

# REGULATORY CULTURE IN SERBIA

## Patterns of SMEs -unfriendly behavior<sup>1</sup>

### CASE STUDIES

CEVES  
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# I Introduction

Serbia has been struggling to reduce the administrative burdens weighing on its businesses for about two decades. Progress has been undoubtable in many regards, with more salient recent examples being mainly related to the digitalization of burdensome administrative procedures such as – tax applications, business registration, construction permits, etc. Other initiatives, such as the Law on Inspections went further, changing administrative behaviors regarding the planning and announcement of inspections, cooperation among different inspections, and introduction of inspection checklists. Some procedures, are now more advanced and efficient than in generally much better regulated countries, as evidenced in the last Doing Business Report of the World Bank. Yet, these improvements and bright spots shine like stars against the backdrop of a regulatory culture that continues to burden entrepreneurship.

The objective of this study is to conduct a thorough examination of the regulatory culture in Serbia and its consequent effects on small and medium-sized enterprises (SMEs). By regulatory culture we mean tacit understandings and perceptions, established structures and built-in incentives that generate patterns of regulatory and policy-making behaviors (“regulatory practices”). Regulatory culture is also a perspective, a way of how regulators perceive or look at things,<sup>2</sup> such as business environment, small and medium enterprises, entrepreneurship, etc. Regulatory culture is closely related to the broader concept of administrative culture<sup>3</sup> that encapsulates a wider range of activities and attitudes that are not limited only to regulatory practices. This study aims to identify and describe regulatory practices that contribute to the self-perpetuation of the unconducive business environment<sup>4</sup>, to illustrate them, and assess their effects. Ultimately, the goal is to offer

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<sup>2</sup> Meidinger, E. (1987). Regulatory culture: A theoretical outline. *Law & Policy*, 9(4), 355-386.

<sup>3</sup> Jamil, I., Askvik, S., & Hossain, F. (2013). Understanding administrative culture: Some theoretical and methodological remarks. *International Journal of Public Administration*, 36(13), 900-909; For Serbia see Mojić, D., Jovancević, J., & Jovancević, S. (2018). Culture and public administration reforms in post socialist transformation: the case of Serbia. *Sociologija*, 60(3), 653-669.

<sup>4</sup> A conducive business environment is one that provides its economic agents above all with predictability. This reduces the risks of doing business, and hence enhances investments in the broadest sense of the word, but it also raises the likelihood of synergies in the actions of different economic agents, hence increasing the productivity of all society’s investments. In addition, as part of overall predictability of the BE, administrative burdens should be clear, and consistently applied (rule of law), and if in addition they are light, i.e. not excessively costly, that is even better.

recommendations that may help address the culture and affect patterns of regulatory behavior although it also suggests possible improvements regarding specific regulations.

Most economic literature so far focuses on the government involvement that may be overly intrusive.<sup>5</sup> But this is not the only way how government may prevent private sector development. Instead, we focus on the other aspects of the culture: a negative or indifferent attitude to entrepreneurship, that includes oppressive approach to regulation and in particular oversight, as well as negligent and disinterested authorities with respect to SMEs. We also examine difficulties in cooperation and coordination among separate units of the administrative units—and the practices they generate in policymaking, oversight, and regulatory implementation.

It is not easy to address culture, cultures do not change fast. Perceptions of bureaucrats (civil servants) are shaped by their environment and by personal attitudes, values, and past experiences. In case of Serbia, this perception and the culture described in this study is largely the result of the combined effects of the peculiar Yugoslav self-management-socialism regulatory legacy – built over no more than 40 years, and the way this system has been transformed in Serbia’s wayward transition since.

At the root of both the negative attitude towards entrepreneurship and the extreme prescriptiveness of regulation of economic life lies the Yugoslav legacy of self-management founded on the concept of “societal property”.<sup>6</sup> To this end a massive structure was built regulating precisely how every aspect of “societal” agent’s decision-making and market transactions are to be conducted, to ensure societal property could not become siphoned off to private accounts. While private property was never abolished, and private enterprise was allowed within increasing size limits, the profit motive tended to be viewed as *a priori* endangering “societal” interests. It was the bane that “societal” property needed to be protected from. Oversight over the implementation of this massive regulation was implemented by the formidable “Societal Accounting Service” (SDK). It

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<sup>5</sup> Hopkin, J., & Rodríguez-Pose, A. (2007). “Grabbing Hand” or “Helping Hand”? corruption and the economic role of the state. *Governance*, 20(2), 187-208; Brown, J. D., Earle, J. S., & Gehlbach, S. (2009). Helping hand or grabbing hand? State bureaucracy and privatization effectiveness. *American Political Science Review*, 103(2), 264-283.

<sup>6</sup> Contrary to frequent assumption, “societal property” was not just an euphemism for state-ownership. It lay at the foundation of the truly autonomous non-state “societal” market agents – businesses, banks etc.— that conducted 95% of economic activity outside of public services (the other 5% being conducted by private businesses). This economy was not run or even directed by government institutions, but it was not privately owned. The construct served to grant this autonomy but stop short of full-blown employee-ownership. The latter would have implied private ownership by employees, ultimately turning the economy into a private one.

performed all payments transactions in the country, and through this, was in the position to second-guess the purpose and conduct of every single one of them.

While SDK was initially reduced to “Payment’s bureau” and eventually dismantled, both the negative sentiment towards entrepreneurship (profit motive) and the prescriptive approach to economic regulation, continued to live. This affects both policymaking and its oversight. On the one hand, we can expect regulators to find it hard to conceive of policies in which regulation works *with* the entrepreneurial incentive system to enhance desirable behaviors and suppress undesirable ones. Instead, they are likely to miss opportunities for creating a conducive environment and policies and may be tempted to proscribe classes of behavior that they see as risky. On the other hand, prescriptive regulation and oversight does not focus on the identification and deterrence of harmful behaviors, but rather on how exactly economic activities should be conducted. Oversight then is more about the *control* of the entire regulated activity, rather than the effective and efficient accomplishment of the ultimately desired result – minimization of harmful behaviors. Ultimately, the restrictiveness and prescriptiveness of regulation means that innovation in economic transactions will not typically be possible (unless it has been “permitted” based on copying foreign models), while those transactions that are allowed tend to be burdened by extremely specific and hence inflexible regulatory prescriptions of what may be done and how.

Not all the aspects of this culture are rooted in this legacy. An important factor has been related to a chronic under-funding of the public sector that emerged with the economic, and hence fiscal, implosion of the 1990s. Instead of reducing entitlements and adapting structures, capacities were squeezed, and a game of transfer of costs to beneficiaries and of accountabilities among the various segments within the public sector itself was started. Clearly, some capacity was recovered and developed since then, but some practices such as “parafiscal charges” and excessive punishments, and the transfer of the burden of the provision of services remained acceptable, while investment in the development of the administration’s capacity, other than when directly required and funded by the EU, remains unimaginable.

The issue of burden transfer, or the absence of its definitive assignment, represents a profound problem with intricate origins that extend beyond the reach of this study. Nevertheless, it is important to note that these issues significantly contribute to an unfavorable business climate and intensify the prescriptive nature of regulatory practice. To safeguard against unpredictable interpretations of a civil servant’s discretion, the optimal approach is to eliminate any ambiguity in the regulations.

The effectiveness of the effort to improve the business environment could be significantly improved if, in addition to the continued effort to simplify and suppress individual onerous procedures, regulatory culture and patterns were confronted head on. This requires that the existence of the culture is first recognized and understood, and the patterns identified.

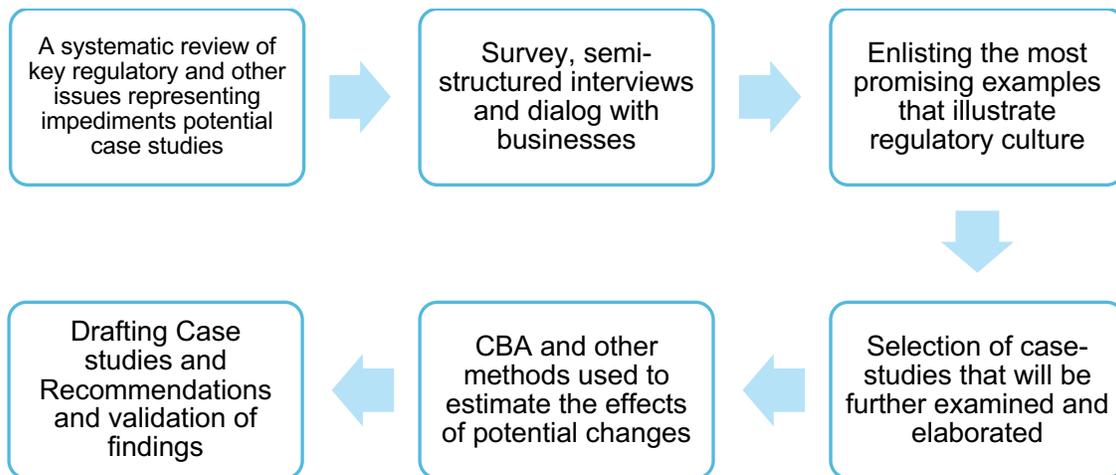
## II Methodology

The aim of this study is to showcase instances of the prevailing regulatory culture and the bureaucratic hindrance to entrepreneurship and SMEs. As outlined in the preceding section, each case exemplifies the entrenched attitudes of Serbian bureaucracy that are averse to entrepreneurial activities. These cases are chosen for their relevance to policymaking, regulatory oversight, or the implementation of regulations.

More specifically, the examples should be related to the negative attitudes toward entrepreneurship that are present in laws and regulations. This includes laws and regulations that introduce unfair treatment, that impose disproportional impediments and shift significant compliance responsibilities to the private sector and/or or introduce unreasonable punishment. These examples illustrate either inefficient (e.g. imposing redundant requirements) or ineffective oversight (e.g. lack of deterrence effect). Finally, the third group of examples are related to problems of regulatory implementation. The laws and regulations may contain uncertainties and inconsistency, that contribute to the lack of transparency and lead to inconsistencies in both oversight bodies and judicial decision making.

This section presents a brief overview of CEVES approach to this assignment and techniques and approaches that were used to select case studies. Figure 1 provides an overview of the six key steps taken to select relevant case studies and subsequent assessment of costs and benefits. These steps included: 1. Systematic review of key regulatory and other issues representing impediments to potential case studies; 2) Conducting survey, semi-structured interviews and dialog with businesses; 3) enlisting the most promising examples that illustrate regulatory culture; 4) selection of case-studies that will be further examined and elaborated; 5) Conducting CBA and other analytical methods to estimate the effects of potential changes; 6) Drafting Case studies and Recommendations and validation of findings.

**Figure 1 Stages of Methodology for Selecting Case Studies**



CEVES began its analysis with a comprehensive review of key sources to identify administrative procedures and policy enforcement practices that hinder Serbia's business environment. This review encompassed the OECD's reports on competitiveness and SME policies in Southeast Europe, the Foreign Investors Council's 'White Book,' NALED's 'Grey Book,' and contributions from the Chamber of Commerce and the Union of Employers. It also included an extensive range of policy publications from the World Bank and EBRD. From this meticulous desk review, CEVES compiled a list of approximately twenty examples that exemplify various patterns and facets of the regulatory culture.

To complement the desk research, CEVES conducted both survey of accounting professionals and semi-structured interviews with representatives of Serbian SMEs.

