

Monitoring the Hidden Economy and Undeclared Work in Southeast Europe

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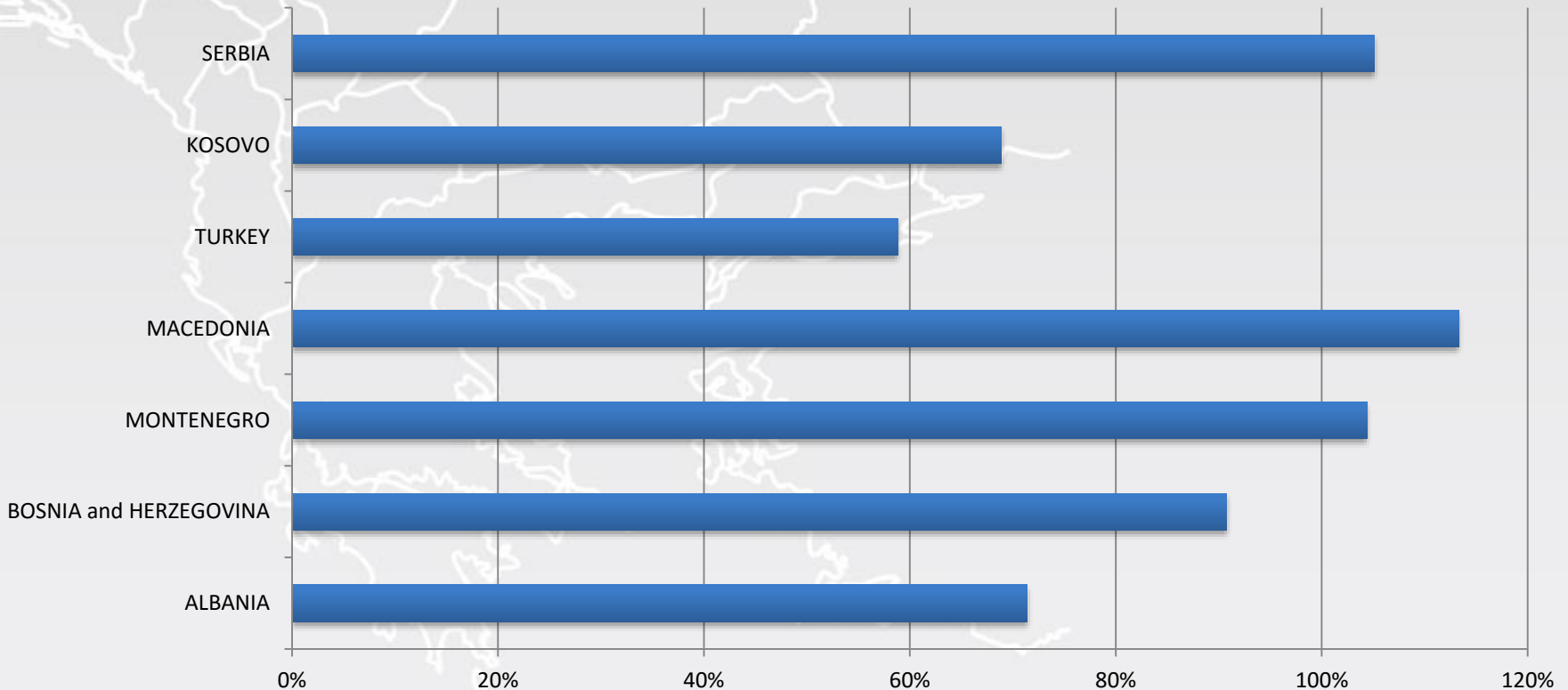


A project implemented
by a consortium led by the
Center for the Study of
Democracy

