to that of most continental European countries – a substantial reduction in the overall tax burden would neither be feasible nor fiscally sustainable. Nevertheless, a moderate reduction, toward the CEE average, could be both economically justified and fiscally viable, provided that efficiency in public expenditures and public service provision is improved.

In light of these considerations, the tax reform blueprint examined in this paper is based on the assumption of revenue neutrality, meaning that the reform parameters are calibrated such that, in a static sense, the tax system generates the same level of tax revenues as before. Although certain elements of the reform could have positive effects on factor activation and the reduction of the informal economy – potentially leading to higher tax revenues over time – such effects are not guaranteed *ex-ante*. Therefore, for reasons of prudence and in order to safeguard the sustainability of public finances and macroeconomic stability, it is necessary to design the tax reform as revenue-neutral in static terms. Should a positive behavioral response to the reform result in additional tax revenues, the resulting fiscal space could be used for further effective reductions in taxation on labor or capital, either through adjustments to tax rates or through increases in tax allowances.

In addition to the revenue-neutrality assumption, the parametrization of the tax reform is derived from its core objectives: promoting economic growth driven by exports, investment, innovation, and technological progress; enhancing horizontal and vertical equity, as well as improving the redistributive role of the tax system; and supporting the green transition, while aligning the tax system with EU directives. Accordingly, a comprehensive tax reform would entail substantial changes to the system of personal income taxation and mandatory social security contributions, as well as to consumption taxation, alongside parametric improvements in the taxation of inheritance and gifts and corporate income tax.

Reform of the Personal Income Taxation

The current system of personal income taxation in Serbia is hybrid. Incomes are taxed at source, dominantly by withholding, at proportional statutory rates of 10%, 15%, or 20%, depending on the type of income. Furthermore, approximately 1.5% of taxpayers – those whose incomes exceed three times the average annual wage in Serbia – are additionally subject to an additional annual personal income tax, levied at progressive rates of 10% and 15%. Such a system is not in line with dominant models of income taxation in European countries, which typically follow one of three approaches: a flat tax with a single marginal rate, a comprehensive income tax with progressive rates applied to all income sources, or a dual income tax system combining progressive taxation of labor income with proportional taxation of capital income.

Although statutory personal income tax rates in Serbia are low by European standards, the overall fiscal burden on labor income is not low, reflecting relatively high social security contribution rates, which amount to 35.05% in total (24% for pension and disability insurance, 10.3% for health insurance, and 0.75% for unemployment insurance). For a taxpayer earning an average wage, with a spouse and two dependents, the labor taxes burden in Serbia amounts to 59.5 dinars per 100 dinars of net wage, which is above the average observed in CEE and the Western Balkans (53.3 dinars). A particularly notable feature is that, in CEE countries and the Western Balkans, the average fiscal burden on wages is more than eight percentage points lower for taxpayers with dependents than for those without dependents, whereas in Serbia the fiscal burden is identical for these two categories of taxpayers due to the non-existence of family tax allowances.

In light of these considerations, it can be concluded that the existing system of personal income taxation in Serbia is neither horizontally equitable – since individuals with the same level of income derived from different sources are taxed at different rates – nor vertically equitable, given that progressive taxation applies to a very small share of taxpayers while the major statutory rates are proportional. At the same time, the above-average fiscal burden on wages in Serbia has a disincentive effect on labor force participation and the formalization of employment. Taking into account limited administrative capacity, a pronounced presence of informality with shadow economy estimated at 21-22% of GDP in Serbia [24], increasing international and regional labor mobility, significant emigration trends, and the need to stimulate labor activation in the formal sector, it is deemed that a sharply progressive personal income tax would not be optimal for Serbia at its current stage of economic and social development. Instead, redistribution aimed at reducing inequality should primarily be addressed through improvements in institutional arrangements that shape the initial market income distribution – such as access to education, anti-corruption measures, the suppression of rent-seeking behavior, and the provision of level playing field for business development. Reforming and improving the social protection policies is also an important avenue for reducing income inequality since social assistance programs are the main instrument for income redistribution and the reduction of inequality and poverty in European countries.

Accordingly, the reform of taxation of personal income could include: *(i)* the abolition of mandatory health insurance contributions; *(ii)* the introduction of a single statutory marginal tax rate applicable to all types of income; and *(iii)* an increase in the tax-free personal income threshold, alongside the introduction of allowances (deductions from the tax base) for dependent family members.

One possible option in this regard would be the introduction of a uniform marginal tax rate of 15% on all types of income, combined with an increase in the tax-free personal income threshold to 40,000 dinars per month (approximately two-thirds of the minimum wage), and the introduction of a family allowance amounting to 15,000 dinars per dependent. Such a reform would reduce the fiscal burden on the average wage of a taxpayer with a spouse and two dependents from 59.5% of net earnings (i.e. 59.5 dinars in taxes and contributions per 100 dinars of net wage) to 40.9%. For taxpayers without dependents, the fiscal burden would be reduced from 59.5% to 48.8% (Figure 3 and Figure 4).