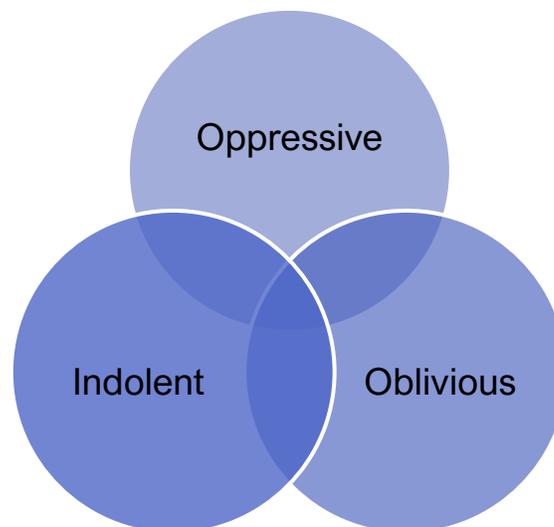
In the subsequent phases, the potential case studies were narrowed down using several criteria. Initially, CEVES assessed the breadth of impact on businesses and the severity of consequences for economic growth, ease of doing business, and market competition. Subsequently, cases were chosen based on their potential to deepen the understanding of SME challenges and to facilitate practical outcomes, aiding authorities in tackling these issues. Additionally, selection hinged on the availability of pertinent data and the feasibility of employing rigorous and appropriate research methods. The chosen case studies then underwent a process of streamlining, featuring either simplified cost-benefit analyses or approximations of the administrative and compliance expenses incurred by SMEs. We should note that our methodology centered on engaging with the business community to discuss the application and enforcement of current policies, but it also yields insights into potential policies that have not yet been implemented.

### III Key Findings

The interplay between cultural factors and the policy-making process, along with regulatory oversight and implementation, reveals distinct patterns. Specifically, three patterns or facets of regulatory culture stand out: the oppressive - which imposes prohibitive regulation and restricts business operations; the indolent - which shows a lack of rigor in developing and enforcing regulations; and the oblivious - which overlooks necessary regulatory measures.<sup>7</sup>

These aspects frequently overlap, making it challenging to disentangle them, as a particular regulation could exhibit characteristics of two or even all three of negative facets of regulatory culture (Figure 2).

**Figure 2 Negative Facets of Regulatory Culture**



**The first facet relates to oppressive aspect of regulatory culture.** It relates to *regulations that are often prohibitive, and the authorities' distrust in private sector.* The

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<sup>7</sup> Of course, there are potentially other traits. For example, the state may be paternalistic - believes that it knows what is best for the businesses and acts accordingly, or even incompetent – does not have sufficient knowledge and capacities to regulate and/or conduct oversight.

essence of a such oppressive approach is that it hinders the SMEs growth, rather than supports entrepreneurial spirit and innovation.

Issue that was frequently referred to in interviews pertains to the **handling of VAT returns**. Namely, taxpayers who opt for a VAT refund instead of a tax credit, are subject to a field audit. This audit prolongs the timeframe for reimbursing previously paid Value-Added Tax, as the process awaits a positive report from the Tax Administration. However, the practice of initiating tax audits based on requests is being improperly used to justify delays in VAT refunds. This practice does not align with the stipulations of the VAT Law or the Law on Tax Procedure and Tax Administration (FIC, 2024).<sup>8</sup> Also, the legal deadline (for non-exporters) is lengthy – 45 days. Although in practice, return period is often shorter it still can impact the liquidity of businesses, particularly affecting SMEs.

Desk research and semi-structured interviews have highlighted a notable missed opportunity for entrepreneurship, specifically the suppression of micro, small, and medium-sized enterprise investment incentives. Therefore, rather than fostering SME investments and structuring oversight to curtail misuse at manageable costs, the state imposed restrictive application of **investment tax credits**. The first case study thoroughly analyzed a lack of equitable treatment for SMEs and large corporations concerning investment tax credits and its consequences. However, the case also illustrates other facets of regulatory culture.

Oppressive regulatory culture may also lead to punitively or discriminatory government actions which impose heavy and disproportionately fines, or fines that disproportionately affect smaller businesses. For instance, during interviews accountants have raised concerns about the **disproportionate fines for small enterprises** relative to medium or large companies, since the Law on Accounting does not differentiate based on the size of the entity.

Several interviewed companies and accountants have expressed concerns regarding the freezing of their accounts. They report that the Tax Administration often **freezes accounts** over minor amounts or pursues **collection actions** even when a prepayment credit exists. However, despite these anecdotal reports, assessing the true extent of this issue remains challenging. The causes, frequency, and amounts related to account blockages certainly merit further investigation.

**The second facet relates to indolent aspect of regulatory culture.** It refers to a government that exhibits a lack of initiative and/or transfers burden to private sector or

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<sup>8</sup> FIC (2023), White Book 2023, Available at <https://fic.org.rs/wp-content/uploads/2023/11/White-Book-2023.pdf>

where the state fails to effectively implement policies due to lack of proper planning. *Regulations besides shifting administrative burden are often designed by the state through a trial-and-error approach, rather than through a process of careful preparation and piloting.*

The enactment of new legislation often leads to a surge in administrative duties for SMEs, as well as enforcement challenges for the relevant authorities. In Serbia, the introduction of new laws and policies frequently often happens without a proportionate expansion of administrative capabilities, resulting in a 'bureaucracy overload.' This overload results in subsequent shift of the burden of implementation to SMEs. However, this is not the sole reason; sometimes, the shift is also a consequence of the opportunistic behavior authorities. The essence of a such approach is that the state would rather reduce its own obligations and the need to conduct oversight, than support the entrepreneurial spirit and innovation. In practice, harassing SMEs to provide additional information does not substantially decrease the likelihood of misuse. However, collecting additional information (that may be of no use) is often used as a cover.

One such example is **POPDV form**. During semi-structured interviews significant number of accountant professionals complained about overly complicated process of maintaining VAT records. Despite several initiatives the scope of the records was not simplified even with the adoption of the new VAT Regulation in 2021 (NALED, 2024). During interviews accountants provided several examples of being required to process invoices that do not affect VAT and have no or limited informational value (for example, supplies that are not considered turnover in accordance with the VAT Law). A particular problem is various additions to the original VAT calculation, such as "internal VAT calculation" in cases where the recipient of goods is the tax debtor. Several accountants also mentioned issues related to high risk of errors and the significant costs imposed on SME taxpayers by preparing the POPDV form.<sup>9</sup>

The study uncovered additional instances of the burden-shifting phenomenon. A concern highlighted by accounting professionals pertains to the **identification of actual beneficial owners**, as required by the Anti-Money Laundering Law. Rather than relegating investigative tasks to accountants, it was proposed that owners should declare the real beneficial owners upon registration. Although it may not be feasible to eliminate

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<sup>9</sup> There is well-supported evidence that the cost of complying is disproportionately high for smaller compared to large businesses. See e.g. Chittenden, F., Kauser, S., & Poutziouris, P. (2003). Tax regulation and small business in the USA, UK, Australia and New Zealand. *International Small Business Journal*, 21(1), 93–115. <https://doi.org/10.1177/0266242603021001244>; Schoonjans, B., van Cauwenberge, P., Reekmans, C., & Simoens, G. (2011). A survey of tax compliance costs of flemish SMEs: Magnitude and determinants. *Environment and Planning c: Government and Policy*, 29(4), 605–621. <https://doi.org/10.1068/c10177b>

a number of responsibilities of accounting professionals with respect to AML requirements, such, or alternative proposals merit consideration.

The **introduction of an electronic invoicing system (SEF)** has sparked varied opinions from respondents. Many accountants and managers, through surveys and interviews, claim SEF has cut administrative costs and could positively affect the VAT refund process and reduce reporting. However, a case study also indicates that the implementation followed a trial-and-error method without sufficient preliminary testing (piloting). Furthermore, respondents assert that the introduction of SEF should coincide with the elimination of other VAT reporting requirements, such as the abolishment of the PO PDV form. However, in practice that was not the case.

This facet is also related to lack of incentives for effective implementation of policies and laws. The third case study, focuses on such an instance, addressing **the oversight of regulations concerning B2B** (business to business) payment deadlines. The case illustrates situation in which state bodies offer declarative support to SMEs, without a genuine intention to provide substantive assistance.

**The third aspect relates to oblivious (negligent) aspect of regulatory culture.** It refers to a government that is indifferent or unaware of the needs and problems of SMEs due to negligence or its focus on other interests at the expense of the SMEs.

An extreme example of such behavior involves the implementation of the new **Law on Archival Material**, which is thoroughly analyzed in one of the case studies. Case study discusses the impact of legislation that was not sufficiently considered, detailing the substantial financial repercussions and the legal uncertainty it has caused.

Another example relates to **payment errors**. In practice, payment errors frequently occur. This is especially prevalent in the case of flat-rate entrepreneurs who make payments to four payment accounts. The consequence of payment errors is a request for reallocation of funds. In some cases, the consequences can be very dire, even though the company has essentially fulfilled all its tax obligations.

Our research confirmed a number of issues previously identified by other reports (e.g. flexible contracting of work outside the employer's premises or simplification of sick leave documentation). The next section contains four case studies that most adequately illustrates facets of regulatory culture.

### III Case Studies

**This section provides four case studies each illustrating one of the negative facets of regulatory culture towards SME sector.** That does not mean that other facets are absent. Several cases show that regulatory culture can exhibit oblivious and indolent facets simultaneously. Similarly, some cases show state that simultaneously feels the need to exercise excessive control and accumulate unnecessary information.

#### Case Study 1: Abolishment of the tax credit for SMEs

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Regulators often ignore interests of the SME sector. We use the case of abolishment of the tax credit for SMEs to showcase **an example where state inadvertently overlook the interests of SMEs, leading to the creation of an uneven playing field.**

#### Introduction

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**To increase investments and to instigate economic growth Serbia implemented an array of investment incentives during the 2000s.** These included direct subsidies, tax incentive for large investments, and tax credit for earnings reinvested in fixed assets.

**The first two types of incentives (subsidies and tax incentives for large investment), by their design, are more suited to large enterprises, typically Foreign Direct Investments (FDIs),** although their intended use is nominally universal. The application process and conditions for direct subsidies are complicated and costly for the domestic, predominantly small, and medium-sized enterprises . That this is indeed the case, we can demonstrate it indirectly. Namely, of the total value of subsidies allocated through the Ministry of Economy, from 2015 to mid-2023, only 12% (22% since 2021) has gone to the domestic economy. Even when adding the programs of the Development Agency of Serbia (RAS), the distribution of direct budgetary disbursements amounts to 70/30 in favour of large FDI companies. On the other hand, tax incentive for large investments, legislated under the Article 50 of the Legal entity profit tax law, by setting the threshold at employing 100 workers and investing 8 million EUR (as of 2023) is practically unattainable for SMEs.

**The third instrument, in the form of a tax credit, was legislated under Article 48 of the Legal entity profit tax law.** Article 48, paragraphs 1 and 2 of the Law on Corporate Income Tax ("Official Gazette of RS", No. 25/01 ... 18/10, hereinafter: the Law) stipulated that a taxpayer who invests in real estate, plants, equipment, or biological assets (fixed assets) owned for the purpose of conducting their primary activity, was entitled to a tax credit in the amount of 20% of the investment made (for a small legal entity 40%), with the condition that the credit could not exceed 50% of the calculated tax in the year the investment was made (for a small legal entity 70%). Furthermore, the unused part of the tax credit could be carried forward to offset future corporate income tax liabilities, up to a limit of 50% or 70% of the calculated tax in that tax period, but not longer than ten years (Article 48, paragraph 3 of the Law). This instrument was intended primarily to meet the needs of the SME economy since it especially favored small and micro enterprises.

**However, the incentive was abolished in 2013 and ceased to be applied from January 1, 2014.** Justification for the abolishment stated the need to increase public revenues (app. 70 million euros in 2015), as well as the claim that at low-interest rates, tax reliefs have little significance. Although the general view in the literature is that tax incentives by themselves have limited effects (James, 2013),<sup>10</sup> the abolition of this incentive had significant negative effects. First, it increased tax distortion in favour of large enterprises (which are able to use far more generous instruments), but it also left SMEs with the impression of the discriminatory treatment by the state that provides support to FDI and large companies. Still, the abolishment of tax credit for SMEs was perceived as rather significant as evidenced by the continuous campaign of the Serbian Chamber of Commerce (PKS), the campaign of the Employers' Union of Serbia (UPS), NALED, as well as public appearances by Serbian entrepreneurs.<sup>11</sup>

**The abolition of instruments that encourage investments is all the more peculiar, given that low domestic private investments in Serbia are one of the most pronounced factors of limited growth and convergence.** Over the past decade, Serbia's average GDP growth rate was 2.6%, marginally trailing behind the 2.8% growth of more developed Central and Eastern European (CEE) countries. This is noteworthy considering the principle of beta convergence, which would typically predict a faster growth rate for less developed economies like Serbia. By 2022, while these more developed CEE countries had achieved 55% of the EU27 average economic level, Serbia

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<sup>10</sup> James, S. (2013). Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications. SSRN Electronic Journal. <https://doi.org/10.2139/ssrn.2401905>

<sup>11</sup> <https://novaekonomija.rs/vesti-iz-zemlje/117976>

had reached only 24%, showing a deviation from the expected convergence pattern and below-potential growth.