Preliminary rationale

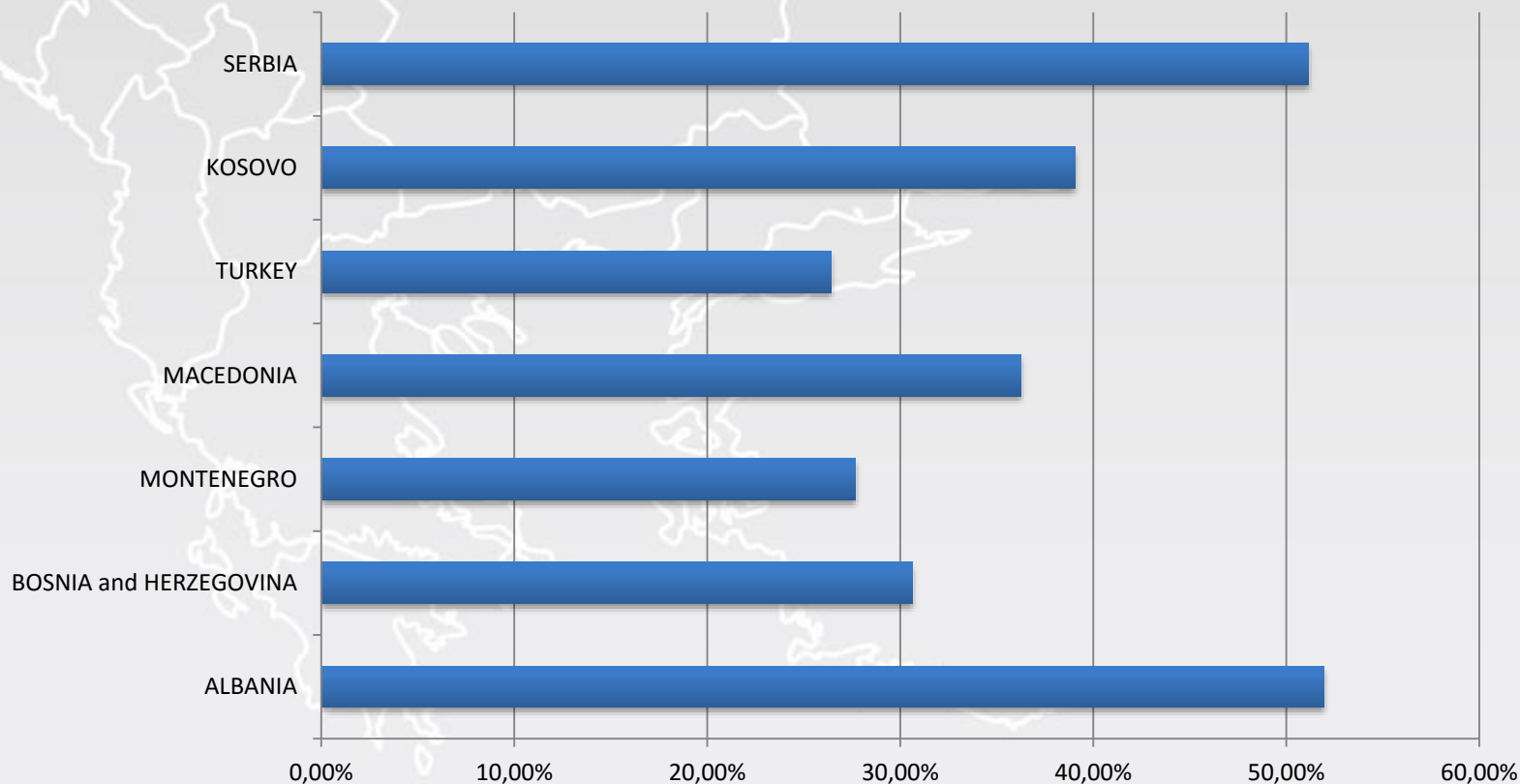
- Institutional asymmetry and non-alignment between formal and informal institutions provide better explanation of undeclared work's prevalence in Southeast Europe compared to more traditional rational cost-benefit optimization models for workers and employers
- The institutional incongruence might explain better the discrepancies in international trade statistics as provided by countries in SEE and by their partners
- Flows of goods and money across borders in SEE are instrumental for economic growth, but also the way it happens fuels illegitimate practices.

Openness of SEE countries (trade to GDP)



Mirror statistics

Discrepancies in reported imports vs reported exports by partner countries EU28+SEE



Major trade partner and discrepancy

REPROTING COUNTRY	MAJOR TRADE PARTNER	Discrepancy (%)
ALBANIA	ITALY	-46
BOSNIA and HERZEGOVINA	CROATIA	-26
MONTENEGRO	BOSNIA and HERZEGOVINA	3
MACEDONIA	GERMANY	-28
TURKEY	GERMANY	-22
KOSOVO	GERMANY	85
SERBIA	GERMANY	-20

Even if you don't see discrepancies at country level, they might appear on product level