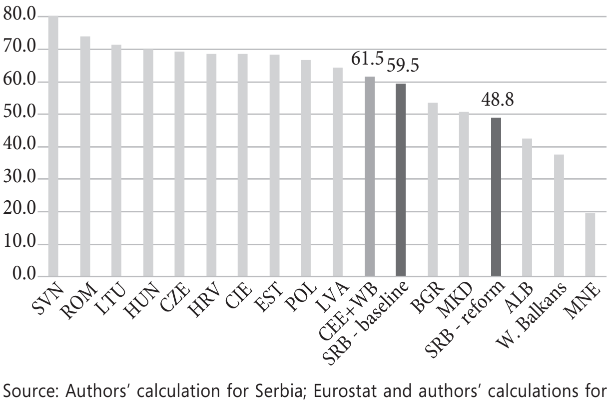
The proposed reform framework would significantly enhance Serbia's tax competitiveness. Measured by the average fiscal burden on wages, Serbia would move from a position in which the burden on taxpayers with dependents is currently well above the CEE and Western Balkan averages – and, for taxpayers without dependents, roughly at the CEE average, but well above the Western Balkan average to a position in which Serbia would rank among the three (out of thirteen) CEE and Western Balkan countries with the lowest tax burden on labor, markedly below the respective regional averages.

By increasing the personal tax-free earnings threshold and introducing allowances for dependent family members, the reform would further enhance indirect progressivity in income taxation. According to simulation analyses based on the Survey on Income and Living Conditions (SILC), disposable income inequality – as measured by the Gini coefficient – could be reduced by approximately 0.15 percentage points. Moreover, the tax burden on taxpayers with dependent family members would be reduced to a particularly large extent. This implies that personal and family circumstances would be explicitly taken into account when determining the tax burden, in line with the practice prevailing in almost all European countries. In this manner, the reform would contribute not only to reducing income inequality but also to reducing poverty, especially among families with children.

Similar conclusions are suggested by simulation results regarding changes in the fiscal burden across lower and higher wage levels. Under the current system, the ratio of the fiscal burden on earnings equal to twice the average wage to that on earnings equal to half of the average wage in Serbia amounts to only 1.1 (Table 1). This implies that when earnings increase fourfold (from one-half to twice the average wage), the fiscal burden rises on average by only 10%, whereas in CEE countries and the Western Balkans the corresponding increase averages around 30%. Following the reform, this ratio in Serbia would increase to 1.2, thereby bringing Serbia closer to the CEE and Western Balkan averages in terms of the degree of progressivity in the taxation of labor income.

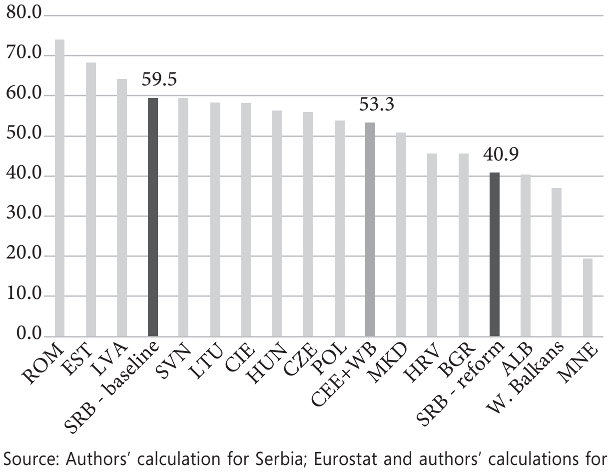
The increase in progressivity would be even more pronounced when comparing the fiscal burden on very low wages (e.g., wages equal to one-third of the average wage, typically earned by part-time workers) with that on wages exceeding five times the average wage. The underlying reason lies in the fact that the calculation of mandatory social security contributions (including health insurance contributions) is subject to minimum and maximum contribution bases. While such rules are economically

Figure 3: Fiscal Burden on Average Wage – Taxpayers Without Dependents (% of Net Wage)



Source: Authors' calculation for Serbia; Eurostat and authors' calculations for other countries

Figure 4: Fiscal Burden on Average Wage – Taxpayers with Spouse and Two Children (% of Net Wage)



Source: Authors' calculation for Serbia; Eurostat and authors' calculations for other countries justified, they introduce a regressive element into the tax system. The abolition of health insurance contributions would substantially mitigate this source of regressivity.[1]

1 Since statutory tax rates on most other types of income would remain nominally and effectively unchanged, no significant redistributive effects are expected in those segments. However, definitive conclusions in this respect would require additional simulations covering other income categories.