### Impact on low SME sector investments

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**One of the primary impediments to Serbia's GDP growth is a cyclical challenge: the interplay between insufficient investments and weak institutional framework.** Poor institutional quality in Serbia, characterized by bureaucratic and regulatory inefficiencies and high prevalence of corruption, deters potential investment; whereas low investments create fewer independent and internationally competitive economic agents which would create a push to higher levels of economic and institutional development. Indeed, World Bank's Governance Indicators show sub-par performance of Serbia's institutional environment vis-à-vis the CEE, while average investments share in GDP stood at only 19.5% of GDP over the past decade. Given a general rule that the investments in developing countries should amount to at least 25% of GDP, it can be estimated that the investment shortfall cuts Serbia's growth by some 0.7 p.p. of GDP growth annually (based on estimates from Petrović *et al.* 2019).<sup>12</sup>

**One of the primary drivers of low investments in Serbia are low investments made by SMEs.** Albeit Serbia managed to reach 25% of investments in GDP in 2022, the share of SME investments remains relatively small. The total growth of the investments in Serbia has been primarily driven by public investments (reaching almost 7% of GDP) and FDIs (over 8%). At the same time, SMEs invest 5-7% of GDP. But especially worrisome is the fact that in the period 2015-2019 share of SME investment stood at around 8% and gradually decreased to current 5-7%, while the investment of FDIs grew constantly.

**The reasons why the SMEs do not invest are numerous, both internal and external.** Internal reasons include lacklustre strategic, operational, and financial management of SMEs, as large majority of them still needs to undergo corporate restructuring. However, even these internal reasons could have been alleviated through strategic and economic policies which Serbia, oriented predominantly on attracting large FDIs, never had to a sufficient extent. And therein lies most SME related problems in Serbia. Namely, the tax credit for reinvested earnings under the Article 48 of Serbian Legal Entity Profit Tax which had allowed SMEs to have 20% (40% for small and micro enterprises) investments recognized as a tax credit was the only financial measure designed especially for SMEs,

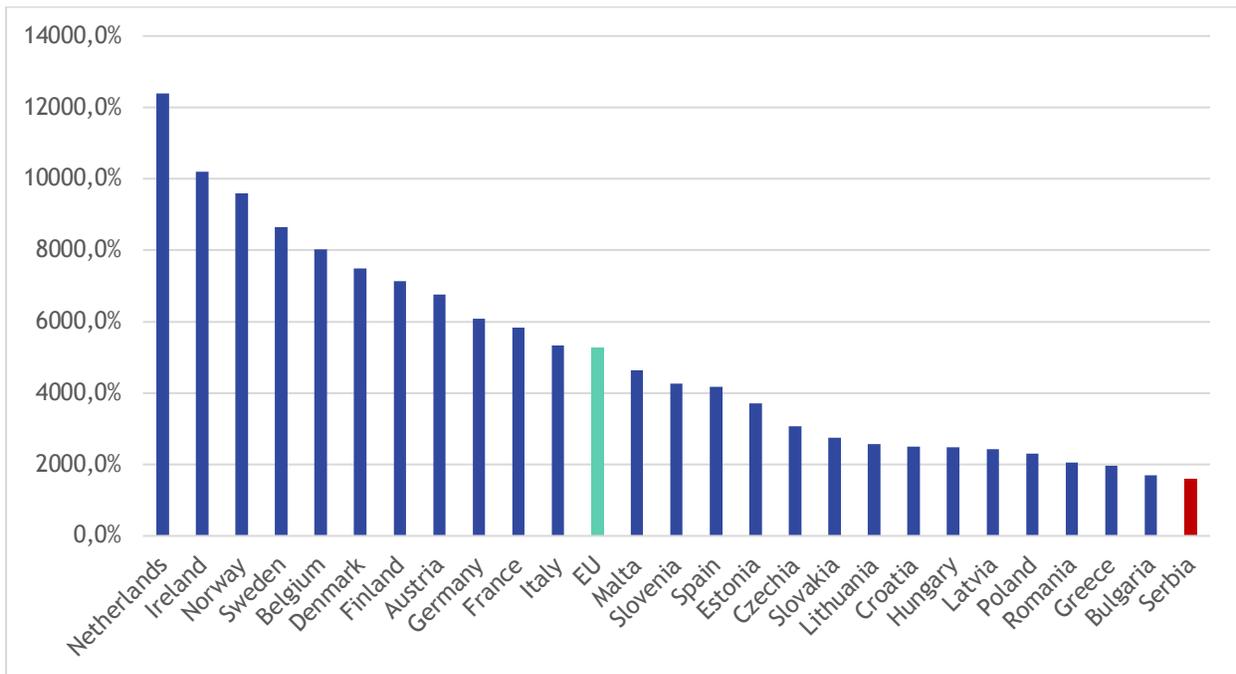
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<sup>12</sup> Petrović, P., Brčerević, D., & Gligorić, M. (2019). Why is Serbia an economic growth underachiever? *Ekonomika Preduzeca*, 67(1–2), 17–33. <https://doi.org/10.5937/EkoPre1808017P>; p. 23 Eq (1)

yet it was abolished in 2014. Remaining two financial measures, subsidies and as stated in the introduction, were a better fit for large companies. Moreover, inadequate, and unequal institutional environment is also one of the more important reasons why Serbian SMEs do not invest as much – as FDIs face red carpet, SMEs are frequently met with a red tape.

**Low SME investment levels are a significant barrier to their growth.** As CEVES SME Compass Index<sup>13</sup> shows the SMEs in Serbia do not invest enough – in new equipment, processes, capacities, machines, and technologies – and that is one of the primary reasons why they lag in digitalization, innovation and expansion of operations.<sup>14</sup> Slow adoption of new technologies and expansion of capacities is reflected in low productivity – EU SMEs are on average 3.3 times more productive than in Serbia (see the figure below). Also, according to the available data related to the average technological age of machines, equipment, means and tools, Serbia with 14.5 years is among the countries with outdated equipment (in comparison to Austria (9.2), Germany (10), Slovenia (11) or Hungary (12))<sup>15</sup>.

**Figure 3 Apparent labour productivity in SMEs (2021)<sup>16</sup>**



<sup>13</sup> <https://mispkompas.rs/explore-sme-compass-index/browse-the-report/>

<sup>14</sup> Application of ERP and CRM in Serbia is two times lower than in the EU (17% and 15% in Serbia vs. 38% and 35% in the EU, respectively).

<sup>15</sup> <https://poslodavci.rs/wp-content/uploads/2023/03/Vracanje-poreskog-kredita-za-ulaganja-u-osnovna-sredstva-1.pdf>

<sup>16</sup> Turnover weighted average.

**Reintroducing tax credit could be a significant incentive for SMEs to invest.** In general, tax incentives are not widely recognized as overly effective instruments for increasing investments, especially when they are used as a sole economic policy instrument (see Klemm 2009)<sup>17</sup> – due to distortive effects, sparking tax competition between countries, or even that tax incentives frequently do not have any effect on investments. On the other hand, higher effective corporate income tax rates are found to have negative impact on investments through increasing user cost of capital with -0.5 to -1.0 elasticity (James, 2013)<sup>18</sup> and reduce total factor productivity (OECD 2008)<sup>19</sup>. Also, studies examining tax incentives frequently use macroeconomic data to evaluate the effects and this approach is very limited due to measurement errors in macroeconomic data, inter-asset reallocation of capital, and simultaneity, which make it difficult to draw causal links or make correct attributions using macroeconomic data (James 2013). In addition, when asked to compare subsidies and tax credit, Serbian SMEs point out that the credit is much more predictable and easier to administer – “I don't need anything from the state, just don't take away from what I want to reinvest.” is a sentence frequently heard from Serbian business leaders.

**Tax credit would increase competitiveness of Serbian SMEs vis-à-vis their European counterparts.** Although corporate tax regimes are far more complex to evaluate than just examining the corporate income tax rate, or tax incentives, here we focus only on tax credits. Tax credit as an incentive exists in some form in 15 of the 24 analysed European countries (excluding Malta, Luxembourg, and Cyprus) – and in various forms. It is most intended either universally for all enterprises, sometimes with special regimes for either large or small companies, making Serbia the only country which has a generous tax credit – only for large companies<sup>20</sup>.

**In continuation we provide some notable CEE examples of tax credit with CIT rate comparable to Serbia:**

- Estonia (20% CIT rate) has the most simplified and most generous tax credit mechanism – all reinvested earnings are fully exempt.

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<sup>17</sup> Klemm, A. (2009). Causes, Benefits, and Risks of Business Tax Incentives. IMF Working paper WP/09/21.

<sup>18</sup> James, S. (2013). Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications. SSRN Electronic Journal. <https://doi.org/10.2139/ssrn.2401905>

<sup>19</sup> Vartia, L. (2008), "How do Taxes Affect Investment and Productivity?: An Industry-Level Analysis of OECD Countries", OECD Economics Department Working Papers, No. 656, OECD Publishing, Paris, <https://doi.org/10.1787/230022721067>.

<sup>20</sup> Until 2022 there was a similar situation only in Hungary. Hungary has implemented the tax credit scheme more adjusted to the SMEs by lowering the investment threshold (see the text below).

- Lithuania (15% CIT rate) allows for up to 100% deduction of the actual acquisition costs of long-term assets from their taxable profits (depreciation expenses will be calculated as usual). The eligible assets include machinery and equipment, computer and communication equipment, software and acquired intellectual property rights, lorries, trailers, and semi-trailers (capped at EUR 300,000 per). Costs exceeding the 100% limit can be carried forward for four years. There is also an incentive similar to tax incentive for large investments in Serbia, albeit with higher threshold (150 new employees, 20 million EUR investment; 200 and 30 in Vilnius district).
- Slovenia (19% CIT rate) has introduced a tax allowance for investments in equipment and intangible assets. The allowance is limited to 40% of the value investment and can be utilised up to a maximum of 63% of the actual tax base. Since 1<sup>st</sup> January 2022 the same rules apply for investments in cloud computing, artificial intelligence, big data, environmentally friendly technologies, cleaner, cheaper public and private transport, decarbonisation of the energy sector, energy efficiency of buildings, and implementing of other standards for climate neutrality. Besides using allowances to encourage investments, Slovenia also uses them as active labour market policies: (a) a taxpayer that employs trainees or students to undertake practical work may reduce its taxable profits by an additional 80% of the average monthly payment paid to such persons for every month the person carries out the work; (b) a taxpayer that employs disabled persons may decrease its taxable profits by an additional 50% of the salary paid to such persons (70% for severely disabled); (c) employing a person in the deficit occupations generates allowance in the amount of 45% of the salary paid to such a person; (d) employing a first-time job seeker generates allowance in the amount of 55% of the salary paid to such a person.
- Croatia (18% CIT rate) has a mechanism which decreases CIT rate depending on the amount of the investment and the number of new jobs created (see the table below). The first category (at least 50.000 EUR investment) is intended only for micro companies and it is valid over a period of five years. The remaining categories are intended for all other company sizes and last 10 years.

**Table 1 Corporate income tax incentives in Croatia – CIT reduction depends on investment size and number of new employees.**

Investment EUR (at least)	Number of jobs	CIT reduction
50.000	3	50%
150.000 (50.000 for ICT)	5 (10 for ICT)	50%

1 million	10	75%
3 million or more	15	100%

Croatia also has incentives for modernizing business processes in manufacturing and processing industries include automation, robotization, and digitalization. Eligibility for modernization incentives requires a minimum investment of EUR 500,000 in fixed assets and maintaining the original number of employees throughout the investment period. The CIT rate is reduced by 50% for investments between EUR 500,000 and EUR 1 million, 75% for investments between EUR 1 million and EUR 3 million, and 100% for investments over EUR 3 million, for ten years from the start of the investment. Productivity per employee must increase by at least 10% within three years after completing the investment project, compared to one year before applying for the project.