PRODUCT/PARTNER	EXPORT TO MONTENEGRO	IMPORT FROM BOSNIA and HERZEGOVINA	%
MINERAL FUELS, MINERAL OILS AND PRODUCTS OF THEIR DISTILLATION; BITUMINOUS SUBSTANCES; MINERAL WAXES	19396.454	7726.939	2.510237754
PHOTOGRAPHIC OR CINEMATOGRAPHIC GOODS	82.182	7.462	11.01340123
COTTON	21.631	1.054	20.5227704
CARPETS AND OTHER TEXTILE FLOOR COVERINGS	45.404	10.763	4.218526433
FOOTWEAR, GAITERS AND THE LIKE; PARTS OF SUCH ARTICLES	29.070	3472.741	0.008370909
HEADGEAR AND PARTS THEREOF	3.940	17.529	0.224770381
NATURAL OR CULTURED PEARLS, PRECIOUS OR SEMI-PRECIOUS STONES, PRECIOUS METALS, METALS CLAD WITH PRECIOUS METAL, AND ARTICLES THEREOF; IMITATION JEWELLERY; COIN	20.174	0.856	23.56775701
IRON AND STEEL	17159.188	18298.594	0.937732593
ALUMINIUM AND ARTICLES THEREOF	10111.241	2589.079	3.905342788
ELECTRICAL MACHINERY AND EQUIPMENT AND PARTS THEREOF; SOUND RECORDERS AND REPRODUCERS, TELEVISION IMAGE AND SOUND RECORDERS AND REPRODUCERS, AND PARTS AND ACCESSORIES OF SUCH ARTICLES	1851.490	3819.036	0.48480559

