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SCIENTIFIC PAPER

Economic and Tax Competitiveness in Selected South East European Countries

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ABSTRACT
National competitiveness has become one of the central preoccupations of government in every nation. International capital flows affect diversification of business activities and intensifying competitive advantage. Market liberalization, open economy, and economic integration have become a key principle of globalization and the disregard of them reduces the possibility of a certain economy to be competitive in global terms. This assertion is primarily directed towards small countries and countries which aren't economic strong enough to withstand the competitive pressure and they are forced to economic integrated. The aim of the paper is to draw the attention to the significance of competitiveness and tax rates in the economy. The subject of the paper is showing the competitive position of Serbia with special emphasis on the WEF indicators and tax rates.

Key words: *competitiveness, GCI, GDP, tax rates, South Eastern European countries*

JEL Classification: E62, H20, H21

INTRODUCTION - THEORETICAL BACKGROUND

Competitiveness is the primary goal of every economy and national competitiveness has become one of the central preoccupations of government in every nation. If the country is competitive, it's attractive to investors and inflow of foreign capital will be more intense. Competitiveness means effective and efficient administration and predictable tax system and it isn't just an attractive business environment. When we say predictable tax system, it' reflects stable tax rates without frequent changes of their level and one segment of this paper properly emphasize the height of tax rates and how their differentiation is in the region. Competition policy is a major instrument for building a modern and competitive market economy (UNCTAD, 2011). To understand the competitiveness of the economy it is necessary to start from the crucial source of prosperity. The standard of living of a nation is the determinant of productivity of its economy, measured by the value of products and services produced per unit of human capital and natural resources (Porter, Schwab, Sorrell and Lopez-Claros, 2004). According to the WEF (Klaus Schwab, 2010) national economic competitiveness is defined as the set of institutions, policies, and factors which determine the productivity of countries. National competitiveness has become one of the central preoccupations of government in every nation. Myles (2000) emphasizes that economic growth is the foundation of increased prosperity. Matthews (2011) defines that competition is primarily determined by fundamental elements which determine productivity and economic progress. He means that political and economic

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stability, efficient and impartial institutions and law enforcement are more important than the level of the tax burden.

The significance of improving national competitiveness is a widely accepted and in order to determine this concept in a good way, it's necessary to proceed from the upgrading of the standard of living of citizens as the foundation of national prosperity (Savić, 2012). Lengyel (2004) defines competitiveness as the complex term that can be applied to all the basic units (company, sector, region, country, and macro-region) and it focuses on two measurable economic components: income and employment. Krugman and Obstfeld (2003) emphasize that countries have to specialize in those products that it can produce more efficiently than other economies. Zeneli (2011) and his statistical research has proven that the quality and performance of the institutions and business environment free of corruption are the main factors that investors consider before entering this region.

THEORETICAL PRINCIPLES AND METHODOLOGY OF COMPETITIVENESS

Before we start to detailed talk about competition it's essential to define and emphasize the main principles without market economy can't operate.

Table 1. Principles of World Competition

Economic performance	**Business efficiency**
Prosperity of a country manifests past economic performance. Competition governed by market forces improves the economic performance of a country. Openness for international economic activities increases a country's economic performance. Export -led competitiveness is related with growth-orientation in the domestic economy.	A well-developed internationally integrated financial sector in a country supports its international competitiveness. The attitude of the workforce affects the competitiveness of a country, Efficiency and ability to changes in the competitive environment are managerial attributes crucial for enterprise competitiveness. Maintaining a high standard of living requires integration with the international economy.
Government efficiency	**Infrastructure**
State intervention in business activities should be minimized, apart from creating competitive conditions for enterprises. Government should provide macroeconomic and social conditions which are predictable and thus minimize the external risks for economic enterprise. Government should be flexible in adapting its economic policies to a changing international environment. Government should provide a societal framework that promotes fairness, justice and equality while ensuring the security of the population.	A well-developed infrastructure includes information technology and efficient protection of the environment, including efficient business systems support economic activity. Adequate and accessible educational resources help develop a knowledge-driven economy. Long term investment in RD is likely to increase the competitiveness of enterprises. Competitive advantage can be built on the efficient and innovative application of existing technologies.