- Hungary (9% CIT rate) offers tax allowance is available for up to 80% of the tax payable and can be claimed in the CIT returns over a maximum period of 16 years from the following year of the original application for the incentive. Minimum investment thresholds depend on either company sizes (from 130.000 EUR for small companies, and 260.000 EUR for medium), or areas (environmental protection, basic research, applied research, and experimental development projects, production of films and videos, equipment for zoogenic food production – 260.000 EUR).
- Poland (19% rate) carries out tax exemptions mostly through economic zones which depending on the region last 10-15 years. These are capped at 10-50% of eligible costs for large and 20-70% for SME, again depending on the region (up to 100% of CIT).

**In summary, the return of the tax credit would signal to the domestic economy that the state is once again counting on them as important levers of economic growth and would align corporate taxation policy closer to the EU (CEE) practices.** SMEs have not been a central point in economic policy of Serbia for quite some time, and that should be changed, especially given the main proclaimed goal of the Industrial Policy Strategy 2021-2030 to enhance competitiveness, facilitate structural changes, and encourage the establishment of an environment conducive to the development of entrepreneurship and SMEs. In that regard, reintroducing tax credit would generate would be a welcomed sign. Moreover, Serbia would align its corporate taxation policy to its EU (CEE) peers, thus at least partially offsetting the current tax distortion favouring large FDI companies.

**Reintroducing the SME oriented tax credit is likely to have a positive net present value with significant spillover and multiplicative effects.** With this in mind, we propose reintroducing the tax credit for reinvested earnings in the Serbian corporate income tax law, tailored for SMEs for the multiple reasons:

- **Eliminating the current tax distortion favouring large SDIs.** Introducing a tax incentive that lowers the effective tax rate for small enterprises is a necessary step toward eliminating the current tax distortion favouring large enterprises and investments, a situation unique to Serbia in Europe.
- **Increasing tax compliance.** Second, such a provision would directly impact compliance with tax laws and regulations. Introducing a tailored tax credit for reinvested earnings for SMEs can significantly improve compliance with tax regulations. This incentive encourages SMEs to engage more actively with the formal economy and accurately report earnings and investments. As SMEs perceive direct benefits from compliance, it fosters a culture of adherence to regulations, enhancing trust in the tax system – contrary to sliding into informality, as became evident in 2023<sup>21</sup>. Overall, such a policy not only stimulates investment but also contributes to a more robust and equitable fiscal environment by broadening the tax base and reducing activities in the informal sector.
- **Increased investments of SMEs.** The extent to which the SME investments would be increased depend on the assumptions and the tax credit model implemented. First, tax credit of 50%, limited to 50% of tax payable in any given year (option a), would reduce cost of investments by 30%<sup>22</sup> (Slovenian model<sup>23</sup> by 28% - option b). A tax credit amounting to 100% as demanded by the SME representatives, with the application of a limit of 67% of the collectible tax (option c), would result in savings of about 49% of the investment. Assuming an investment elasticity of 0.75 in relation to a reduction in the costs of investing (median elasticity rate, James

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<sup>21</sup> <https://naled.rs/vesti-siva-ekonomija-ponovo-preti-potrebne-nove-sistemske-mere-8354>

<sup>22</sup> The decrease in the cost of investing is less than the tax credit, as the credit is carried forward through the years. Here, we assume an investment to taxable income ratio of 1.5 to 1 (the average across 2018-2022) and investment cycle of 5 years. However, this depends on a particular company – companies that have smaller investments relative to their profits have higher savings (50% maximum), while companies with higher investments relative to their profits save less than 30%.

<sup>23</sup> 40% tax credit, up to 63% of tax payable in a given year.

2013) the resulting increase in investments would amount to some 22.5% (option a), 21% (option b) and 37% (option c). The fiscal cost of this measure, in terms of reduced tax revenues, would range from 300 to 400 million EUR (17-23% of corporate tax, or 0.5 to 0.7% of GDP) for options a and b, while the cost of the option c would amount to 500-660 million EUR (28-38% of corporate tax, or 0.8 to 1.1% of GDP).<sup>24</sup> At a social discount rate of 7%, this venture would be economically justified (showing a positive net present value) under the assumptions and a gross return rate on fixed assets of 8.3%. Additionally, greater success could be guaranteed by applying solutions similar to the previous law, which limited the type and kind of property to which the incentive applies. Furthermore, the practice in some European countries (Netherlands, Italy, Slovenia, Slovakia) shows that this type of incentive can be used as an additional stimulus for the digitalization and green transformation of enterprises.

- Fourth, introducing a tax credit would increase SME investments and accelerate the economic growth rate by 0.5 percentage points in the medium to long term (options a and b), and up to 0.8 percentage points in case of option c over the long run.

### Regulatory culture as a root of the problem

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**The main reasons for the state's decision to abolish the tax credit for SMEs were to increase public revenues and the belief that with lower corporate tax rates, the tax credit is of little significance.** The elaboration of the amendments to the Law stated that the primary reason for these amendments is the need to create conditions for increasing the inflow and collection of public revenues – increasing budgetary funds from corporate income tax. For the year 2015, MoF projected a saving of about 70 million euros, while the tax expenditure in 2012 on this basis amounted to about 200 million euros. The Ministry of Finance also stated that such a measure, when viewed in the long term, is in the interest of the economy, given that the state budget was in a very difficult situation and that there is a real danger of the inability to perform public functions of the state due to a lack of financial resources if restrictive fiscal measures like this are not taken. An additional argument was that, with a low tax rate, tax incentives do not represent an

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<sup>24</sup> Assessments and calculations are based on Serbian Business Registry Agency Annual Bulletin of Financial Statements, assuming that the SME sector is represented by a single company with a combined/consolidated assets and results.

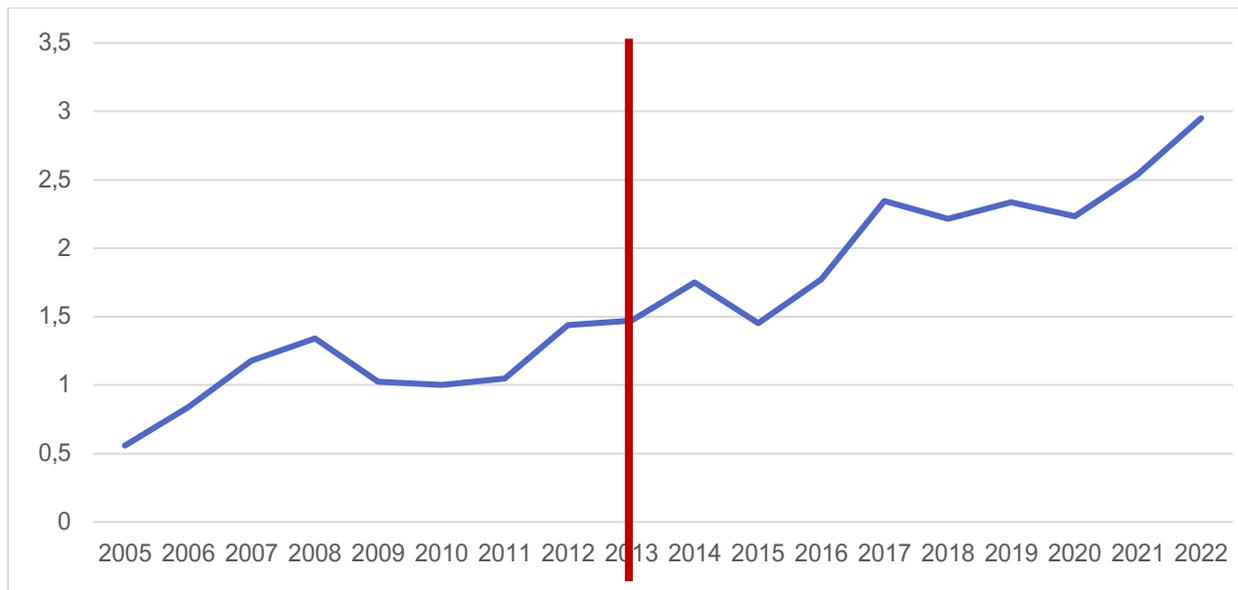
effective mechanism for encouraging investments, and that the abolition of the tax credit will not have a significant impact on the decision to invest.

**While these arguments held some validity at the time, the current context suggests a need to revise the policy mix.** From 2012 to 2017, Serbia implemented a fiscal consolidation program requiring numerous savings. Indeed, revenues from this source gradually increased, reaching 3% of GDP<sup>25</sup> (about 1.78 billion euros) in 2022 (see the figure below). This increase of 1.5 percentage points of GDP, however, cannot be entirely attributed to the abolition of the tax credit – especially considering the economic context in which the tax credit was abolished – as total tax revenues increased by 6.3% of GDP (or 17.4%) between 2013 and 2022. Nonetheless, the current moment in terms of fiscal position is significantly better, while the state spends considerable funds on various ad hoc measures to assist citizens (2.1 billion euros in the period 2021-2023). Also, the state's capital expenditures in the period 2013-2022 have increased 3.7 times – from 2% to 7.4% of GDP. In other words, the savings generated by increased tax collection from private company investments are being used by the state to subsidize consumption and invest heavily in infrastructure projects, often without conducting cost-benefit analyses. We emphasize that tax itself is a distortive instrument of economic policy, and effectively reducing tax rates diminishes this distortion, leaving resources in the hands of those who can utilize them more productively. Moreover, the argument that tax credits have a low impact in case of low CIT rates does not only suffer from the measurement problems (James 2013), but it also fails to explain why the government decided to keep the very generous tax credit for large undertakings (Article 50 of Legal entity profit tax law). In addition, many EU (CEE) countries with comparable CIT rates have significant tax incentives based on CIT.

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<sup>25</sup> It should be noted that 2022 was somewhat atypical due to record-high corporate profits.

Figure 4 CIT revenues as % of GDP



Source: Ministry of finance

**The main proclaimed goal of the Industrial Policy Strategy 2021-2030 is to enhance competitiveness, facilitate structural changes, and encourage the establishment of an environment conducive to the development of entrepreneurship that stimulates SMEs.** Without adequate support in the form of programs and support schemes, transformation of SME sector in Serbia will be hardly possible. Nevertheless, neither the recently adopted Strategy for the Development of Micro, Small, and Medium Enterprises for the period 2022-2027<sup>26</sup>, nor an accompanying action plan rectify past mistakes - the measures proposed are fragmented and insufficient, with no mention of reinstating the tax credit. The anticipated increase in investments through measure 3.2 is modest (8.8% cumulatively over a 6-year period, with 2021 used as the base year) and predominantly relies on external financing sources. It is commendable that the need for financial literacy is recognized, but it is not entirely clear why the return of the credit is being avoided, especially since officials have not made any statements on this matter, despite pressure from associations and the public.

**One reasonable explanation for the difficulties in implementing the tax credit could be the significant operational challenges faced by the Tax Administration.** Administering this measure would represent a substantial additional burden. A potential solution to this problem could at least partially be found in simplifying procedures compared to the system established before 2013. In this regard, it would be possible to

<sup>26</sup> <https://privreda.gov.rs/dokumenta/propisi/strategije/strategija-za-razvoj-malih-i-srednjih-preduzeca-za-period-od-2023-do-2027-godine>

introduce a threshold, as is the case in other countries (for example, EUR 10,000), which would eliminate investments where the tax credit would have minor material significance but significant administrative costs for the state. Additionally, full utilization of the SEF could facilitate easier monitoring of procurements and reduce the risk of abuses, considering the opposing interests of parties (in terms of input and output VAT for the company purchasing and selling the asset subject to investment/tax credit).