The proposed substantial reduction in the fiscal burden on wages would improve Serbia's position in the increasingly pronounced "wage race" within the Western Balkan region. In an effort to deter emigration to more developed EU member states, Western Balkan countries have been increasingly resorting to policies aimed at

Table 1: Fiscal Burden on Wages in Serbia, CEE, and Western Balkans (% of Net Wage)

Single person with no children				
	50% of average wage	100% of average wage	200% of average wage	RATIO: 200%/50% of average wage
SVN	58.1	80.4	95.2	1.6
ROM	70.8	74.0	74.4	1.1
LTU	53.8	71.4	76.3	1.4
HUN	69.9	69.9	69.9	1.0
CZE	58.1	69.3	75.6	1.3
HRV	45.3	68.7	79.0	1.7
CEE - average	*55.2*	*68.7*	*73.6*	1.3
EST	45.7	68.3	70.0	1.5
POL	57.8	66.7	83.3	1.4
LVA	38.9	64.3	67.7	1.7
CEE+WB - average	*49.5*	*61.5*	*66.4*	1.3
SRB - baseline	**55.6**	**59.5**	**61.8**	**1.1**
BGR	53.6	53.6	44.4	0.8
MKD	47.5	50.8	52.5	1.1
SRB – reform	**42.7**	**48.8**	**52.6**	**1.2**
ALB	31.4	42.4	46.6	1.5
W. Balkans - average	*30.7*	*37.6*	*42.6*	1.4
MNE	13.0	19.6	28.6	2.2
One earner couple with two children				
	50% of average wage	100% of average wage	200% of average wage	RATIO: 200%/50% of average wage
ROM	67.5	74.1	74.4	1.1
EST	45.7	68.3	70.0	1.5
LVA	39.0	64.3	67.7	1.7
SRB - baseline	**55.6**	**59.5**	**61.8**	**1.1**
SVN	51.0	59.5	79.0	1.5
LTU	38.1	58.3	69.2	1.8
CEE - average	*44.4*	*58.2*	*65.8*	1.5
HUN	44.6	56.3	62.8	1.4
CZE	36.2	55.9	68.1	1.9
POL	44.9	53.9	64.5	1.4
CEE+WB - average	*41.2*	*53.3*	*60.4*	1.5
MKD	47.5	50.8	52.5	1.1
HRV	38.4	45.6	62.2	1.6
BGR	38.3	45.6	40.6	1.1
SRB – reform	**29.7**	**40.9**	**48.4**	**1.6**
ALB	31.4	40.3	45.5	1.4
W. Balkans - average	*30.7*	*36.9*	*42.2*	1.4
MNE	13.0	19.6	28.6	2.2

Source: Authors' calculations based on Eurostat data and national statistics offices of WB countries raising workers' (net) wages, often at rates significantly exceeding labor productivity growth. In recent years, wage growth in CEE countries has been markedly higher than productivity growth, thereby posing risks to domestic competitiveness [20]. One of the most common policy instruments used to increase nominal wages is an upward adjustment of the statutory minimum wage, which in Serbia has cumulatively increased by 40% from January 2025 to January 2026.

As shown in Table 2, the total labor costs (net wage + wage tax + social contributions on employee and employer) of the statutory minimum wage in Serbia in 2026 ranks among the highest in the region, exceeding even that of some considerably more developed EU member states, such as Romania and Bulgaria. At the same time, although the total labor costs in Serbia are substantially higher than in Montenegro, the net minimum wage is lower (EUR 555 in Serbia compared to EUR 600 in Montenegro). This difference reflects the radical reduction in the fiscal burden on wages implemented in Montenegro in recent years, including the abolition of health insurance contributions [1].

As the analysis indicates, if the tax incidence is on employer, the proposed reform would reduce total labor costs for paying the minimum wage in Serbia from EUR 857 per month to EUR 789 in the case of a worker without dependents, and to EUR 715 in the case of a worker supporting two children and an unemployed spouse. This relief would substantially narrow the gap between minimum wage labor costs in Serbia and those in other Western Balkan countries.

Table 2: The Total Labor Costs of a Minimum Wage in the Western Balkans, 2026

Country	EUR
Croatia	1,223
Hungary	947
Serbia – Baseline	857
Romania	813
Serbia – Reform	715-789
Bulgaria	739
Montenegro	678
Albania	603
North Macedonia	586

Source: Authors' calculations for Serbia; Eurostat; and authors' calculations for other countries

Reform of Environmental and Health-Related Taxes

From 2026 Serbia started implementing a tax on greenhouse gas (GHG) emissions with the objectives of reducing emissions, promoting the green transition, and gradually aligning with the climate policies of the EU. The immediate trigger for introducing the GHG emissions tax was the tightening of EU climate policy regarding the full application of the Carbon Border Adjustment Mechanism (CBAM) to all relevant goods imported into the EU for which an equivalent price for emissions generated during the production process has not been previously paid in the country of origin. In Serbia, tax is imposed on all major GHG – carbon dioxide, nitrous oxide, and fluorinated gases – covering all emission-intensive sectors and products.