Source: Garelli (2006)

Table 1. shows economic performance, business efficiency, infrastructure and government efficiency as major principles of world competition. It's necessary to realize these principles together and set the economy on a competitive basis to enable the countries to profile their place in the globalized market.

Garelli (2014) creates a list of golden rules of the competition:

- create a stable and predictable legislative environment,
- work on a flexible and resilient economic structure,

- invest in traditional and technological infrastructure,
- promote private savings and domestic investments,
- develop aggressiveness on the international markets as well as attractiveness for foreign direct investment,
- focus on quality, speed and transparency in government and administration,
- maintain a relationship between wage levels, productivity and taxation,
- preserve the social fabric by reducing wage disparity and strengthening the middle class,
- invest heavily in education, especially at the secondary level and in the life-long training of the labour force,
- balance the economies of proximity and globality to ensure substantial wealth creation while preserving the value systems that citizens desire.

In line with the economic theory of stages of development, the GCI assumes stages of an economy based on a factor, efficiency, and innovation. Factor-driven economies are very sensitive to world economic cycles, exchange rate fluctuations and commodity prices and their main competitive advantage are low-cost labour and unprocessed natural resources. Efficiency-driven economies are countries which have advanced products and services, heavy investment in infrastructure, strong investment incentives, improving skills and better access to investment capital, etc. At the end, economies driven by innovation are characterized by distinctive producers and a large share of services in the economy and they are quite resilient to external shocks. The main competitive advantage is innovative products and services at the global technology frontier using the most advanced methods.

Table 2. Stage of development economy

Stage of development					
Indicator	**Stage 1: Factor-driven**	**Transition from stage 1 to stage 2**	**Stage 2: Efficiency-driven**	**Transition from stage 2 to stage 3**	**Stage 3: Innovation-driven**
GDP per capita (US$)	< 2000	2000-2999	3000-8999	9000-17000	> 17000
Weight for basic requirements	60%	40-60%	40%	20-40%	20%
Weight for efficiency enhancers	35%	35-50%	50%	50%	50%
Weight for innovation and sophistication factors	5%	5-10%	10%	10-30%	30%

Source: WEF (2014)

World Economic Forum (WEF) analyses the productive potential of countries around the world more than 30 years and indicates which factors of competitiveness are the most important as well as why some countries are more successful and better ranked than others. Since 2005, the WEF is based on an analysis of the competitiveness of GCI (Global Competitiveness Index) which deals with macroeconomic and microeconomic fundament of competitiveness.

All components are grouped into twelve factors: a) institutions, b) infrastructure, c) macroeconomic environment, d) health and primary education, e) higher education and training, f) goods market efficiency, f) labor market efficiency, g) financial market development, h) technological readiness, i) market size, j) business sophistication and innovation.

COMPETITIVENESS IN SOUTH EAST EUROPEAN COUNTRIES

After 25 years of transition, the economies of the Western Balkans are in a risky state. Unemployment has climbed to alarming levels and this is partly because to the fallout from the spillover effects of the crisis in Eurozone, but structural unemployment were high in the preceding period (Bartlett, 2013). Contemporary world economic development takes place in the era of globalization and open market with emphasized liberalization and privatization of property as well as stabilization of macro and micro level. It's necessary to improve productivity and adapt production structure with a high level of finalization and technology. Also, the permanent involvement of new technical content and innovation, as well as modern management is key prerequisites for potential growth of the economy. After 2000, the Western Balkan countries enjoyed sustained economic growth up until the global economic crisis. During pre-crisis period, real GDP per capita in the region increased by more than 40% on average, riding the tide of deeper financial and trade integration with the rest of Europe, rapid credit expansion, high capital inflows and productivity growth. (Murgasova et al., 2015). Growth needs to be driven by competitiveness and economic integration, productivity and investment (Zeneli, 2014)