## Potential measures

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**One potential measure is to reinstate a tax credit ranging from 50-100% of the recognized investment amounts, in line with the comparative practices of European (CEE) countries.** The tax credit should be simple to administer in terms of requirements set by the Tax Administration. Along these lines, we offer the following three sub-options:

- The threshold for the investment amount recognized for the purpose of the credit could be set at EUR 10,000 to eliminate investments of minor material significance that would create significant administrative costs.
- SEF could facilitate easier monitoring of procurements and reduce the risk of abuses, considering the opposing interests of parties (in terms of input and output VAT for the company purchasing and selling the asset subject to investment/tax credit).
- Defining the types of assets that are recognized or not recognized (*numerus clausus*) would reduce administrative demands and increase certainty of implementation. A proposal for a list of assets for which the application of the tax credit could be excluded is found in the text box below.

Assets, in terms of recognizing the tax credit, should not include:

- Aircraft and watercraft not used for business activities,
- Passenger cars, except for taxis, rent-a-car, driver training, and special passenger cars with devices for patients,
- Furniture, except furniture for equipping hotels, motels, restaurants, youth, children's, and workers' resorts,
- Carpets,
- Artworks of fine and applied arts and decorative items for space decoration,
- Mobile phones,
- Air conditioners,
- Video surveillance equipment,
- Advertising media,
- Tools and inventory with calculative write-offs.

In line with international practice, it would be advisable to include/enable the acquisition of software and other assets that imply digitalization/automation/green transition of enterprises. Software acquisition was not included in the previous tax credit program in Serbia.<sup>27</sup> To protect tax revenues, it would be possible to introduce a fiscally neutral measure, either by increasing the CIT rate or increasing the withholding tax rate, with the simultaneous introduction of a tax credit on investments.

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<sup>27</sup> [https://www.mena.rs/cms/index.php?option=com\\_content&view=article&id=297%3Ada-li-se-priznaje-pravo-na-poreski-kredit-iz-lana-48-zakona-o-porezu-na-dobit-pravnih-lica-obvezniku-koji-izvri-ulaganja-u-softver&catid=58%3Afin-porez-na-dobit&Itemid=87&lang=sr](https://www.mena.rs/cms/index.php?option=com_content&view=article&id=297%3Ada-li-se-priznaje-pravo-na-poreski-kredit-iz-lana-48-zakona-o-porezu-na-dobit-pravnih-lica-obvezniku-koji-izvri-ulaganja-u-softver&catid=58%3Afin-porez-na-dobit&Itemid=87&lang=sr)

## Case Study 2: Obligations Imposed by the Law on Archival Materials

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Regulators often underestimate, completely ignore, or are not aware of the administrative burden they impose on the economy, especially on the SME sector. In some cases, these requirements are not only disproportionate but also completely meaningless. **This case study illustrates an example of an oblivious facet of regulatory culture.** The case study concerns the burden imposed by the Law on Archival Materials and Archival Activities. Excessive burden and legal uncertainties are some of the factors that deter people from becoming entrepreneurs.

### Introduction

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**The Law on Archival Materials and Archival Activities has been in effect since February 1, 2021.**<sup>28</sup> The law regulates the system for the protection of archival materials and documentary material, the conditions and manner of using archival materials, the organization, competence, and activities of archives. While the law addresses numerous issues that are not of interest for this case study, we focus on the sections of the law that concern the business sector. Namely, several provisions of the law relate to entrepreneurs and companies, given that businesses may create material through their business operations and daily activities which, according to the law, can be classified as a category of documentary material, and in exceptional cases, as archival material.

**According to Article 9, creators and holders (in our case businesses) are obliged to diligently preserve archival and documentary materials in an organized way.** On the one hand, entrepreneurs as creators of archival materials are only required to conscientiously keep the material in an orderly and secure condition in the form in which it was created. On the other hand, the obligations of legal entities are much broader and include, among other things, maintaining an archive book and submitting its copy to the competent archive, appointing a responsible expert for the protection of archival material and documentary material, providing appropriate space and equipment for the storage and protection of archival material and documentary material, and similar actions. However, when considering the solutions adopted by the law, it seems that all these obligations are completely overlooked. Moreover, the conducted impact assessment that accompanied the Law stated that:

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<sup>28</sup> Закон о архивској грађи и архивској делатности („Службени гласник РС“, бр. 6/2020),

***„The implementation of the law will not create new costs for citizens and the economy when it comes to handling documents originally created on paper, as the obligations provided for creators and holders of archival material and documentary material do not significantly differ from the obligations set by existing regulations related to the storage, classification, archiving of documents, selection of archival materials, disposal of worthless registry material, submission of archival materials, etc. However, considering that the economy creates archival material originally in electronic form in its operations, it will have to be stored in accordance with the provisions of this law and regulations governing reliable electronic storage to ensure its preservation. In this sense, the economy will not have additional costs other than those it already incurs based on the application of regulations that govern reliable electronic storage. “***

**In addition to the Law itself, several subordinate legal acts have been adopted for more detailed regulation of the area.** Besides the costs imposed on the SME sector by the mentioned regulation, it has also created legal uncertainty and introduced disproportionate sanctions. The requirements prescribed by the law in the case of SMEs are rather problematic and their value added is quite dubious. Finally, the implementation itself, as well as the supervision of the law's implementation, are questionable.

#### Impact of administrative burden on the SME sector

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**Administrative burden represents a significant aspect of business, especially in the context of micro, small, and medium enterprises (MSMEs).** MSMEs often have limited resources compared to larger companies, making administrative demands particularly challenging. Investing time and money to meet administrative requirements can significantly impact their productivity and competitiveness in the market. In the MSME sector, these demands often fall on the owner or a small number of employees, which can lead to overload and a decrease in productivity. While individual requirements, in this case, those from the Law on Archival Materials, may not have a decisive impact, a large administrative burden can significantly affect the sustainability of the business.

In recent years, Serbia has further reduced the administrative burden of the private sector. According to the latest estimates by the PPS, total administrative costs amount to 2.95% of GDP. In addition, responses regarding the time that the company's management, or the entrepreneur, spends on administrative requirements imposed by regulations is also a proxy for administrative burden. Based on the latest World Bank enterprise survey, the burden that is placed on Serbian managers and entrepreneurs **is higher than average**

for ECA region. The greatest burden is borne by medium-sized enterprises, which is understandable, given that they are often faced with numerous administrative requests.

**Table 2 Time spent dealing with government regulation**

% time spent dealing with government regulation	Serbia	Europe and Central Assia	All countries
<b>Total</b>	<b>10</b>	<b>9</b>	<b>8.7</b>
<b>Small (5-19)</b>	7.8	8.7	8.3
<b>Medium(20-99)</b>	14.2	9.6	9.8
<b>Large (100+)</b>	10.6	10.1	10.3

Source: <https://www.enterprisesurveys.org/en/data/exploreeconomies/2019/serbia>

**Adding new and redundant obligations is move in the wrong direction.** In the case of the Law on Archival material undesirable consequences and unnecessary burden on the MSME sector were completely neglected. Regulators did not ask themselves whether the requirements imposed by regulations on SMEs are purposeful and justified – so that there is a valid reason for their introduction, and/or proportional as they put SMEs at a disadvantage compared to large economic entities.

## Box 1 MSME TEST

A systematic approach that prevents the introduction of unnecessary burdens is the MSME test, which analyzes the effects of proposed solutions contained in the regulation on micro, small, and medium-sized business entities. The application of the MSME test involves going through five steps

Illustration 1 Steps of the MSME Test



Many problems that arose from the adoption of the Law would have been avoided if SME test was properly applied. Of course, if the regulation does not affect economic entities, or does not affect MSMEs, it is not necessary to conduct an analysis. However, this answer in the analysis does not correspond to reality. In the case of the Law on Archival Materials, the proposer should have first considered:

- Is there an impact? The answer is positive because the law affects the entire SME sector. Is there a difference between sectors (according to size or activity)? Here too, the answer is positive, as it mainly concerns legal entities.
- Is it possible to limit the application or otherwise facilitate the implementation of the regulations for the economy, especially for SMEs? Similarly to entrepreneurs, at least small enterprises could be exempt from the requirements prescribed by the law.
- Is it possible to determine the costs that will be borne by SMEs? Yes, but this was not the case. This case study will provide a conservative assessment of costs borne by SMEs.
- How is it possible to reduce costs? At least several ways to reduce or in some cases even eliminate costs for SMEs could be suggested.

**The Law on Archival Materials, or the obligations imposed on the economy, represents a typical information requirement that can be calculated using the Standard Cost Model.** The number of economic entities affected by the law, or the frequency on an annual level, is easily obtained based on data from the APR (Agency for Business Registers). When drafting regulations, it is certainly desirable to know the total number of entities that will have to apply the regulation, i.e., the proposer should state the total number and structure of economic entities that are obligors under the law and classify them according to the size of the obligations imposed. As mentioned in the introduction, none of this is the case.

To assess the administrative costs imposed on the economy (to the greatest extent on the MSME sector), a calculation was made for the following obligations introduced by the regulation:

1. Creation of a general act on the manner of recording, classifying, archiving, and storing archival materials and documentary materials.
2. Creation of a list of categories of archival materials and documentary materials with retention periods.
3. Creation of a general act on the method of recording the protection and use of electronic documents.
4. Submission of a copy of the archive book by the end of April of the current year for documentary material created in the previous year, where the copy is submitted in paper form (as electronic submission is not yet enabled).
5. Obtaining the opinion of the archive before undertaking measures related to archival materials and documentary materials (status changes, liquidation, bankruptcy, relocation, etc.).

**Based on information collected through semi-structured interviews and survey we estimated time spent and other costs.** It was assumed that the same amount of time was spent on the first and third items, with part relating to familiarization with the regulation and part to the drafting of the act. In practice, some companies engaged third parties or transferred this obligation to their accountants. The calculation was made under the assumption that the companies themselves were preparing all the documents. For the purposes of estimating administrative costs, the PPS online calculator was used.

**The calculation was made under the assumption that it applies to all business entities and all sectors.** The total number of economic entities is 137,361. The assumption is that all sectors are covered, using the corresponding average salaries for managers and executors, with the former getting familiar with the obligations, and the

latter drafting the act, with each requiring 60 minutes. This is certainly a conservative estimate because, due to a number of ambiguities, the required time in practice was often much longer. Besides, accountants and other professional advisors allocated many hours to familiarize themselves with the obligations and then to inform their clients about them. Due to the number of various interpretations, accounting and other professionals provided in most cases conservative advice trying to protect clients from extremely high penalties.

**The Law imposed substantial costs on Serbian enterprises.** In the case of the first and third administrative obligations, the total one-time costs are 178.4 million dinars per procedure, or 356 million dinars for both procedures (about 2,700 dinars per economic entity). Again, this is a rather conservative estimate, and due to the time owners and managers spent to inform themselves and subsequently to apply the law this estimate is three to four times larger. This burden is substantial on the individual company level as well for the whole economy due to exceptionally high frequency because it is an obligation imposed on all business entities. Unfortunately, these are irreversible costs. However, some costs arising in the future will apply only to newly established companies, so the additional annual costs on this basis while still redundant will be significantly lower and amount to approximately one-tenth of the calculated one-time costs. The list of categories is an integral part of the General Act on the method of recording, classifying, archiving, and storing archival material. A simplified assumption is used for the calculation that the same amount of time is spent for all activities. In practice, due to the diversity of activities, and thus the specificity of the documentary material they create, each business entity has a different List. An additional step in this requirement is submitting the proposal (in two copies!) to the competent archive for approval. The reason for doing this is not clear. On this occasion, the submitter prepares a letter to obtain approval. Compiling the list implies knowledge of the documentation that a business entity creates, i.e., the relevant legal framework.<sup>29</sup> When preparing, all categories of documentary material that are created are listed, since the competent archive will not approve the destruction of documentation that is not listed, regardless of whether its retention period specified in a certain regulation has expired. The list contains the material's designation (if there is a classification system or archival numbering), the name of the category, and the retention period. As a rule, this concerns material whose retention is already regulated by laws on accounting, companies, VAT, or other laws that introduce the obligation to keep records. For the creation of the list by SMEs and its annual revisions, more time is needed (assumption of a total of 100 minutes), as well as 30 minutes for managers to familiarize themselves with the content and requirements. Compared to the previous two requirements, this is a

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<sup>29</sup> The proposal of the list is available on the website of the Historical Archive of Belgrade. Preporuka za izradu Liste kategorija.

recurring cost. Again, we have very conservatively estimated the costs of delivery (including the time spent by employees) at 100 RSD. Annual costs amount to 199.8 million dinars. The conservative estimate of cost per company is 1,525 dinars, which may not seem very high but is imposed on a very large number of economic entities. Additional recurring costs, with a series of facilitating assumptions regarding the management and delivery of the list, amount to 86.6 million RSD, while the cost of obtaining opinions, assuming that there are about 50,000 different cases – liquidations, bankruptcies, status changes, annually, is 18.6 million RSD. In other words, about 100 million RSD of opportunity costs arise due to obligations imposed by the law.