However, the initial tax rate of EUR 4 per ton of emissions is far too low to reflect current emission costs in the EU, which are approximately EUR 80 per ton, with a tendency to increase further in the coming years.[2] Such a low domestic tax rate implies that exporters of relevant products (fertilizers, aluminum, steel, and others) will continue to pay the bulk of the fiscal charge associated with greenhouse gas emissions into the EU budget through the CBAM mechanism. Consequently, there exists both scope and a clear rationale for increasing the domestic carbon emissions tax rate so as to redirect fiscal revenues from the CBAM mechanism to the Serbian budget, without adversely affecting the competitiveness of the covered industries and producers in Serbia.

The Fiscal Council [12] estimates that an effective carbon tax rate of EUR 40 per ton, applied to the production of cement, aluminum, fertilizers, and steel (i.e., all CBAM-covered products except electricity), could generate additional budget revenues amounting to 0.2% of GDP. Nevertheless, even a tax rate of EUR 40 per ton would not fully cover the CBAM burden, which – based on current EU ETS prices – amounts to approximately EUR 80 per ton, with an upward trend. Accordingly, increasing the domestic carbon emissions tax to a level that would fully cover the CBAM burden (for example, EUR 100 per ton

2 Furthermore, the law allows for the reduction of the tax base to account for the reference level of relevant emissions in EU member states, reducing the effective tax rate even further.

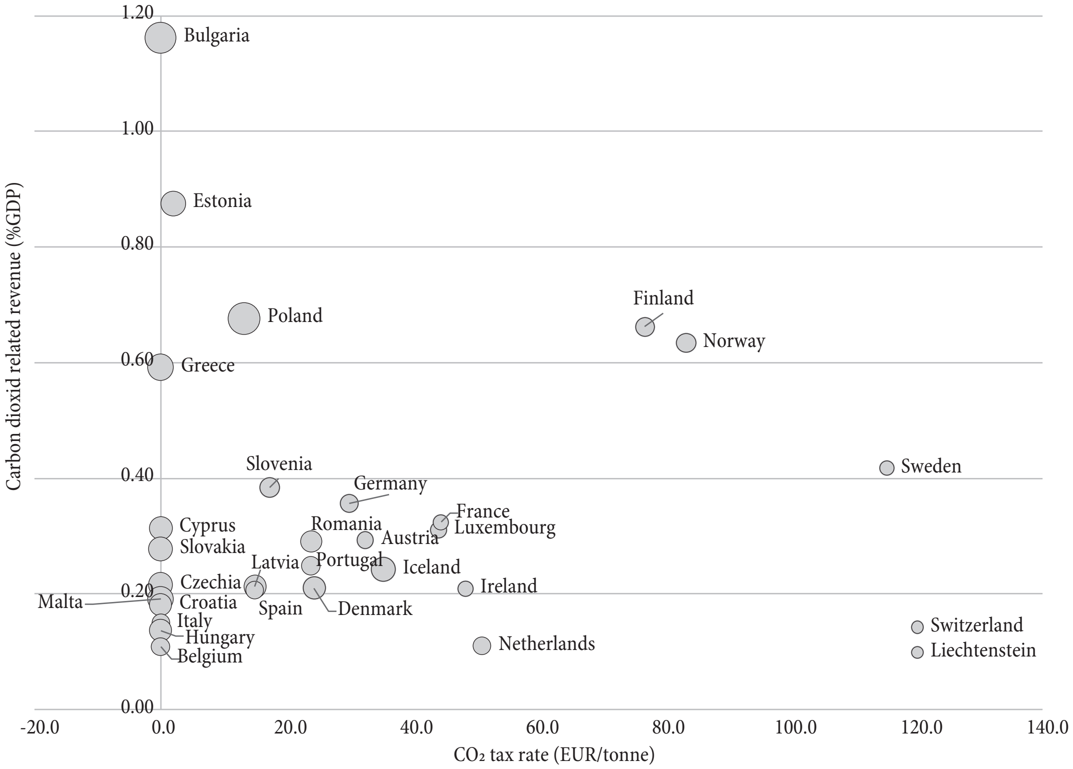
in the medium term) could generate additional budget revenues of around 0.5% of GDP.

The greatest potential for increasing public revenues lies in implementation of a carbon emissions tax to electricity generation in Serbia. Full implementation of such a tax at a level sufficient to cover the CBAM burden could, in theory, generate additional budget revenues of approximately 2.5% of GDP, which could fully offset the revenue loss associated with the abolition of health insurance contributions. However, the Fiscal Council [12] cautions that, given Serbia's heavy reliance on coal-fired power generation, a substantial increase in taxes on electricity production would not only lead to significant social disruptions but would also undermine the competitiveness of the domestic power sector, unless preceded by radical and comprehensive reforms of the public utility Elektroprivreda Srbije and substantial improvements in existing social protection systems. For reasons of prudence and realism, the present paper therefore does not consider the options or effects of applying a carbon tax to electricity generation in the near term.

