



## **Weekly Briefing**

### **Montenegro social briefing:**

**New tax solutions may negatively affect the standard of living**

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## **New tax solutions may negatively affect the standard of living**

### **Summary**

*In February, the Government of Montenegro made a number of decisions in the area of tax policy that could negatively affect the standard of living and economic activity in the country. Such decisions include an increase in excise duties, the introduction of new excise duties, an increase in the profit tax, the introduction of a new business turnover tax, but also numerous other levies that will directly or indirectly affect the economy and the population. Such decisions are a consequence of earlier populist policies that brought public finances to a catastrophic state.*

### **Introduction**

At the end of February, several proposals for tax laws were on the agenda of the Parliament of Montenegro - Law on Amendments to the Excise Law, Law on the Amendments to the Law on Tax on Turnover of Immovable Property, Law on Supplements to the law on Prevention of Illegal Business Operations, Law on Amendments to the Law on Corporate Profit Tax, and Law on the Amendments to the Law on Budget and Fiscal Responsibility.<sup>1</sup> The Parliament adopted the aforementioned bills.<sup>2</sup> On the other hand, the Proposal for the Law on Amendments to the Law on Games of Chance was withdrawn from the agenda.

### **Additional burden on the economy and the population as a continuation of irresponsible politics**

It seems that the aforementioned laws were part of the agenda at the parliamentary session primarily because of the extremely bad situation in public finances. The disastrous populist policy that was implemented during the previous years led to an uncontrolled growth of state spending. Unfortunately, that consumption growth was dominantly related to current consumption, while capital consumption suffered. The populist policy is not planned to be suspended, so in the run-up to the elections, an additional increase in current spending for various items is promised, such as, for example, an increase in the wages of employees in the

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<sup>1</sup> Parliament of Montenegro, Agenda of the Fourth extraordinary session session is available at <https://www.skupstina.me/me/sjednice/sjednice-skupstine>

<sup>2</sup> Parliament of Montenegro, Sitting of Fourth Extraordinary Session in 2023 <https://www.skupstina.me/en/articles/sitting-of-fourth-extraordinary-session-in-2023-ends>

public sector in 2023. The increase of wages of public administration employees is foreseen by the Work Programme of the Government of Montenegro for 2023.<sup>3</sup>

Such an irresponsible attitude towards the state budget and the easy decision to borrow led to a growing projected deficit in the budget for the next period, because the assumed obligations must be serviced. Namely, in the Government Work Program for 2023, an increase in the missing funds in the budget is projected in the following years, so there was an obvious intention to redefine the tax policy and increase certain taxes. As a consequence, the document states that according to the movement of the budget deficit and debt repayment, the missing seats in the period 2023, 2024 and 2025 will amount to EUR715.8 million, EUR842.1 million euros in and EUR1,196.6 million, respectively.<sup>4</sup>

Therefore, the budget deficit will increase by over 67% by 2025 compared to 2023. The projections were made by analysing the movement of budget revenues and expenditures in the medium term, so that the projected budget deficit (not counting debt repayment obligations) will amount to almost EUR365 million, or almost 6% of projected GDP. That part of the deficit will grow both in absolute terms (almost EUR428 million in 2025) and in relative terms (6.2% of projected GDP in 2025).<sup>5</sup> If to these amounts are added the maturing obligations related to debt repayment, then the budget deficit increases to 11.6% of GDP in 2023 and even 17.3% of GDP in 2025.<sup>6</sup>

### **New tax burdens may have a negative impact on the functioning of the economy and the standard of living of citizens**

Numerous works indicate a negative relationship between the growth of the tax burden and economic growth and living standards. For example, Kotlan and Machova (2013) investigated the impact of tax burden on the economic growth and living standard in OECD countries and showed the existence of negative impact.<sup>7</sup> Also, some of the works related to Montenegro indicate that despite the significant reduction of the tax burden in Montenegro (primarily labor costs) during the previous decades, this burden is still significantly higher than

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<sup>3</sup> Government of Montenegro, Work Programme of the Government of Montenegro for 2023, February 2023 (available at: <https://www.gov.me/en/documents/83c638de-063b-4bff-b881-03798b9d74c3> )

<sup>4</sup> Ibid, p. 7

<sup>5</sup> Ibid.