**The consistent application of the law would have created costs in the initial year of its implementation amounting to minimum RSD 650 million.** In reality, the costs are probably two to three times higher. However, due to the absence of the law's application, these costs are somewhat lower. However, these are irreversible costs, as many requirements were completely unnecessary, or had unnecessary steps. About 6 million euros in administrative costs incurred by the introduction of the law will certainly not dramatically affect the competitiveness of MSMEs, but the question arises whether they are truly necessary. Besides these direct costs, the additional effect on the sense of legal uncertainty due to the unpredictability of the business environment created by such laws must be considered—because not only is the introduction of such obligations unexpected for the economy, but very soon after its introduction, it becomes completely unclear whether it will be implemented or not.

#### Regulatory culture as a root of the problem

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**What did lawmakers intend to achieve and what is the purpose of archiving in the case of the business sector?** Do similar obligations exist, and whether the purpose of the law is already fulfilled by some existing regulations and procedures? For example, the Law on Companies ("Official Gazette of RS", nos. 36/2011, 99/2011, 83/2014 - other law, 5/2015, 44/2018, 95/2018, and 91/2019) prescribes the obligation to keep acts and documents, distinguishing between limited liability companies and joint-stock companies. Provisions of Article 240 for limited liability companies, respectively Article 464 for joint-stock companies, specify the acts and documents that a business entity must possess, as well as the obligation of their holding and keeping and the retention periods. So why create the identical obligation?

**Besides unreasonable requirements, the enactment of the Law was not followed by an adequate preparation for its implementation.** This led to several paradoxical

situations where those expected to enforce the regulation are unable to do so. Furthermore, The Law was adopted despite the lack of appropriate infrastructure for its application. This is best exemplified by a notice published by the Belgrade Historical Archives (Illustration 3). Despite widely proclaimed digitalization of public services, instead of utilizing digital solutions, communication with archives has been unnecessarily maintained in paper form.

**The late 2023 amendment to the Regulation governing electronic documentary material has eased the redundant administrative requirement for businesses.** Previously, companies were burdened with the requirement to keep electronic documents that were already archived by state agencies. For instance, financial reports are held by the Business Registration Agency, while other institutions, such as the Tax Administration, Customs, Central Registry of Obligatory Social Insurance (CROSO) and the National Bank of Serbia, manage their respective documents electronically. With the amendment made in late December 2023, the duty to store such documents now rightly falls to the relevant authorities, easing unnecessary administrative pressures on businesses. Yet, it prompts the question as to why this rationalization wasn't enacted sooner. However, one may wonder, why wasn't this change implemented immediately?

**Regrettably, the current Regulation mandates a costly and intricate electronic document archiving process.** This includes the requirement for each document to be certified with a qualified time stamp as per Article 2. The FIC White Book highlights concerns that the projected expenses for implementing this electronic archiving system, coupled with the necessity of affixing a qualified time stamp on every document, might rival or even surpass the costs associated with maintaining a traditional paper archive, as estimated earlier. This financial burden may deter businesses from transitioning to, or continuing with, electronic operations and could represent a significant step backward for those already operating digitally.

## Illustration 2 *The Historical Archives of Belgrade Announcement*



**ПОШТОВАНИ,**

Услед изузетно великог броја до сада примљених захтева за издавање сагласности на **Листу категорија архивске грађе и документарног материјала са роковима чувања**, као и законског рока за достављање **преписа архивске књиге**, а из непостојања адекватних техничких и кадровских капацитета, обавештавамо Вас да Историјски архив Београда **НИЈЕ У МОГУЋНОСТИ ДА ДО ДАЉЕГ ПРИМА НОВУ ДОКУМЕНТАЦИЈУ**, на до сада једини примењени начин - искључиво писаним путем.

**ЈОШ ЈЕДНОМ ВАМ УКАЗУЈЕМО ДА БЕЗ ОБЗИРА НА ПРИБЛИЖАВАЊЕ ЗАКОНСКОГ РОКА ЗА ПРЕДАЈУ ПРЕПИСА АРХИВСКЕ КЊИГЕ НАМ ДО ДАЉЕГ ИСТЕ НЕ ДОСТАВЉАТЕ НИ ЛИЧНО НИ РЕДОВНОМ ПОШТОМ.**

У циљу адекватног решавања овог проблема, у овом тренутку се, у сарадњи са еУправом, ради на успостављању е-сервиса којим ће се документација примати и у електронском облику. Чим се за то стекну услови о истом ћемо вас, на овај начин, благовремено обавестити.

**Док сви ствараоци и имаоци не буду у прилици да нам доставе поменути документацију везану за Закон о архивској грађи и архивској делатности, Архив Београда, по овом питању, НЕЋЕ СПРОВОДИТИ КАЗНЕНЕ МЕРЕ НАВЕДЕНЕ ЗАКОНОМ.**

Напомињемо да је Архив Београда до сада примио преко 22.000 захтева за издавање сагласности на Листу категорија и да се исти континуирано обрађују у складу са поменутим могућностима, те је до сада обрађено и уручено око 13.000 сагласности.

Хвала на размјевању!

Source: <https://www.arhiv-beograda.org/rs/>

The law's penalties are excessive, especially given that the responsibility to maintain essential records is already covered by existing legislation. Legal entities could face fines from 50,000 to 2,000,000 dinars for violations. This creates a scenario where a business may be penalized under multiple laws for the same infringement. For instance, the Accounting Law imposes fines between 100,000 and three million dinars for not retaining accounting records and reports as mandated, which could result in additional penalties under the Law on Archival Materials.

### Potential measures

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The burden imposed on SMEs by the Law on Archival Materials should be substantially reduced. Several measures may be imposed in this respect.

- **Eliminate the requirement to submit lists for approval to archives.** Everything contained in the lists is already prescribed by law, so the question arises as to why then seek approval. This requirement should be abolished.
- **Prescribing a minimum content, instead of imposing requirements for drafting. Instead of imposing obligations to draft general acts, which SMEs often simply copy from one another, it is simpler to prescribe a minimum required content.**
- **Consider adopting clear deadlines for when the law will start to be applied, which would create legal certainty.** Many businesses have formally complied with the requirements imposed by law out of fear of penalties. Essentially, all companies would apply laws related to documentary material, which regulate specific areas. Since obligations have already been imposed, and regulations are not applied by the competent authorities, the postponement of its application should be considered in the part related to companies until the conditions for its functional application are met.
- **Adopt a special regulation on the classification of documentary material with retention periods for businesses.** However, this is only the second-best option. The question arises whether the same matter is being regulated multiple times. In Germany, the issue of archiving, that is, storage and organization, is regulated by company, accounting, and tax laws depending on the documentation. The Federal Archiving Law itself does not deal with these issues. In practice, there have been quite a few problems with the application, and the regulation concerning the classification of documentary material in public administration is not the simplest to interpret in the case of the economy.
- Simplify requirements regarding electronic archival system.

## Case Study 3: Inadequate Safeguards for SMEs Against B2B Payment Delays

### Introduction

**The issue of late payments carries considerable weight for the SME sector, which is disproportionately impacted by payment delays** due to its restricted access to financing sources, elevated financing costs, and limited capacity for managing working capital and mitigating delays. Late payments adversely affect cash flows, incur additional financial burdens, and introduce uncertainty in transactions with creditors. The roots of these delays are multifaceted, with contributing factors ranging from macroeconomic conditions to ingrained business practices and culture. However, they are primarily driven by an imbalance in negotiating leverage and market power between buyers and suppliers. Inflation further complicates the matter, as each payment delay results in the diminution of receivables' real value.

**The Republic of Serbia, motivated by the prevalence of insolvent businesses and the requirement to integrate Directive 2011/7/EU into national law, preempted many EU member states by enacting relevant legislation in 2012.**<sup>30</sup> This law significantly enhanced the position of companies vis-à-vis payment deadlines in transactions with the public sector. However, within the B2B sphere—commercial dealings among private sector companies—evidence suggests that the law's enforcement has had a modest, albeit limited, effect. While the rights afforded by the law are recognized and can be exercised, SMEs remain apprehensive about asserting these rights, fearing potential harm to their business relationships. A fundamental issue is that the law provides only nominal protection to SMEs outside of specific application areas. The responsibility for monitoring

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<sup>30</sup> Law on Settlement Deadlines in Commercial Transactions (Закон о роковима измирења новчаних обавеза у комерцијалним трансакцијама ("Сл. гласник РС", бр. 119/2012 68/2015, 113/2017, 91/2019, 44/2021, 44/2021 - др. закон, 130/2021, 129/2021 - др. закон и 138/2022). <https://www.pravno-informacioni-sistem.rs/SlGlasnikPortal/eli/rep/sgrs/skupstina/zakon/2012/119/3/reg>. The law was adopted on December 15, 2012, and came into effect on December 25, 2012. The key provisions of the Law relate to: 1) establishing a payment deadline of 60 days for B2B transactions with certain exceptions; 2) limiting payment deadlines to 45 days when public sector entities purchase goods and services from within the private sector; 3) entities may demand the payment of default interest in case of delays, as well as an amount of RSD 20,000 as compensation for the delay; 4) High penalties businesses and responsible persons; 5) Enforcement procedures and settlement in the case of undisputed claims should allow for the process to be concluded within 90 days based on an enforceable title.

the law's application in commercial exchanges between businesses is assigned to the Tax Administration that lacks adequate motivation to enforce the B2B section of the Law.<sup>31</sup>

## Impact on liquidity of SME sector

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**Trade credit represents a significant form of financing for companies in the Republic of Serbia.** Trade credit is common in the operations of micro and small enterprises, which often cannot pay their suppliers before collecting payments for goods sold and services provided to their clients. Regarding the importance of trade credit in financing working capital, Serbia leads among transition economies. Data from the World Bank's 2019 Business Environment and Enterprise Performance Survey reveals that 50.1% of Serbian companies utilize trade credit for this purpose—double the rate seen in neighboring economies. Notably, for Serbia's economy, reliance on trade credit is a sustained trend rather than an isolated occurrence.<sup>32</sup>

**Table 3 % Companies that use trade credit to finance working capital**

% Companies that use trade credit to finance working capital	Serbia	Europe and Central Asia	All countries
Total	50.1	23.3	25
Small (5-19 employees)	48.8	21.5	23.9
Medium (20-99 employees)	51.8	24.1	27.1
Large (100+ employees)	55.1	24.2	26.2

Source: <https://www.enterprisesurveys.org/en/data/exploreeconomies/2019/serbia#finance>

**In practice, there are significant differences between agreed and actual payment deadlines.** The European Payment Report for 2022 (EPR) provides estimate of the average payment terms that businesses grant to customers, but also the average terms

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<sup>31</sup> Besides the Law, the issue of the oversight is stipulated by a Regulation that only provides general guidelines for its implementation. The Regulation on the manner and procedure of supervising the enforcement of the law on the settlement deadlines of financial obligations in commercial transactions between economic entities ("Official Gazette of RS", No. 54/2016). If it is determined during supervision that the supervised entity does not settle financial obligations within the deadlines set by law, they must submit a request to the competent misdemeanor court to initiate misdemeanor proceedings. The financial penalty ranges from RSD 100,000 to 2,000,000 in the case of a legal entity, and from 10,000 to 500,000 dinars in the case of an entrepreneur. The procedure of conducting inspection oversight over the application of the Law is not regulated by the Regulation's provisions, hence, the provisions of the Law on Tax Procedure are applied accordingly. There are several problems related to supervision, which have not been resolved even with the latest amendments and supplements to the Law on Settlement Deadlines.