According to Eurostat data presented in Figure 5, revenues from taxes related to carbon emissions in European countries averaged around 0.3% of GDP in 2023, with substantial variation among countries. The highest revenues from energy taxes linked to carbon emissions were recorded in Bulgaria (1.16% of GDP), Estonia (0.88% of GDP), Poland (0.68% of GDP), Finland (0.66% of GDP), and Norway (0.63% of GDP). In contrast, countries such as Hungary, the Netherlands, and Belgium generated significantly lower revenues from these sources, amounting to only around 0.1% of GDP. With expected carbon tax revenues of approximately 0.5% of GDP, Serbia would be positioned above the EU average – a result that is consistent with the substantially higher carbon emission intensity observed in Serbia relative to most EU member states.

With respect to excise taxation in the energy sector, Serbia is already largely aligned with European practice, and therefore no substantial additional public revenues can realistically be expected from this segment. Specifically, excise duties on petroleum products in Serbia are generally above the minimum levels prescribed by current EU

Figure 5: Energy – Carbon Dioxide-Related Taxes, Emission Intensity, and Carbon Tax Rates in the EU in 2023



Source: Eurostat and World Bank

* The size of the circle shows the intensity of a country's emissions, measured in kilograms per 1 euro of GDP.

** Total revenues represent the sum of revenues from the sale of permits under the EU Emissions Trading System (EU ETS) and complementary national carbon taxes in member states where such taxes have been introduced. National carbon tax rates are displayed on the horizontal axis.

regulations: excise duties on gasoline and diesel amount to around EUR 0.6 per liter, while excises on liquefied petroleum gas are approximately EUR 0.5 per kilogram. By comparison, the EU minimum excise levels are EUR 0.36 per liter for gasoline, EUR 0.33 per liter for diesel, and EUR 0.12 per kilogram for liquefied petroleum gas. Existing excise duties on electricity in Serbia are also broadly in line with EU directives, although there is scope to consider, in the coming period, a shift from an *ad valorem* excise to a unit tax ratee based on the quantity of consumption (per MWh), without changing the overall average burden on consumers and, consequently, without affecting the level of budget revenues. In addition, the introduction of an excise duty on coal – foreseen under the EU regulation – should be considered in the future; however, this segment does not offer significant potential for additional public revenues.

Excise taxation of tobacco products in Serbia is likewise largely aligned with current EU regulations and follows recent trends observed in more advanced countries with respect to expanding the coverage of tobacco-related products subject to taxation. In Serbia, excise duties on most tobacco products already exceed EU minimum requirements, while excises on cigarettes remain partially below the prescribed standards. EU regulation requires that the minimum excise duty on cigarettes to amount to at least EUR 1.8 per pack and that the total excise burden reach at least 60% of the weighted average retail price. Although the minimum excise duty on cigarettes in Serbia already exceeds the prescribed nominal threshold, the overall excise burden remains slightly below the required level.

However, it should be noted that the EU is planning a further strengthening of the tobacco taxation framework, which is expected in the coming years to lead to a substantial increase in minimum excise duties and an expansion of coverage, with the objective of reducing tobacco consumption and improving population health outcomes. With regard to cigarette excises, a significant increase in minimum excise levels is expected – from the current EUR 90 per 1,000 cigarettes to EUR 215 per 1,000 cigarettes – along with the introduction of a mechanism under which minimum excise levels would be adjusted across countries according to purchasing power standards [9]. Taking into account price levels in Serbia in line with the proposed directive formula, the minimum excise duty on cigarettes in Serbia would amount to approximately EUR 190 per 1,000 cigarettes (around EUR 3.8 per pack). In addition, for the first time, minimum excise duties would be defined for heated tobacco products (HTPs), which – if sold in packs – would amount to EUR 108 per 1,000 units, corresponding to approximately EUR 95 per 1,000 units (EUR 1.9 per pack) when adjusted for the relevant purchasing power standard in Serbia.

Achieving the expected minimum excise level on cigarettes in Serbia is probably not feasible in the short term, due to the risk of a contraction of the legal market and increased cross-border trade [23]. However, the timely adoption of a medium-term excise calendar aimed at gradual alignment with the new, more restrictive EU rules could realistically ensure that the minimum excise level in 2030 is approximately 30% higher than in 2025. Given that current trends and the adopted excise calendar suggest that the excise burden by 2030 would be around 15% higher than the current level, this additional increase of 15% – under realistic assumptions regarding a further marginal decline in consumption – could generate additional public revenues amounting to approximately 0.1% of GDP in 2030.