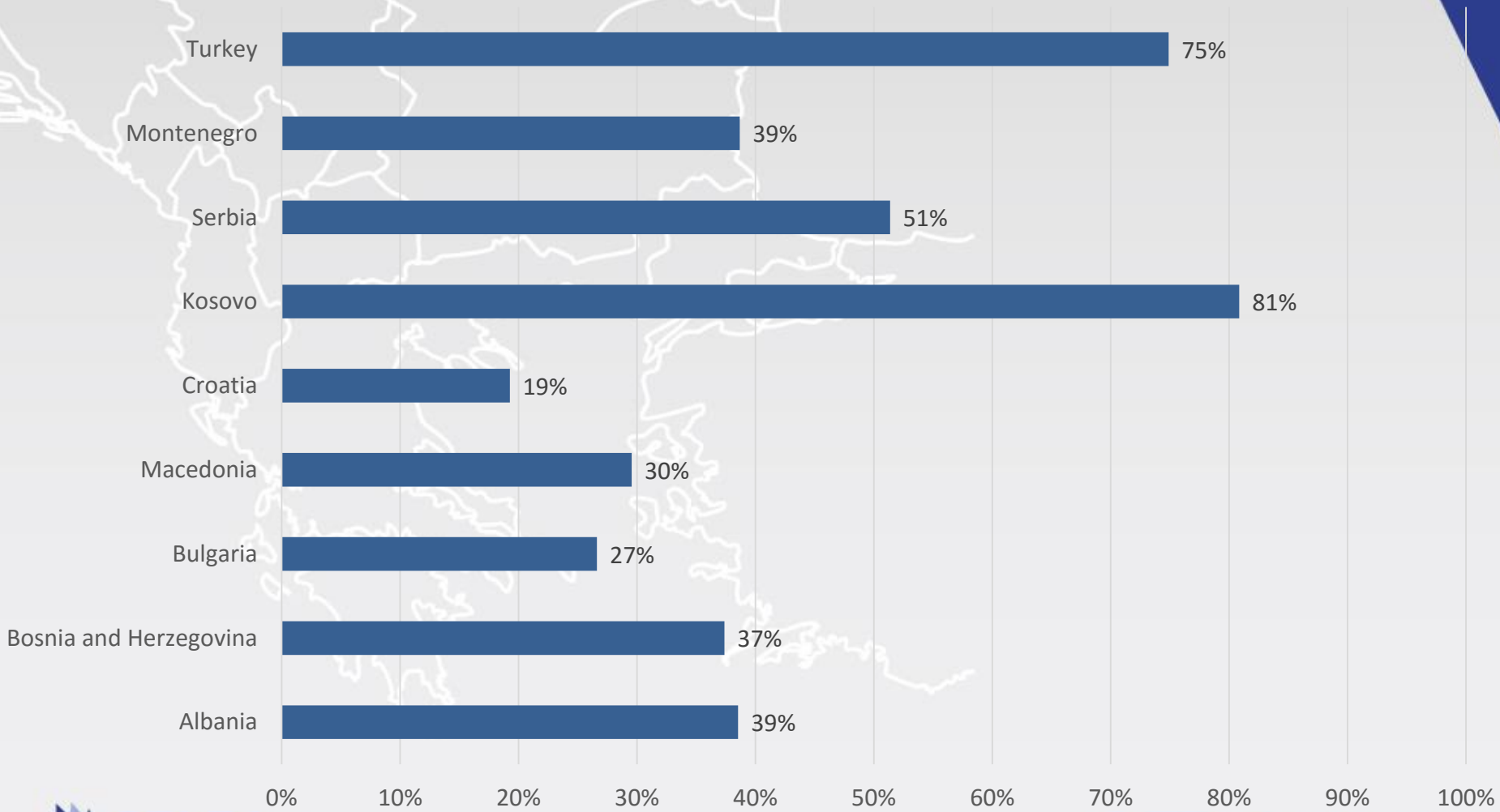
Preliminary findings

- Immense diversity of scale and patterns
- Wage premium
- Role of minimum wage
- Demographics
- Location of hidden employment
- Choice or trap
- Corruption pressure
- Non-observed economy imputations
- Tax-gaps
- Schneider's Shadow Economy Estimates