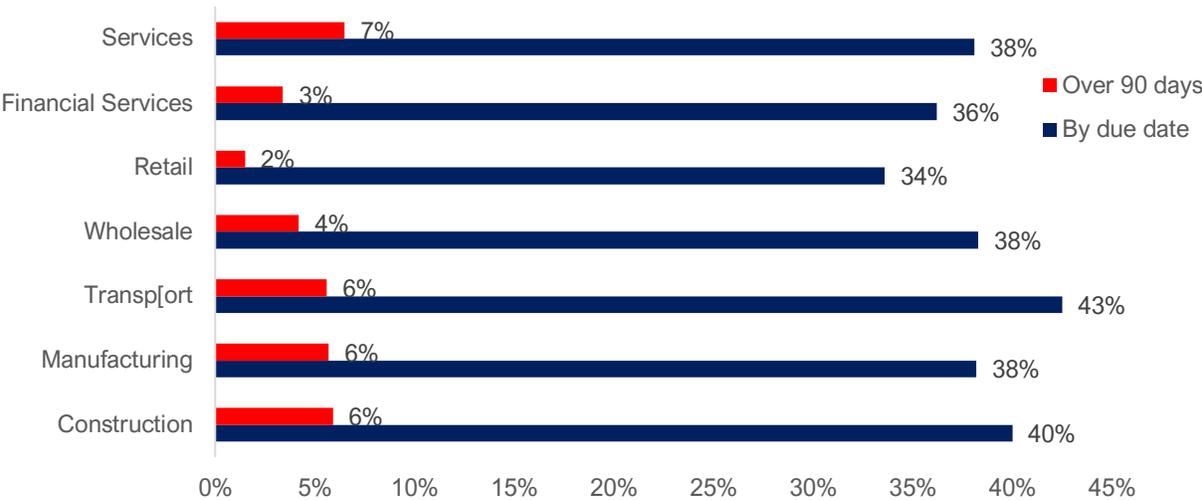
<sup>32</sup> Compared to previous survey from 2013, the share of companies that used trade credit to finance working capital was 43.3%.

in which payments are actually made. The key findings of the Report specific to Serbia are as follows:

- Half of the respondents indicate that it is very difficult to come to an agreement on payment terms that are fair in the existing business environment.
- 69% of respondents expect negative effects on the partner's payment ability due to inflation.
- According to the respondents, the average term they give in commercial B2B transactions is 41 days, while payments in commercial B2B transactions are made with an average term of 56 days.
- About a third of the respondents believe that they have financial costs due to delays.
- 73% of respondents claim that large customer companies demanded payment terms that are longer than acceptable.
- The key mechanism for protection is advance payment (practiced by half of the respondents).

**The 2023 Payment Report by Dun and Bradstreet displays notable industry variations regarding late payments.** Interestingly, the Retail and Wholesale Trade sectors overperforms other sectors in terms of payment timeliness. Nevertheless, it's noted that in nearly all sectors, the proportion of Serbian companies failing to pay by the due date is either above or nearing 60%.

**Figure 5 Payment Practices in Serbia by Sector Q4 2022**



Source Dun and Bradstreet 2023 Payment Report

**The relative significance of delays is greater for small and medium-sized enterprises.** According to data from the Business Registration Agency (BRA) in 2022, receivables from sales for the small enterprises sector amounted to RSD 632 billion, and for micro enterprises RSD 379 billion, representing 16.3% and 11.9% of total assets respectively. For medium-sized enterprises, this share amounted to 14.5%, while for large enterprises it was significantly lower, at 10.1%. The accounts receivable turnover ratio which shows how many times receivables from customers are collected on average annually (relationship between net sales revenue and the average accounts receivable - customer balance), amounts to about 6.5 for medium-sized, 5.91 for small, and 3.89 for micro enterprises).

## Impact Assessment

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**When assessing the negative effects, several limitations should be considered.**

- Firstly, the loss incurred by creditors is offset by the gain to debtors, rendering essentially the net effect neutral. While creditors endure the hardships of illiquidity and associated detriments, on the other side, debtor entities, particularly those with significant market influence or in the public sector, inadvertently benefit from cost-free financing via payment deferrals. By prolonging payment deadlines, they are effectively able to utilize the capital owed to them for the cycling of goods or services multiple times.
- Secondly, the ripple effects of liquidity shortages can manifest in several ways, incurring additional costs. Issues such as reduced investment activities, liquidations, bankruptcies, delivery complications, tarnished reputations, and job cuts can escalate. Yet, quantifying these indirect consequences is challenging due to the scarcity of relevant data.
- Third, it is difficult to separate the direct effects of applying the law from other factors that influence the duration of payment terms, i.e., delays. The potential effects of the implementation of regulations are limited by the causes of delayed payments. Namely, the delayed payments may be caused by the debtor's illiquidity problems, and not by the abuse of the negotiating position. Hence, the application of the law will have less impact. The opposite also applies; if delayed payments are the result of the debtor's intention to prolong payment, then more efficient implementation of the regulations could potentially have a substantial effect.

- Fourth, part of the blame also falls on the SMEs. Namely, a significant number of companies and entrepreneurs are not familiar with the provisions and deadlines prescribed by the Law on Settlement Deadlines and do not exercise their rights.
- Fifth, although in principle there are no obstacles to exercise rights (lump-sum compensation, compensation for other costs) provided by the Law, in practice a large number of companies do not use this right. The basic reason for the inadequate observance of regulations is the fear on the part of suppliers that they will jeopardize their business relationship with customers.

**Given the mentioned constraints, we present an estimation of the potential financial costs borne by SMEs.** Utilizing available data on the duration of payment delays and the value of outstanding sales receivables, we can approximate the financial burden on the SME sector. These estimations could fluctuate based on various factors (like the net amount of claims, the extent of delay, etc.). If larger receivables are delayed longer, our estimated result is likely undervalued. Conversely, if smaller receivables experience longer delays, our estimate may be inflated. For more accurate estimations, detailed information on the nature of receivables is required, such as whether they pertain to domestic or international entities. Regrettably, the annual financial reports provided by BRA do not facilitate the calculation of precise net sectoral positions.

**A straightforward calculation takes into account the necessity for companies to offset liquidity shortages caused by payment delays with borrowed funds.** Essentially, delayed payments compel companies to source working capital through borrowing at market rates. Additionally, we presume that companies do not levy any penalty charges, such as default interest. The estimation of short-term financial costs incorporates the annual interest rate applicable to non-financial legal entities against the total sales receivables.

The cost estimate is obtained using the following formula:

$$\text{Financial Costs} = \text{sales receivables} \times \text{average interest rate (for non-financial sector)} \times \text{delay}$$

Assuming an average payment delay of 15 days beyond the due date, the estimated costs associated solely with interest expenses amount to over RSD 2 billion.

$$\text{SME sector financial costs} = \text{RSD 632 billion} \times 0.085 \times 15/365 = \text{RSD 2.20 billion}$$

**The specified amount should be viewed as an indicative figure.** To conduct a more accurate analysis of the effects, individual company data from financial statements would be necessary. For instance, extending payment delays by an additional ten days would result in a projected 40% increase in costs. However, it should be borne in mind that

companies are typically both creditors and debtors to some extent, so the net amount is significantly lower. As previously stated, getting an accurate effect is limited due to problems with aggregated data by the size of the sector, which prevents proper comparison and calculation of potential savings from the implementation of new solutions.

### Regulatory culture as a root of the problem

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**The selection of the oversight body with respect to B2B transactions in the context of Serbia is inadequate.** In the Republic of Serbia, the Tax Administration is tasked with overseeing the enforcement of B2B transactions, while budget inspections handle transactions involving the public sector. Yet, the Tax Administration lacks the motivation to oversee B2B transactions effectively. Essentially, the Tax Administration's primary duties are centered on tax collection, and its resources are better allocated to these activities rather than safeguarding SMEs from unfair practices. This is further evidenced by the absence of any data on the enforcement of the Law on Settlement Deadlines in the Tax Administration's 2022 Annual Report.<sup>33</sup>

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<sup>33</sup> Report is available at <https://www.purs.gov.rs/sr/o-nama/lzvestaj.html>.

**Supervision of the enforcement of relevant regulations in EU member states is delegated in various ways.** For instance, in Spain, the Federation of Small and Medium Enterprises, in collaboration with the Government, publishes a quarterly report on settlement deadlines, complete with an accompanying analysis. A similar approach is used in Poland, where indicators tracking delays and deadlines are monitored monthly. In the United Kingdom, the Small Business Act, which came into effect in 2015, mandates that the largest companies report on their payment practices on a biannual basis. This obligation applies to companies that meet two of the following three criteria: a turnover of 35 million pounds, over 250 employees, and a total asset value of 18 million pounds. Essentially, this is a requirement for medium and large enterprises. The introduction of this obligation is partly because the amount of payment delays to the SME sector in the United Kingdom was over 25 billion pounds, and that a large number of SMEs shut down annually due to the inability to collect receivables.

**Box 2 NEW EU LATE PAYMENT REGULATION**

It should be noted that similar problems are present in some EU member states. The results indicate that the Directive is associated with improved cash flow in those companies that have historically had longer periods for collecting their receivables. The results show that four years after the adoption of the Directive, the average cash flow of companies was twice as high as its value a year before the introduction of the directive when comparing firms that were highly exposed to payment delays with those that were less exposed. Although the effects are assessed as positive, the implementation of the Directive, as well as some of the solutions, are judged to be insufficiently effective. The EU is in the process of evaluating the Proposal for a Regulation aimed at combating late payment in commercial transactions. This proposal seeks to enhance the legal framework to better protect suppliers, with a particular focus on the SME sector. It suggests a range of substantial and significant changes, such as the introduction of restrictive payment terms, the automatic calculation of default interest and compensation, the designation of a responsible state authority for enforcement, and various other noteworthy measures.

**Potential measures**

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**Given that the Tax Administration’s resources are limited and that overseeing B2B transaction compliance is not within its actual purview,** it is necessary to explore options for altering the supervisory approach or transferring the oversight function to another body. Enhancing SME protection could be achieved by reallocating existing

responsibilities to a different government body. This approach has precedent; last year saw a notable shift in duties not inherently related to the Tax Administration. Specifically, the task of identifying violations of intellectual property rights—pertaining to the usage of diverse software solutions and databases—was transitioned to the Market Inspection. This move suggests that a similar reallocation of duties could more effectively safeguard SMEs. If the oversight function is to be transferred, it could potentially be shifted to either the Market Inspection or the Commission for Protection of Competition, taking into account existing legal constraints and the Commission's capacity to perform such supervision.

**Furthermore, the implementation of the SEF (System for Electronic Invoices) facilitates the easy tracking of deadlines** (notably, the issuance date of an electronic invoice). Consequently, this system could significantly enhance the efficiency of oversight processes. Article 17 of the EU Regulation Proposal encourages members to use digital solutions. Unlike Serbia, many EU members do not have ready-made solutions that would facilitate the calculation and application of requirements in accordance with the Regulation Proposal. The electronic invoicing system is a good foundation, and its enhancement and enabling of additional functionality to ease the monitoring and application of interest calculation automation would significantly alleviate the administrative burden that economic entities will have if changes to the law occur, and the solutions of the Regulation Proposal are adopted.

## CASE STUDY 4 – Electronic invoicing system (SEF) and VAT reporting requirements

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### Introduction

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**Serbia has introduced the obligation of e-invoicing for certain categories of business entities.** The SEF (Electronic Invoicing System) is the Information Technology solution of the Ministry of Finance through which the sending, receiving, recording, processing, and storage of electronic invoices are conducted. The obligation to register VAT in SEF is prescribed for taxpayers in accordance with the VAT law and refers to businesses who are liable for value-added tax as well as for voluntary users.

**Comprehensive mandatory e-invoicing like the one applied in Serbia remain an exception.** The first such system has been introduced in South Korea (since 2011). The introduction of mandatory e-invoicing and the centralization of information gathering are characteristic of economies with a higher level of shadow economy and tax evasion. Similar obligations have been introduced in Indonesia, Italy, Turkey, Mexico, Brazil, and Chile.<sup>34</sup> However, many countries limit their mandatory e-invoicing for specific business segments or transactions.