Overall, it is realistic to expect that the introduction of carbon emissions taxes that would redirect the fiscal burden associated with CBAM into the Serbian budget (excluding the potential effects on electricity generation), together with the alignment of excise taxation with EU directives, could generate additional public revenues of at least 0.6% of GDP. In this way, it would be possible to offset about one quarter of the budget revenue losses resulting from the abolition of health insurance contributions.

Compensatory Adjustment to Consumption Taxation

The abolition of mandatory health insurance contributions would result in a loss of budget revenues amounting to 2.5% of GDP. One quarter of the lost tax revenues, amounting to 0.7% of GDP, would be offset through higher revenues from reformed personal income taxation, while another quarter would be compensated by environmental and health-related taxes (0.6% of GDP). In order for the tax reform to remain revenue-neutral, in static sense, the remaining half of the lost tax revenues (1.2-1.3% of GDP) could be compensated through an increase in VAT rates by two percentage points – from 10% to 12% for the reduced rate and from 20% to 22% for the standard rate. As a result, Serbia's standard VAT rate would be slightly above the average standard rate in EU countries (21.5%) and the average reduced rate (11.3%). Notably, 11 EU member states apply a standard VAT rate of 22% or higher. In this way, the reform would achieve the effect of fiscal devaluation - shifting the tax burden from labor to consumption – thereby further enhancing the export competitiveness of the domestic economy.

If the implementation of the tax reform were preceded by structural reforms in the area of government expenditures – such as improvements in the performance of state-owned enterprises or more efficient execution of public investment – additional fiscal space could be created, allowing the required VAT rate adjustment to be smaller. According to World Bank analyses, the net contribution of state-owned enterprises to Serbia's state budget in recent years has been negative, averaging around −0.7% of GDP [25]. If this negative contribution were eliminated through improvements in corporate governance and management of these enterprises, it would become feasible to implement the proposed tax reform with a VAT adjustment of only one percentage point.

Reform of Other Taxes

Given that empirical evidence indicates that wealth inequality in Serbia, as in most European countries, is significantly higher than income inequality, the issue of wealth inequality could be addressed within the tax reform through changes to the taxation of inheritance and gifts. In Serbia, tax rates in this area are relatively low – 1.5% and 2.5%, respectively – while in EU countries they range from 3% in Romania to as much as 80% in Belgium, with the EU-27 average at around 25%. However, considering that inheritance in Serbia largely relates to real estate and often serves as a means of addressing housing needs for future generations, maintaining low tax rates or partially aligning them with the CEE average (5-15%) may be more appropriate than substantially increasing them to the EU average.

Nevertheless, in addition to tax rates, the effects of inheritance taxation are strongly influenced by the system of allowances, which in Serbia is universal – providing full tax exemption for heirs in the first line of inheritance. While such an approach can be justified on sociological grounds, it is inherently regressive. In particular, the tax relief for an individual inheriting property worth EUR 1 million amounts to EUR 15,000, whereas for an individual inheriting property worth EUR 100,000 the relief is only EUR 1,500. This implies that wealthier individuals receive a substantially larger implicit subsidy through this exemption than poorer ones. For this reason, many European countries have replaced universal exemptions for first-line heirs with tax-free inheritance thresholds – for example, in Germany up to EUR 500,000 for spouses and EUR 400,000 for children; in France up to EUR 100,000 per child; in Italy up to EUR 1 million for all first-line heirs; and in the United Kingdom GBP 325,000, with an additional exemption of up to GBP 175,000 for inheritance of the family home.

Accordingly, it would be justified to consider replacing the universal exemption in Serbia with a tax-free inheritance allowance for first-line heirs. One possible option would be to link the tax-free threshold to the present value of average lifetime earnings. For example, the present value of a monthly net wage of EUR 1,000 earned over a 40-year working career, discounted at a rate of approximately 3%, would amount to around EUR 300,000. Under such a design, individuals inheriting assets of small or moderate value would remain exempt, while heirs of high-value assets would be subject to taxation.

Within the framework of this tax reform, improvements to the corporate income tax system could also be considered. The current statutory rate of 15% in Serbia is below the average in CEE countries (16-17%) and the EU-27 average (21-22%), representing a comparative advantage that should be preserved. Nevertheless, certain changes to the system of corporate income tax incentives could enhance the overall economic effects of this tax. The OECD initiative on the global minimum corporate tax of 15%, which has been adopted by most advanced economies, requires multinational enterprises with annual revenues exceeding USD 750 million to pay tax on their global profits at an effective rate of no less than 15%. This effectively implies that Serbia's existing tax incentive for large investments (investments exceeding one billion dinars and employment of more than 100 workers) loses its incentivizing effect for multinational companies, since parent companies would be required to pay the difference up to the 15% effective rate in their home jurisdictions.