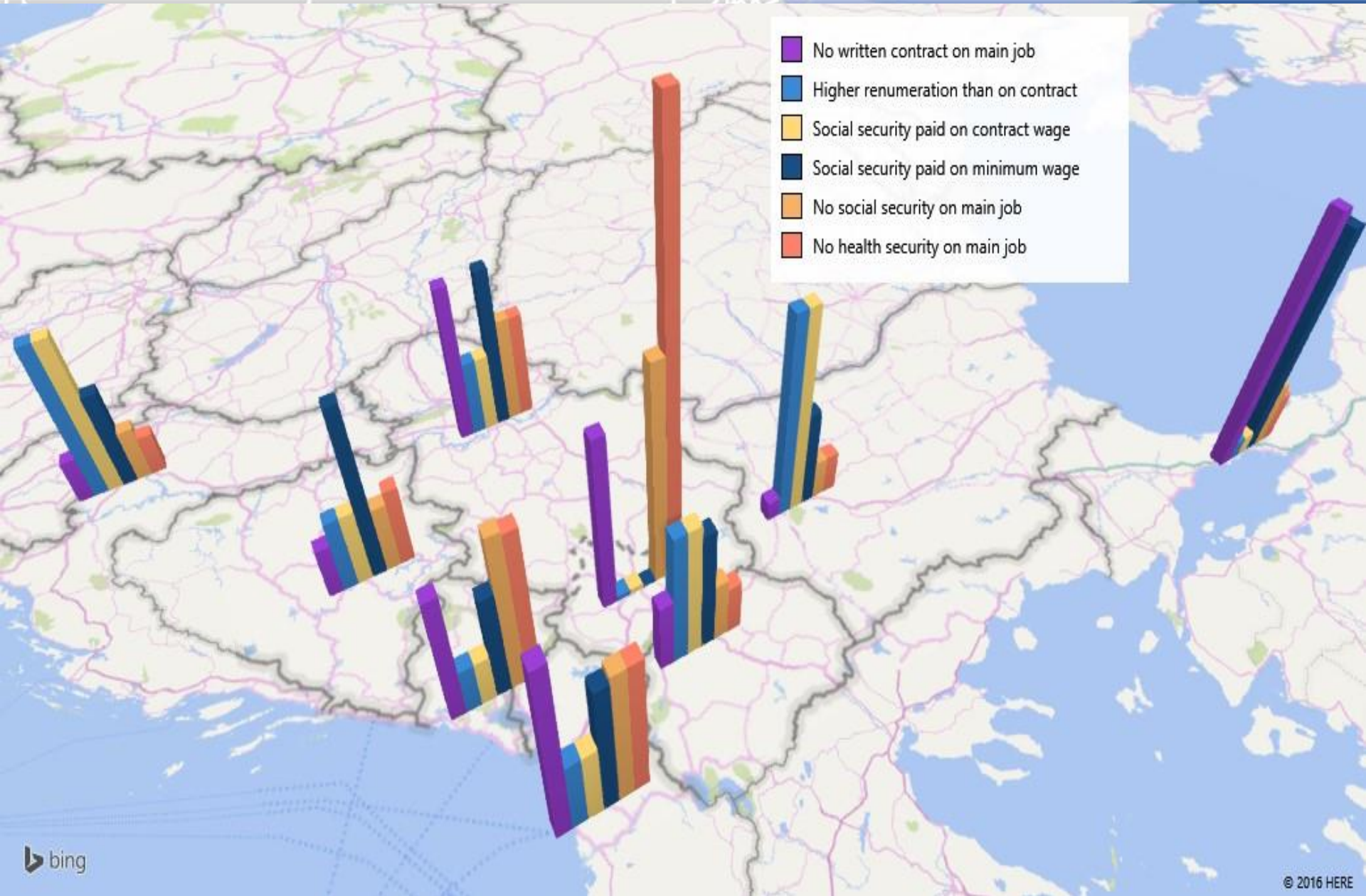
Hidden employment

- No written contract with the employer at the main job;
- The actual remuneration received last month was higher than the one written in the contract with the main employer, but was agreed verbally with him/her;
- There is no social security on the main job;
- The base for the social security paid is at the minimum wage, despite the actual salary is higher;
- The base for the social security paid is the amount written in the contract and not the actual received, which is higher;
- There is no health insurance on the main job

Diversity



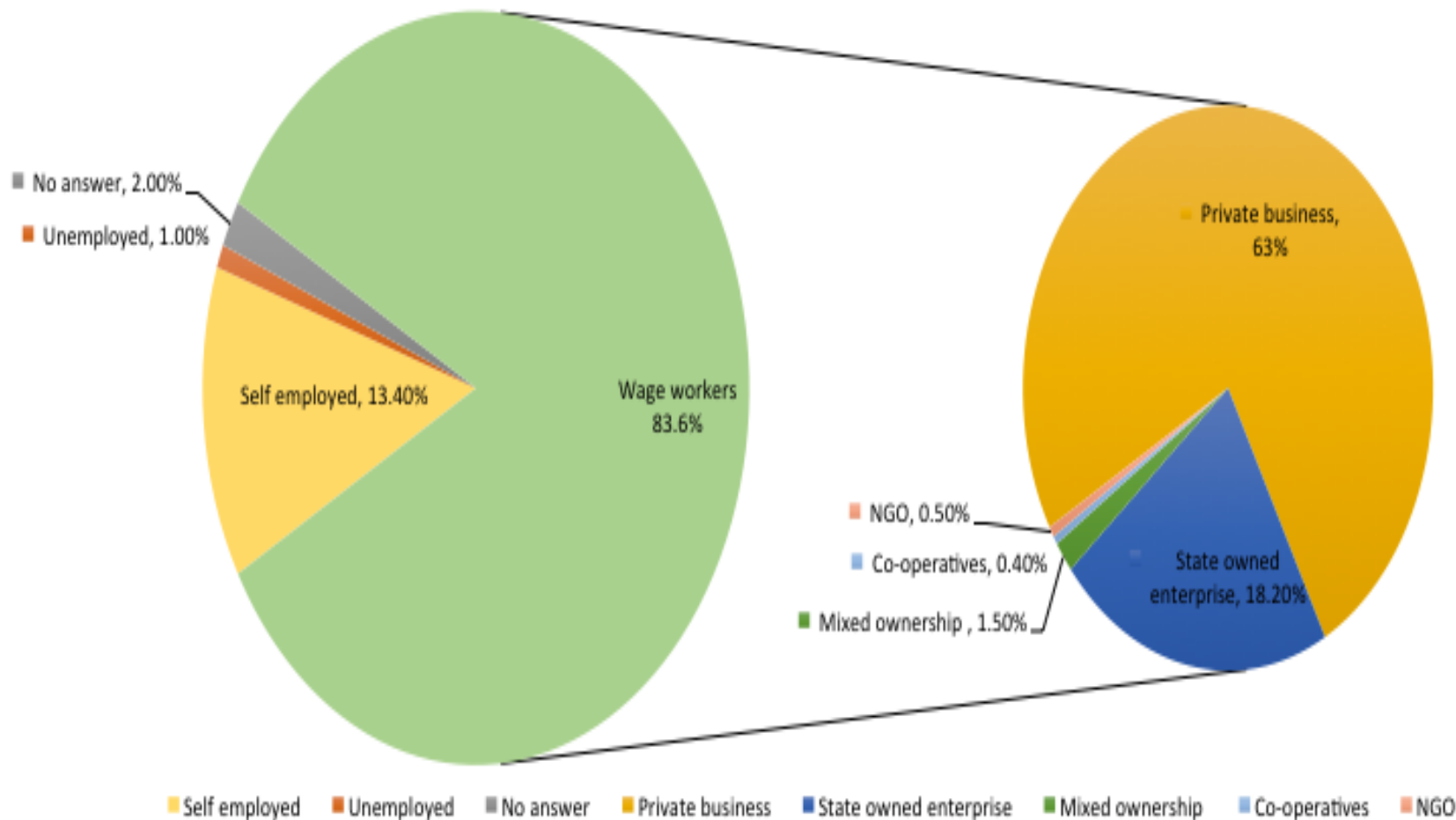
- No written contract on main job
- Higher remuneration than on contract
- Social security paid on contract wage
- Social security paid on minimum wage
- No social security on main job
- No health security on main job