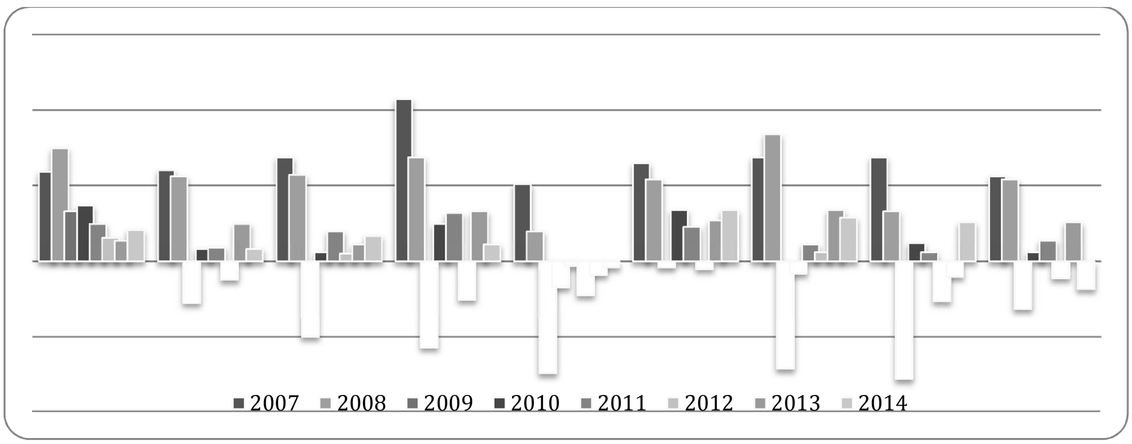

Figure 1. GDP growth rates in Western Balkans (2007-2014)

Source: Authors based on http://www.imf.org/

At the beginning of the observed period, countries recorded encouraging growth rates to the escalation of the crisis that there was a significant fall in GDP where Slovenia dropped by 7.8%, which is the largest decrease with Croatia whose GDP fell by 7.4%. At the end of 2014, countries in the region have achieved positive rates of a given indicator, in addition to Croatian and Serbian which recorded a negative result. In Croatia, a slight drop of 0.8% in economic activity, while in Serbia, the drop was particularly noticeable was 1.8%. The economy of Macedonia has had a respectable growth of 3.4%, which represents the highest rate in the observed group of countries, while the economies of Romania and Montenegro had an increase of over 2% (Kalaš, 2015). As can be seen, only Albania had positive growth rates throughout the period to the end of 2014 amounted to 2.6%.