<sup>6</sup> Personal calculations based on data from the Work Programme of the Government of Montenegro for 2023. The projected GDP specified in the document Program of Economic Reforms 2023-2025 was used. (available at: <https://www.gov.me/en/documents/da1d441a-47a6-4245-a156-c94602f21ab6> )

<sup>7</sup> Kotlan, I., Machova, Z. (2013). The Impact of the Tax Burden on the Living Standard in OECD Countries. *Ekonomický časopis*, Vol. 61, No. 9, pp. 951-962.

the average of the OECD countries and higher than in most countries of the region.<sup>8</sup> This additionally leads to the fact that Montenegro has the highest in-work poverty rates among all ex-Yugoslav countries.<sup>9</sup> Therefore, the standard of living of the citizens of Montenegro is not at an enviable level, not even those who are employed, which is influenced by numerous factors. Therefore, new tax burdens, regardless of whether they relate to the economy, should be viewed in the context of the impact on citizens.

Businessmen and producers, who are undoubtedly faced with even larger tax levies, may try to pass on part of the additional burden to customers through an increase in product prices. This would have very bad consequences for society through the growth of inflation. The tax burden on products and services is already at a high level. Namely, recent research has shown that Montenegro has the highest tax burden on products and services in all of Europe and that it is the only European country where this burden exceeds a fifth of GDP and amounts to 22.86% of GDP.<sup>10</sup>

Therefore, recently adopted tax laws could affect the additional impoverishment of citizens through the weakening of their purchasing power. Hence, the laws that were passed without public discussion and without taking the opinion of business associations, aim to alleviate the budget deficit caused by irresponsible spending and populist politics. Inflation in Montenegro, which during 2022 was a record among the countries of the Western Balkans and exceeded 17% in December 2022 (compared to the same month of the previous year)<sup>11</sup>, will be further stimulated by the adoption of new laws (especially due to the expected increase in excise taxes) and will affect the reduction of the real income of citizens. The explanation of the proponents of the law that it is necessary to harmonize our legislation with the EU legislation (because it is about increasing the excise duty on carbonated drinks, sweets, etc.) seems hypocritical. If so, numerous other, much more important regulations would have been enacted. Therefore, it seems that the essential reason for the adoption of such laws is high, irrational and

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<sup>8</sup> Katnić, M. (2017) Poresko opterećenje rada u Crnoj Gori - procjena uticaja promjene nivoa poreskog opterećenja rada. UNDP Country Office, ISBN 978-9940-614-27-0, Podgorica, available at: [https://www.researchgate.net/profile/Milorad-Katnic/publication/320264096\\_PORESKO\\_OPTERECENJE\\_RADA\\_U\\_CRNOJ\\_GORI-procjena\\_uticaja\\_promjene\\_nivoa\\_poreskog\\_opterecenja\\_rada/links/59d88a09aca272e609668ff4/PORESKO-OPTERECENJE-RADA-U-CRNOJ-GORI-procjena-uticaja-promjene-nivoa-poreskog-opterecenja-rada.pdf](https://www.researchgate.net/profile/Milorad-Katnic/publication/320264096_PORESKO_OPTERECENJE_RADA_U_CRNOJ_GORI-procjena_uticaja_promjene_nivoa_poreskog_opterecenja_rada/links/59d88a09aca272e609668ff4/PORESKO-OPTERECENJE-RADA-U-CRNOJ-GORI-procjena-uticaja-promjene-nivoa-poreskog-opterecenja-rada.pdf)

<sup>9</sup> Golubovic, V., Mirkovic, M., & Kaludjerovic, J. (2022). In-work poverty in Montenegro. *Journal of International and Comparative Social Policy*, 38(2), 180-191. doi:10.1017/ics.2022.8