**While the E-invoicing may be seen as a compliance simplification tool that can reduce the VAT filing compliance burden, the ultimate goal was to improve tax collection.** The primary motive for introduction of mandatory e-invoicing is to improve VAT collection and the state's attitude that there is significant tax evasion, especially in the SME sector. However, recent research suggests that evasion is more closely related to non-VAT taxpayers (Krstić, Radulović 2015).<sup>35</sup>

**In parallel to e-invoicing, Serbia has initiated reform of system of fiscalisation.** These two systems combined (e-invoicing system for transactions between businesses with a POS system for sales to consumers) should provide the necessary data for extensive

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<sup>34</sup> Italy has implemented mandatory e-invoicing for domestic transactions through the Sistema di Interscambio (SDI) platform. Mexico has the Comprobante Fiscal Digital por Internet (CFDI) as a mandatory e-invoicing system. Turkey has a mandatory e-invoicing system for certain taxpayers. Brazil has implemented a mandatory e-invoicing system known as Nota Fiscal Eletrônica (NF-e). Chile has implemented mandatory e-invoicing through the DTE (Documento Tributario Electrónico) system.

<sup>35</sup> Krstić, G., & Radulović, B. (2015). Shadow Economy in the Business and Entrepreneurial Sectors. In G. Krstić & F. Schneider (Eds.), *Formalizing the Shadow Economy in Serbia* (pp. 77–99). Cham: Springer International Publishing. [https://doi.org/10.1007/978-3-319-13437-6\\_6](https://doi.org/10.1007/978-3-319-13437-6_6).

input-output monitoring<sup>36</sup> and facilitates comparison of invoice data with financial and accounting data. An expected notable benefit provided is easier tracking of discrepancies between levels of recorded supplies and unrecorded sales. In general, the introduction of SEF aimed to ensure accurate audit trails, i.e. tax authorities can run more accurate audits as E-invoicing systems provide detailed records of all transactions happening and facilitate legal check-ups as mandatory integration between businesses and tax authorities allows governments to set standards for compliance and reporting, which eases the process of knowing who's breaching any of these standards. However, in practice this is not an easy task to perform.<sup>37</sup>

### Importance for SMEs and minimizing SEF as administrative burden

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**Serbia had relatively high administrative burden of paying taxes.** Serbia scored 75.3 points in the Ease of Paying Taxes 2020 measurement, ranked 85th overall (World Bank and PWC, 2020).<sup>38</sup> This result indicates that Serbian companies face a relatively high administrative burden of paying taxes and complying with filing and post-filing procedures.

**However, according to BEEPS data, Serbian companies did not perceive tax administration among the most burdensome requirements.** Only 4% of Serbian companies stated that they find tax administration as a key impediment for doing business. This is four times lower compared to average for Europe and Central Asia (16.4%).

**The implementation of SEF concerns all VAT taxpayers.** In 2020, there were 117.292 VAT taxpayers (out of which 52.104 companies and 18.175 entrepreneurs who were monthly VAT obligors, and 28.970 companies and 18.043 entrepreneurs who were quarterly VAT obligors). Basically, all large and medium sized businesses, and significant number of small businesses are affected by the introduction of SEF. In practice, due to scarce resources and the complexity of tax codes, small businesses often defer tax

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<sup>36</sup> See Awasthi, R., & Engelschalk, M. (2018). Taxation and the shadow economy: how the tax system can stimulate and enforce the formalization of business activities. *World Bank Policy Research Working Paper*, (8391).

<sup>37</sup> Korean system was successful insofar as it contributed to increasing sellers' reporting compliance. However, invoice matching was time-consuming, and it could take up to two and half years to identify discrepancies between sales and purchase declarations. A large staff was required to operate the system, and the results of the matching exercise often were unreliable, with many discrepancies between sales and purchase invoices resulting not from hiding transactions, but from data entry mistakes.

<sup>38</sup> World Bank, & PWC. (2020). *Paying Taxes 2020: The Changing Landscape of Tax Policy and Administration Across 190 Economies*.

compliance issues to accountants as the most frequently sourced professional advisors. On average Serbian accounting firm has somewhat over 30 clients. As substantial burden is transferred to accounting firms for the purpose of this case study, CEVES conducted a survey, as well as semi-structured interviews with accountant professionals.

**According to information gathered through an accountant questionnaire or interviews, SEF has encountered significant implementation problems.** The system was prematurely applied without a comprehensive assessment of potential practical issues. Subsequent changes removed certain issues that occur in practice, but other features that would facilitate fulfilling other VAT-related obligations were not enabled. For instance, there is no access to a consolidated record allowing SEF users to see the overall VAT.

**Several examples may be used to illustrate that authorities did not appropriately consider a number of issues that may occur in practice prior to introduction of SEF.**

For example, when an invoice needs to be canceled on SEF for any reason, it is necessary to obtain a statement that the other party has not utilized the deductible VAT from that invoice. However, this statement is not processed through SEF but must be submitted in paper form, i.e., by mail or email. In the meantime, if this statement is not received on time, it can happen that VAT has to be paid twice based on the canceled invoice and the new one, and in the next period, that VAT has to be deducted. This may cause substantial problem for businesses if transactions involve large amounts. Similarly, if the reason for cancellation is an error in the invoice itself, like price, quantity, or discount, then the invoice must be canceled.

However, if the error is, for example, that accompanying documentation was not attached or there is a typographical error, or a contract number, etc., i.e., data that do not substantially affect the correctness of the invoice itself, providing an access that invoice and enable correction of those details to avoid canceling and the whole accompanying procedure would be justifiable. It should be noted that accompanying documentation is not mandatory on SEF, but both public services and private legal entities can request it and reject the invoice if it is not sent, which only increases the number of cancellations, wasting time, and causing frustration.

Besides accountants who are the main users of the platform, software companies who provide solutions for businesses state that the system specification and documentation has been and remains scant and insufficient for a clear interpretation of programming requirements. Instead, they state that clear written instructions have been replaced with

the form of webinars with lacking appropriate clarification. Finally, according to the software companies, the technical support from the Ministry of Finance regarding SEF has been insufficient.

**User experiences with SEF differ significantly.** Although the majority of accounting firms and companies report minimal issues when using SEF, a subset of accounting professionals expresses dissatisfaction. This disparity suggests that the quality of software applications interfacing with SEF might vary. Further investigation into this matter is warranted.

Finally, questions arise about the details of the data collected, the justification for collecting non-essential information for VAT collection, and the potential exposure of a business entity's business model, including its trade secrets (pricing policy, customer structure, etc.). Tax administration is not using

## Impact Assessment

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**The implementation of SEF has progressed to a point where it is unreasonable to consider any fundamental changes to the system.** Therefore, it is better to focus on simplifying the existing requirements, some of which are unnecessary. Many of these objectives will be part of SEF's further development, but we believe that at this stage, this should be the primary goal to fully facilitate businesses' compliance with legal requirements. In this part, we primarily consider the reports that SEF renders unnecessary (at least in the medium term).

**Recording VAT in SEF does not involve registering the entire calculated VAT in the tax period, nor does it involve entering the VAT return or POPDV form into SEF.** SEF records the VAT calculated by the taxpayer, but for which no electronic invoice is issued through SEF or fiscal receipt through the fiscalization system. VAT taxpayers also prepare a consolidated calculation using the POPDV form, a summary of the VAT calculation used to report data in the tax return. The VAT calculation summary is submitted together with the tax return by completing the tax return within the user application on the Tax Administration portal. Failure to submit the POPDV form with the tax return will be considered as if the tax return has not been filed.

**With the introduction of the e-invoicing obligation, the Tax Administration gains a significant data source for checks related to the collection of tax obligations.** Hence, requirement related to other data provision, including the obligation to submit the POPDV

form has become redundant, and the relevance of data from these forms is questionable, representing an unnecessary administrative burden on taxpayers.

**This additional requirements create necessary costs.** We provide rough estimate of costs related to the submissions of the redundant requirements, based on average cost of VAT calculation and filing tax returns on an annual level by accounting agencies. According to data based on a survey of accountants conducted by NALED for PPS, it is possible to calculate the weighted average annual cost of calculation and submission of VAT by accounting agencies. The lower limit 40% of accounting agencies do not charge for these services. In the case of the 60% that do, the cost of the service (median - amounts to RSD 42,000, respectively RSD 12,000). Depending on the solution that will be implemented, the savings (reduction of this service price) can be significant. Effects depend on which part of the timesaving will reflect on the price of the service.

Following the introduction of the new POPDV form, the preparation of the calculation has become significantly more challenging as it requires processing invoices that do not affect VAT and were not previously recorded (invoices outside the VAT system, etc.). Various additions to the original VAT calculation, such as the "internal VAT calculation" in the case of secondary raw materials and the import of software, pose a specific problem, distorting the original principles of VAT accounting.

According to NALED's Grey Book and research conducted by CEVES, the submission of the POPDV form has not significantly improved the oversight and tax compliance. Inspectors were still requesting the review of invoices data (KUF and KIF, as well as individual invoices from suppliers or invoices issued to customers). Therefore, the suggestion is to abolish the reporting obligation prescribed by the Regulation on Value Added Tax or to minimize the content of that form, enabling cross-checking positions from the submitted tax return (PPPDV) with positions in the taxpayer's internal books and records. The E-invoicing should be used as a compliance simplification tool that can reduce the VAT filing compliance burden, the announcement of tax authorities does confirm that this is one of the goals.

## V Recommendations

**The process of altering the regulatory culture is inherently a long-term endeavor.** Nonetheless, Serbia can take immediate action by adopting certain strategic recommendations in the short term. This proactive approach involves not only the introduction of new policies but also the cultivation of an administrative mindset that prioritizes efficiency, transparency, and responsiveness to the needs of businesses, especially SMEs. By focusing specific areas, Serbia can make significant strides in fostering a more business-friendly regulatory environment, even as the broader cultural transformation continues to unfold over time.

- **It is essential to adopt and consistently implement the 'think small first' paradigm.** The Program for Public Policy Management Improvement and Regulatory Reform, as outlined in the Action Plan for 2021-2025, recommends the adoption of tools for regulatory impact analysis. These include the SME test, administrative cost calculator, and the checklist for assessing the regulatory impact on competition. All the above-mentioned tools of think small first policy are developed but their real world implementation is still sporadic. **The diligent use of these instruments could mitigate the adverse effects highlighted in our case studies.** This approach necessitates redefining the mandatory application of these tests and calculations. Such a refinement would ensure the accurate depiction of the results these tools generate in the reports analyzing the effects of regulation, particularly concerning micro, small, and medium-sized enterprises (SMEs) and their competitive environment.
- **Implementing a pilot program for regulations impacting a substantial number of economic entities** is crucial to ensure that only thoroughly vetted and complete
- **Strengthen the negotiation power of the SME sector** is imperative. One strategy to achieve this is by enabling collective legal actions, known as class actions.
- **To this end Serbia should think about the establishment of SME-dedicated ombudsman.** In that respect, Serbia should assess the most appropriate model. Probably, the most adequate option would be the advocacy model as SMEs have not been at the top of the policy agenda in Serbia and, as a result, tax, labor and general business regulations have not been particularly sensitive to the needs of SMEs.

- **Introduce regular feedback and adapt practices:** Collect regular feedback from the business community on the performance of civil servants and adapt practices.
- **Focus on accounting profession.** The focus should not solely be on SMEs but also on the accounting profession, which serves as a pivotal support and crucial advisory resource for SMEs. Advancing the accounting profession and elevating professional standards are vital for ensuring regulatory compliance and reducing administrative burdens. The profession is crucial; as per the feedback from our surveys, accountants are seen as fulfilling an educational role, whereas governmental agencies are perceived as enforcers.
- **Provide training programs for civil servants focused on understanding the needs and challenges of businesses and SMEs.** Courses that are not traditionally offered by NAPA such as SME policies and entrepreneurship can be beneficial for changing perception towards private sector.