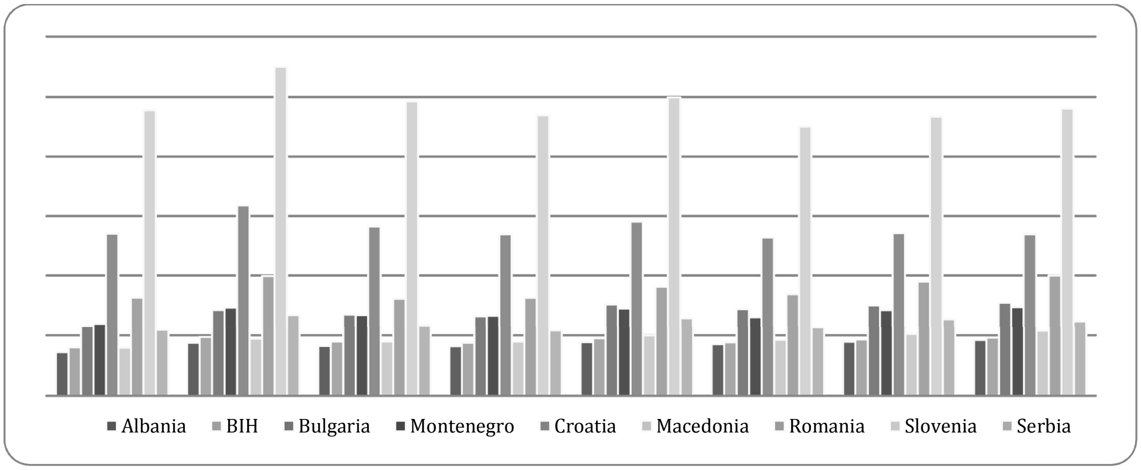

Figure 2. GDP per capita by country

Source: Authors based on http://www.worldbank.org/

Figure 2. shows the trend in GDP per capita in countries in the region in the period from 2007 to 2014. As we can see Slovenia has the highest GDP per capita exceeding 22,000 US with the largest value recorded in 2008 when it was at the level of 27,502 US. It should emphasize that only Croatia still has a double digit value of this indicator while other countries are far below. Serbia occupies a medium position in the observed group of countries where it's value increased by 33.37% during the period 2007-2014. It is notable that all countries in 2009 recorded a reduction of GDP per capita which is certainly attributable to the impact of the economic crisis and this decrease in Serbia amounted to 13.13% compared to 2008. Albania and Bosnia and Herzegovina are economies that have the lowest value of this indicator and it doesn't exceed the value of 5000 per capita.

Table 3. GCI (Global competitive index) by country

GCI	2007.	2008.	2009.	2010.	2011.	2012.	2013.	2014.
Albania	3.5	3.6	3.7	3.6	4.1	3.9	3.8	3.8
Bosnia and Herzegovina	3.6	3.6	3.5	3.6	3.7	3.8	3.9	-
Bulgaria	3.9	3.9	4	4.1	4.2	4.3	4.3	4.4
Montenegro	3.9	4.1	4.2	4.4	4.3	4.1	4.2	4.2
Croatia	4.2	4.2	4	4.2	4.1	4	4.1	4.1
Macedonia	3.7	3.9	3.9	4	4.1	4	4.1	4.3
Romania	4	4.1	4.1	4.2	4.1	4.1	4.1	4.3
Slovenia	4.5	4.5	4.6	4.4	4.3	4.3	4.3	4.2
Serbia	3.8	3.9	3.8	3.9	3.9	3.9	3.8	3.9

Source: Authors based on Global Competitiveness Report (2007-2014)

Table 3. reflects GCI measured by WEF in Serbia and countries in the region in period 2007-2014. The reference value of this indicator is from 1 to 7 and as we can see, Serbia has almost identical score in an observed group of countries like Albania and Bosnia and Herzegovina which their value is not above 4. Macedonia and Montenegro are countries which are good placed and have similar value like EU countries regardless they aren't members of EU. If we just look 2014. Bulgaria takes the first place with highest GCI of 4.4 while Albania has the smallest GCI of 3.8 but it's important to say that data for BIH is not available for a previous year.

Table 4. Rank and score of Serbian economy by WEF indicators

Parameters	2012.		2013.		2014.		Growth score	
	Rank	Score	Rank	Score	Rank	Score	2014/2013	2014/2012
Basic requirements	**95**	**4.1**	**106**	**4**	**101**	**4.1**	**2.5**	**0**
Institutions	130	3.2	126	3.2	122	3.2	0	0
Infrastructure	77	3.8	90	3.5	77	3.9	11.7	2.6
Macroeconomic environment	115	3.9	136	3.4	129	3.5	2.9	-10.3
Health and primary education	66	5.7	69	5.7	68	5.8	1.75	1.75
Efficiency enhancers	**88**	**3.8**	**92**	**3.8**	**80**	**3.9**	**2.6**	**2.6**
Higher education and training	85	4	83	4	74	4.3	7.5	7.5
Goods market efficiency	136	3.6	132	3.6	128	3.8	5.6	5.6
Labor market efficiency	100	4	119	3.9	119	3.7	-5.1	-7.5
Financial market development	100	3.7	115	3.5	109	3.5	0	-5.4
Technological readiness	58	4.1	60	3.9	49	4.4	12.8	7.3
Market size	67	3.6	69	3.7	71	3.7	0	2.8
Innovation and sophistication factors	**124**	**3**	**125**	**3**	**121**	**3.1**	**3.3**	**3.3**
Business sophistication	132	3.1	137	3.2	132	3.2	0	3.2
Innovation	111	2.8	112	2.9	108	2.9	0	3.6