It would therefore be justified to introduce a corrective mechanism in Serbia's tax system in the context of the global minimum corporate tax, preventing revenue losses without generating real investment incentives. This would help create fiscal space for the introduction of targeted tax incentives – such as an investment tax credit for small and medium-sized enterprises (SME) investing in technological innovation and green technologies. Such measures could address one of the key weaknesses of Serbia's previous growth model, namely low levels of domestic private investment, given that most domestic firms belong to the SME sector [20]. These incentives could potentially also be extended to large enterprises that do not fall under the global minimum corporate tax regime.

Reform of Social Assistance Programs

An increase in VAT rates, reform of the excise duties (including the potential introduction of excise duties on coal), and higher environmental taxes may, when viewed on an annual basis, have regressive effects, as they could impose a relatively higher burden on poorer segments of the population. In order to mitigate or neutralize these adverse distributional effects, it would be desirable, within the framework of a broader reform, to strengthen means-tested social protection programs, such as child allowances and social assistance for low-income households. This could be achieved through a revision of some of the highly restrictive eligibility parameters in order to expand program coverage, as well as through increases in the benefit levels provided under these programs [11]. A reform of social assistance oriented toward a general increase in the coverage and generosity of these programs represents a more appropriate solution than, for example, expanding the "energy-vulnerable customers" program. Expanding that program would partially neutralize the intended environmental effects – such as the shift from coal toward cleaner household heating sources – since the effective price of carbon-intensive energy sources faced by beneficiary households would not change significantly.

Alternatively, or as a complementary measure, the introduction of earned income tax credits (EITCs), following the practice of advanced economies, could be considered. Such credits would be targeted at reducing poverty among low-skilled employed individuals with very low earnings, and could also contribute to higher labor force participation within this population group.

Economic and Social Effects of the Proposed Tax Reform

The proposed tax reform model would, in essence, imply a major reduction in the tax burden on labor, accompanied by a shift of taxation toward general consumption and environmentally and health-damaging consumption. Specifically, around 1.4% of GDP in tax burden would be shifted from direct to indirect taxes, while approximately 0.5% of GDP in direct taxes on labor would be reallocated toward the production of goods associated with harmful greenhouse gas emissions. Empirical evidence ([2], [5]) indicates that taxes on factors of production – most notably corporate income taxes and personal income taxes – are significantly more detrimental to future economic growth than taxes on consumption and property (including inheritance and gift taxes). Accordingly, the analyzed tax reform model, which substantially reduces the fiscal burden on labor income and partially lowers the tax burden on capital (corporate profits), while increasing general and environmental taxes on consumption and property/inheritance, could, consistent with these empirical findings, have positive effects on the future growth dynamics of the Serbian economy.

In this context, a significant reduction in the fiscal burden on labor could contribute to higher labor force participation, which is particularly relevant given that inactivity and unemployment rates in Serbia remain higher than the CEE average, despite convergence observed over the last decade. Moreover, such a reform would incentivize a further reduction in informal employment and facilitate transitions into formal labor market arrangements. To the extent that tax savings are passed on to employers through lower total labor costs, the reform would positively affect investment and export competitiveness of the Serbian economy, which in recent years has been adversely affected by wage growth outpacing productivity growth, that is, by rising unit labor costs. By contrast, the compensatory adjustment of consumption taxes (primarily VAT) would not negatively affect the export-oriented segment of the economy, but only its import-oriented component, given that exports are exempt from consumption taxes while imports are subject to them. This implies that the proposed tax reform would have a positive impact on net exports over time. In addition, somewhat higher taxation of consumption would encourage households to postpone consumption and increase savings. Despite notable increases over the past decade, domestic savings in Serbia remain relatively low, and higher savings could contribute positively to the future investment financing opportunities.

The proposed reform of the organization of personal income taxation would significantly improve horizontal equity, as well as vertical equity, i.e. progressivity, while maintaining a balance between equity and economic efficiency. Increasing the personal tax-free income threshold and introducing deductions for dependent family members would indirectly raise the degree of progressivity of the tax system. Moreover, improvements in vertical equity and progressivity would also be achieved through additional mechanisms – most notably through the abolition of health insurance contributions, which disproportionately affect low-skilled individuals working part-time while having no impact on very high-income earners, as well as through the activation of low-income individuals whose fiscal burden (for taxpayers with dependent family members) would be reduced from over 55% to below 30%. The tax reform would further contribute to reducing economic inequality by replacing regressive exemptions in inheritance taxation with a progressive system of tax allowances. [3]

An increase in the VAT rate by two percentage points would have a direct effect on the inflation rate, with the magnitude of this effect depending on the extent to which the additional tax burden is passed on to consumers. If the entire additional tax burden were fully passed through to prices, inflation would increase on a one-off basis by up to 1.7 percentage points in the year of implementation. In certain market segments where demand is more price-elastic than supply, full pass-through would not occur, suggesting that the actual static inflationary effects would likely be smaller than this upper-bound estimate. Furthermore, the substantial reduction in the fiscal burden on labor would significantly lower production costs for certain goods and services, which – under competitive market conditions – could exert downward pressure on prices. As a result, the overall net effect on inflation in the medium and long term would likely be smaller.