<sup>10</sup> The research was carried out by UNU-WIDER, and the interactive map and data by country can be found at: [https://www.index.hr/vijesti/clanak/ovo-je-karta-poreza-na-kupnju-hrvatska-je-najgora-u-eu/2428458.aspx?index\\_tid=303884&index\\_ref=naslovnica\\_vijesti\\_prva\\_d](https://www.index.hr/vijesti/clanak/ovo-je-karta-poreza-na-kupnju-hrvatska-je-najgora-u-eu/2428458.aspx?index_tid=303884&index_ref=naslovnica_vijesti_prva_d)

<sup>11</sup> MONSTAT, Consumer price indices, RELEASE 1/2023 (available at: [https://www.monstat.org/uploads/files/cijene/CPI/2022/12/CPI\\_EN\\_Decembar\\_2022.pdf](https://www.monstat.org/uploads/files/cijene/CPI/2022/12/CPI_EN_Decembar_2022.pdf))

often unjustified public spending, that will not be stopped because there is no political responsibility and will. Such behaviour needs additional sources of financing. Therefore, these measures can only be seen as a temporary solution, or mitigation of an existing problem, the solution of which requires a significantly more responsible approach of policy makers. However, it is hard to expect radical changes in their thinking. Moreover, the continuation of unreasonably high public spending may soon result in new requests for tax burdens, such as an increase in VAT.

The increase in excise taxes on cigarettes has already proved unsuccessful in the past, so it was expected that such an increase would lead to an increase in the shadow economy. In addition to the increase in excise duties on sugar products, cocoa and ice cream, and on carbonated and non-carbonated water with added sugar as well as on cigarettes, a special impact on price growth and the living standard of citizens will be an increase in excise duties on fuel. The fiscal effect of this will undoubtedly be reflected in inflation, which will additionally lead to a decrease in the real income of citizens.

Also, the introduction of the so-called "Solidarity Contribution" would represent an additional burden on businessmen, and indirectly on the entire economic activity in the country. This contribution would be taken from the profits of economic entities. According to the draft law<sup>12</sup>, companies with annual revenues of more than EUR5 million will pay 33 percent<sup>13</sup> extra in taxes in 2023 and 2024. The money collected would be used to fund social welfare spending. This solution of filling the budget at the expense of entrepreneurs who contribute most significantly to the increase in employment, investments and economic growth did not receive the support of the Chamber of Commerce of Montenegro because it is a legal proposal that introduces additional and unexpected obligations for the economy, and a detailed public discussion on the same is required.<sup>14</sup> This additionally indicates the arbitrariness of the government, which wants to continue its insatiable need for uncontrolled spending at the expense of the economy and citizens.

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<sup>12</sup> Draft Law on Solidarity Contribution (available at: <https://www.gov.me/en/documents/70fed6e9-dfd9-4791-af81-fa692ad61faf>)

<sup>13</sup> According to the draft law, the solidarity contribution rate is proportional and amounts to 33%.

<sup>14</sup> PKCG: The Law on Solidarity Contribution is a blow to the economy, an urgent meeting with the Prime Minister and ministers is requested (PKCG: Zakon o solidarnom doprinosu udar na privredu, zatražen hitan sastanak sa premijerom i ministrima, available at; <https://press.co.me/pkcg-zakon-o-solidarnom-doprinosu-udar-na-privredu-zatrazen-hitan-sastanak-sa-premijerom-i-ministrima/>)

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The government suddenly adopted a set of tax laws that it wants to provide additional funds for current spending, which is mostly populist and uncontrolled. There is currently no publicly elaborated analysis of the various impacts (macroeconomic effects in the short and medium term) of such legal changes. This additionally confirms that the government, when making these decisions, was not guided by expert opinions and studies dealing with these impacts, but arbitrarily, without any strategic approach, passed potentially very harmful laws. Thus, the government, instead of thinking about measures aimed at suppressing inflation, is passing laws that could further increase the already high inflation. This would, of course, lead to a deterioration in the living standards of citizens.