Source: Authors based on Global Competitiveness Report (2012-2014)

Table 4. reflects the trend of WEF competitive indicators in Serbia in the reporting period 2012-2014 and growth of score looking 2014 as the current year. At the beginning, basic requirements are observed and we can see improvement rank of infrastructure which is essential for foreign capital but also worse position of Serbia when it comes to the macroeconomic environment. Regardless Serbia increases her rank for 7 places it isn't good enough information for big investors. Efficiency enhancers are the second main indicator and his value is growing from year to year where our economy climbed to 80 place. The greatest growth is presented in higher education and training and technological readiness which reflect encouraging data for competition but on the other hand, deterioration of labour market efficiency and financial market development is a serious problem for Serbia economy. When it comes innovation and business sophistication factors, Serbia didn't much improve this segment regardless our economy increase rank for four places of 112 to 108 for one year.

Based on Figure 3. Serbia has to upgrade state bureaucracy and facilitate access to funding, reduce the level of corruption and ensure policy and government stability. Further, it’s necessary to pay attention to tax regulation and tax rates, because the favourable and flexible tax system is one of the main prerequisites for attractive investment environment. Also, the business environment will need to improve significantly in order to boost private sector investment and improve competitiveness (World Bank, 2014).

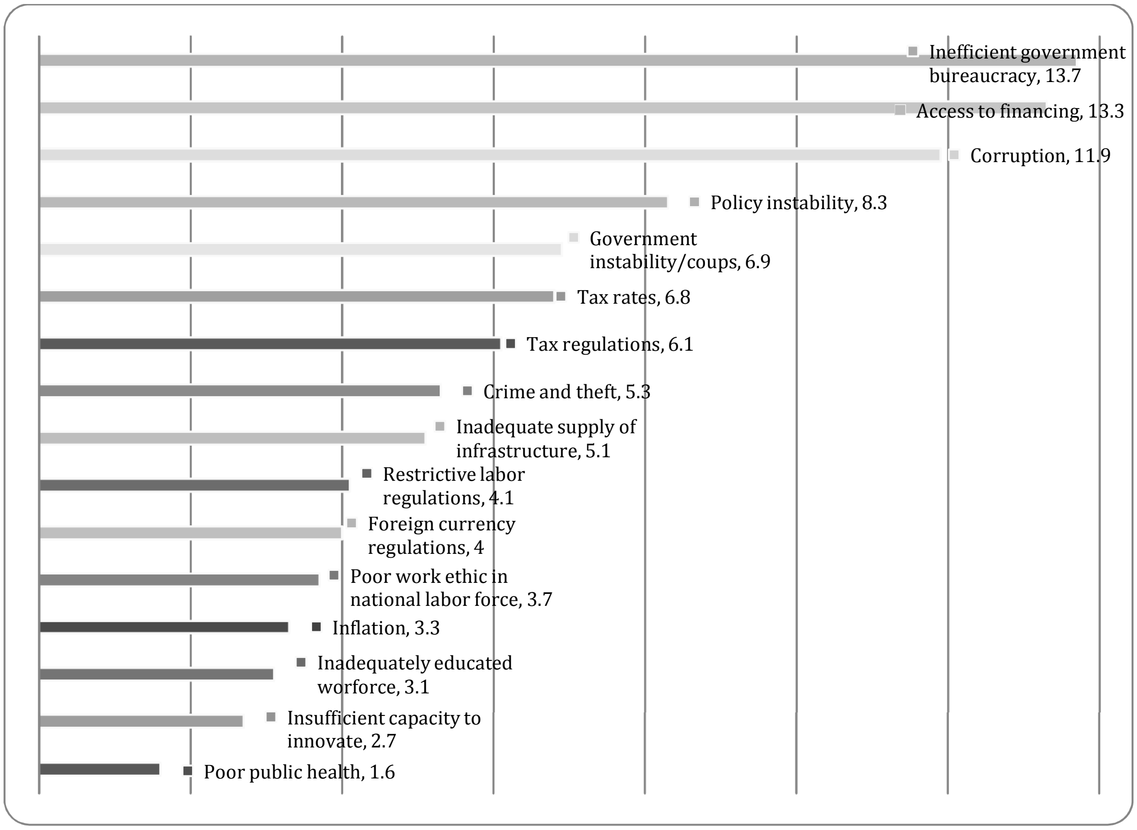

Figure 3. The most problematic factors for doing business

Source: WEF (2014)