In addition to its economic effects, the proposed reform would also generate important positive social outcomes by enabling universal access to the public healthcare system for all Serbian citizens (for example, through access based on a personal identification card). Although a large share of the population is already covered under the existing system, there remain certain groups – estimated at around 150,000 to 200,000 individuals – who do not have free access to the public healthcare system. To ensure the financial stability and predictability of public healthcare financing, institutional mechanisms (e.g. within the Budget System Law) should be introduced to guarantee the level of financing of the Republic Health Insurance Fund from general tax revenues in an amount at least equal to the contributions that would have been collected had the reform not been implemented. In this way, Serbia would *de iure* adopt a Beveridge-type model of healthcare financing, which is already largely present *de facto*, albeit accompanied by substantial and unnecessary administrative burdens.

3 More progressive taxation of wages could also affect the allocation of revenues used to finance local governments. This issue could be addressed relatively easily through an alternative parametrization of intergovernmental revenue-sharing arrangements—for example, by basing transfers to local governments on registered wage levels rather than on collected personal income tax revenues.

According to empirical analyses [12], between 2010 and 2023 greenhouse gas emissions in CEE countries declined by approximately 20%, while in Serbia they decreased by only 3-4%. Starting in 2026, certain export sectors of the Serbian economy have also come under the scope of EU environmental border charges (CBAM). By significantly strengthening the system of environmental taxes, revenues from this source would be redirected from the budgets of EU member states to the Serbian budget, while simultaneously providing incentives for a transition toward green and environmentally sustainable technologies and business models. This would support Serbia in achieving a meaningful improvement in environmental quality in the coming period.

Finally, reform of the system of tax incentives in the area of corporate income taxation could stimulate investment by small and medium-sized enterprises – most of which are domestic firms – as well as technological progress through investments in innovative and green technologies. Although the tax system is not the primary bottleneck for higher levels of domestic private investment and faster technological progress – these constraints are more closely related to the overall business environment and the quality of the institutional framework [21] – such tax incentives could nevertheless contribute, to some extent, to improvements in these areas. In parallel, reform of the tax exemptions within the inheritance tax scheme, by replacing regressive general exemption, with non-taxable amount of inheritance, would additionally contribute to overall progressivity of the reform and reduction of economic disparities.

Concluding Remarks

In this paper, we have argued that Serbia's current tax system – shaped under the specific transitional conditions of the early 2000s – is increasingly misaligned with the contemporary development needs of the economy and society. Although fiscal policy over the past decade has ensured macroeconomic stability, the structural characteristics of the tax system continue to exert disincentive effects on employment, labor formalization, and domestic investment, while contributing relatively little to the reduction of inequality and the acceleration of the green transition. Our analysis demonstrates that there is substantial scope for improving the structure of the tax system without increasing the overall tax burden.

The proposed model of comprehensive tax reform is based on the principles of revenue neutrality, horizontal and vertical fairness and fiscal devaluation, achieved through a significant reduction in the tax burden on labor and a corresponding shift toward taxation of consumption and environmental externalities. Simulation results suggest that such a reform could enhance the cost competitiveness of the Serbian economy, stimulate employment and exports, and increase household disposable income – particularly for households with dependent members. At the same time, the abolition of health insurance contributions and the transition toward financing healthcare from general public revenues would enable universal access to the public healthcare system for all citizens of the Republic of Serbia, regardless of their employment or income status. By increasing the personal tax-free earnings threshold and introducing family allowances for dependent household members, the tax burden would be more closely aligned with taxpayers' actual socioeconomic circumstances, in line with prevailing practice in European countries, thereby improving both horizontal and vertical equity of the tax system.

An important dimension of the proposed reform relates to the promotion of the green transition and environmental sustainability. The proposed increase in taxes on greenhouse gas emissions would mitigate the adverse effects of CBAM on export competitiveness while redirecting newly collected fiscal charges from EU budgets to the domestic budget. Finally, we emphasize that the proposed tax reform should not be viewed in isolation, but rather as an integral component of broader social and institutional reforms aimed at strengthening the rule of law, fostering a supportive environment for private entrepreneurship and innovation, and advancing the process of accession to the EU. Such a reform agenda would support development convergence of the Serbian economy thus contributing to mitigation of the middle-income trap risk.

The quantitative parameters presented in this paper should be understood as indicative benchmarks that illustrate the direction, internal consistency, and potential macroeconomic and distributional effects of a comprehensive reform, rather than as fixed policy prescriptions. The final parametrization of individual tax instruments should be determined through more refined empirical evaluations, including updated microsimulations and behavioral assessments, as well as through an inclusive and transparent public debate involving policymakers, social partners, the academic community, and the broader public. Such a deliberative and evidence-based approach is essential to ensure political legitimacy, institutional feasibility, and long-term sustainability of the reform.

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