TAX POLICY AND RATES IN SOUTH EAST EUROPEAN COUNTRIES

Siyan and Adebayo, (2005) defined fiscal policy is one of the most important tools used by the government to realize macroeconomic stability of the economy of most developing countries. The opening of the Western Balkans and other countries in South East Europe more than a decade ago has fundamentally changed the political and economic landscape of the Europe (MIGA, 2000). The political changes in Western Balkan countries were followed with a lot of institutional changes linked with the new system based on market economy and one of the most important changes was the fiscal reform (Pere, Hashorva, 2011). Lawrence (1998) tried to econometric models relationship between tax policy and competitiveness and concluded that in short-term tax incentive policy can contribute to increased competitiveness. Tax policy changes that are most likely to raise growth in any particular country will depend on its starting point, in terms of both its current tax system and the areas in which its economic performance is relatively weak (OECD, 2010). The tax policy and administration can contribute to a competitive economy in next way (Matthews, 2011):

1) raising tax revenues in a way that is broadly accepted as fair is more likely to achieve high levels of voluntary compliance
2) good administration that is effective in deterring evasion reinforces social cohesion and ensures no unfair advantage accrues to business that evades tax
3) tax administration which isn't open to corruption and consistent tax laws with the predictable tax regime

4) efficiency in tax administration reduces the number of an economy's resources which have to be devoted to revenue collection
5) low compliance costs and burdens on business decrease the time that taxpayers have to spend on tax compliance
6) tax policy making that is evidence-based and transparent.

High tax rates are more difficult to sustain in this new economic environment and as economic integration increases, individuals and business gain greater freedom to take advantage of foreign economic opportunities. That raises the sensitivity of decisions about investment and location to taxation (Edward and Rugy, 2002). Today all countries in the region have set up a tax system similar to one of the developed countries in Europe and these systems are based on the three major types of taxes: individual income tax (PIT), corporate (CIT) and value added tax (VAT).

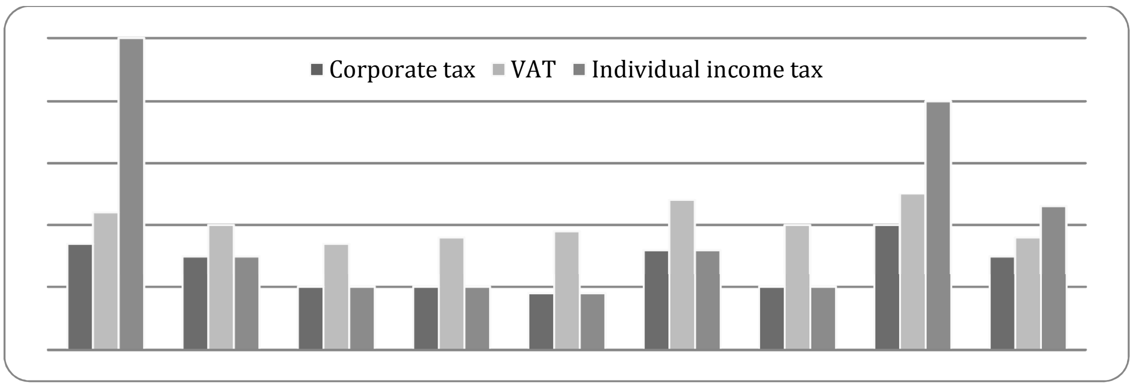

Figure 4. Tax rates in Western Balkan and SEE countries 2014

Source: Authors based on http://www.kpmg.com/

Figure 4 reflects the trend of tax rates in Western Balkans and SEE countries at the end 2014. First, Montenegro economy has an only one figure corporate tax rate of 9% and this is the lowest rate in the region. On the other hand, companies pay the highest tax on profit in Croatia and it's amounts 20% which is slightly less than Slovenia and Romania where the rate of this tax is 17% and 16%. Serbia is a country where the tax rate is 15% and it is a medium tax burden for companies if we look other corporate tax rates in the environment. Second, there is no large difference between countries when it comes VAT rate. Croatia and Romania have VAT 25% and 24% and this is the high level of this type of tax while BIH has the lowest tax rate of 17%. As we can see, Serbia takes again medium position in the observed group of countries and VAT is 20% which is the same as in Bulgaria. Third, Slovenia and Croatia have the biggest individual tax rates where it goes to 40% and 50% which is much higher compared to other economies. Five countries have individual tax rates around the level of 15%, including a Serbia which is more less than in Romania and Albania. The Doing Business (DB) database provides objective measures of business regulation and their enforcement, comparable across 180 countries. The dataset is attractive for the ranking of economies according to the number of procedures, time and costs borne by a typical firm to carry out activities. Authors are focused on tax paying indicators in Serbia and other countries in the region from 2014 to 2015. This indicator includes number and time payments per year, the percentage of profit tax, labour tax and contributions, total tax rate and other taxes.

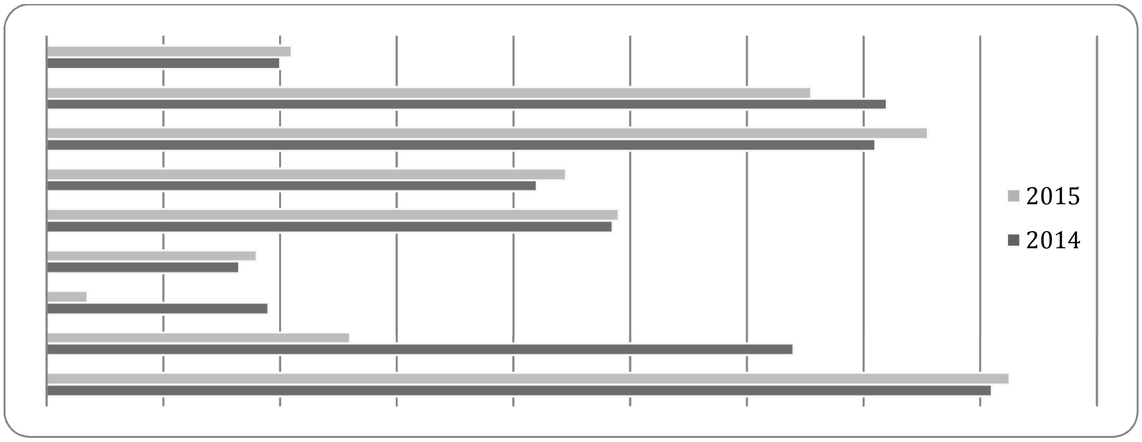

Figure 5. Paying taxes indicators of 189 countries (2014 - 2015)
Source: Authors based on htp://www.doingbusiness.org/

Observing the paying taxes indicator, Serbia is located at the rear which represents alarming information, especially as there has been a further deterioration in 165 to 167 place compared to 2014. Likewise, Albania and Bosnia and Herzegovina are very bad ranked 131 and 151 of 189 analysed countries. Romania and Macedonia are the best examples how an economy can rapidly progress in the ranking DB because of improving components of the tax system and appreciation of its relevance as part of the economic system. Thus, Romania recorded an impressive progress as much as 76 places compared to last year.

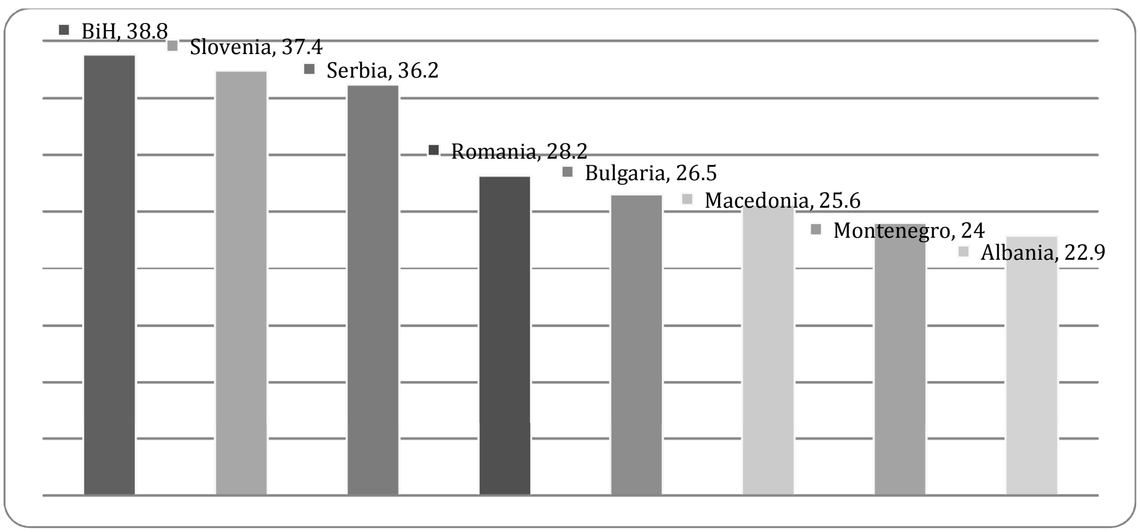

Figure 6. Tax burden (% of GDP) in Western Balkan and SEE countries 2014
Source: Authors based on http://www.economywatch.com/

Figure 6 represents the tax burden in countries in the region in 2014. The analysed indicator is expressed as the ratio of the fiscal burden and income as a percentage of GDP. As we can see, the biggest tax burden is presented in Bosnia and Herzegovina, Slovenia and Serbia, where it exceeds 35% which is far more than in other countries in the region. In order to analyse the position of Serbia in Europe in terms of this indicator, it's included the average of Member states of the European Union that is 34.5% at the end of 2014 which is less for 1.7%. Montenegro and Albania are the countries where the tax burden is the lowest in an analysed group of economies, whose share in GDP doesn't exceed 25% respecting 10% below the EU average.

It' s very important points out key economic challenges in the Western Balkans (European Commission, 2014): a) strengthening fiscal consolidation by reducing budget deficit and implementing credible public sector reforms, including reform of the public administration and pension system; b) restructuring and improving governance of state-owned enterprises; c) improving the business environment, supporting private sector development, reducing para-fiscal charges, simplifying regulation and increasing research investment; d) establishing functioning and flexibility labour markets and improving the employability of workers by aligning education and skills with labour market needs.

CONCLUSION

Growth and development strategy following the European perspective of the region's future and innovation, skills, and trade integration should be primary drivers of growth. Competitiveness of the Serbian economy even after twelve years of the transition process is still very poor. Serbia economy occupies an unacceptably low level of competition, especially when it's observed GDP per capita and this also indicates that there is a large space for improvement of competitiveness. In 2014, Serbia was ranked 94th among 144 countries with the score of 3.89 and this data is an alarm for our economy to improve economic and institutional performances in future. Bearing in mind that only Albania and Bosnia and Herzegovina have the smallest score than Serbia it speaks about the insufficient level of her competition especially on the European market. One of the competitive advantages could be a tax system which is stable, predictable and efficiency that means an optimal number of procedures, payments, tax incentives and exemptions as well as parafiscal charges. Serbia needs to build modern material and information infrastructure with enhancing state companies. Also, investments in contemporary equipment and production are a crucial prerequisite for improving competitiveness. To raise the rate of economic growth and creating a constant increase in GDP and employment standards, Serbia has to reach the global level of competitiveness, especially with EU countries. Economic policy must make and develop competitive advantage of the Serbian economy, not just comparative advantages. The final goal of economic policy is to increase GDP growth rate and hold at the optimal level and also narrow the gap in GDP per capita between Serbia and the EU countries as well as countries in transition. Productivity and price stability represent one of the primary assumptions of the long-term development and only that can create a framework for growth of domestic and foreign investment.

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