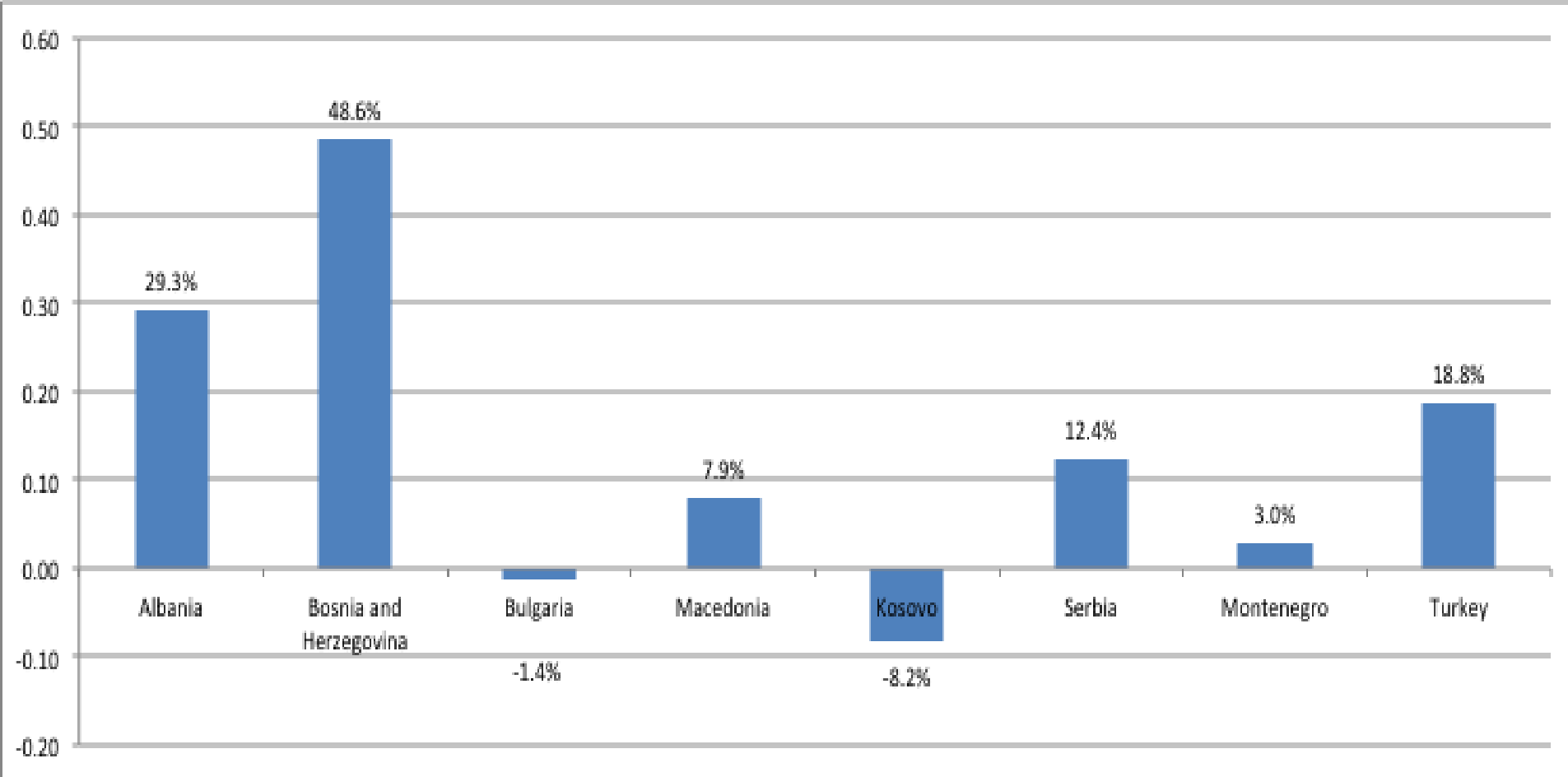
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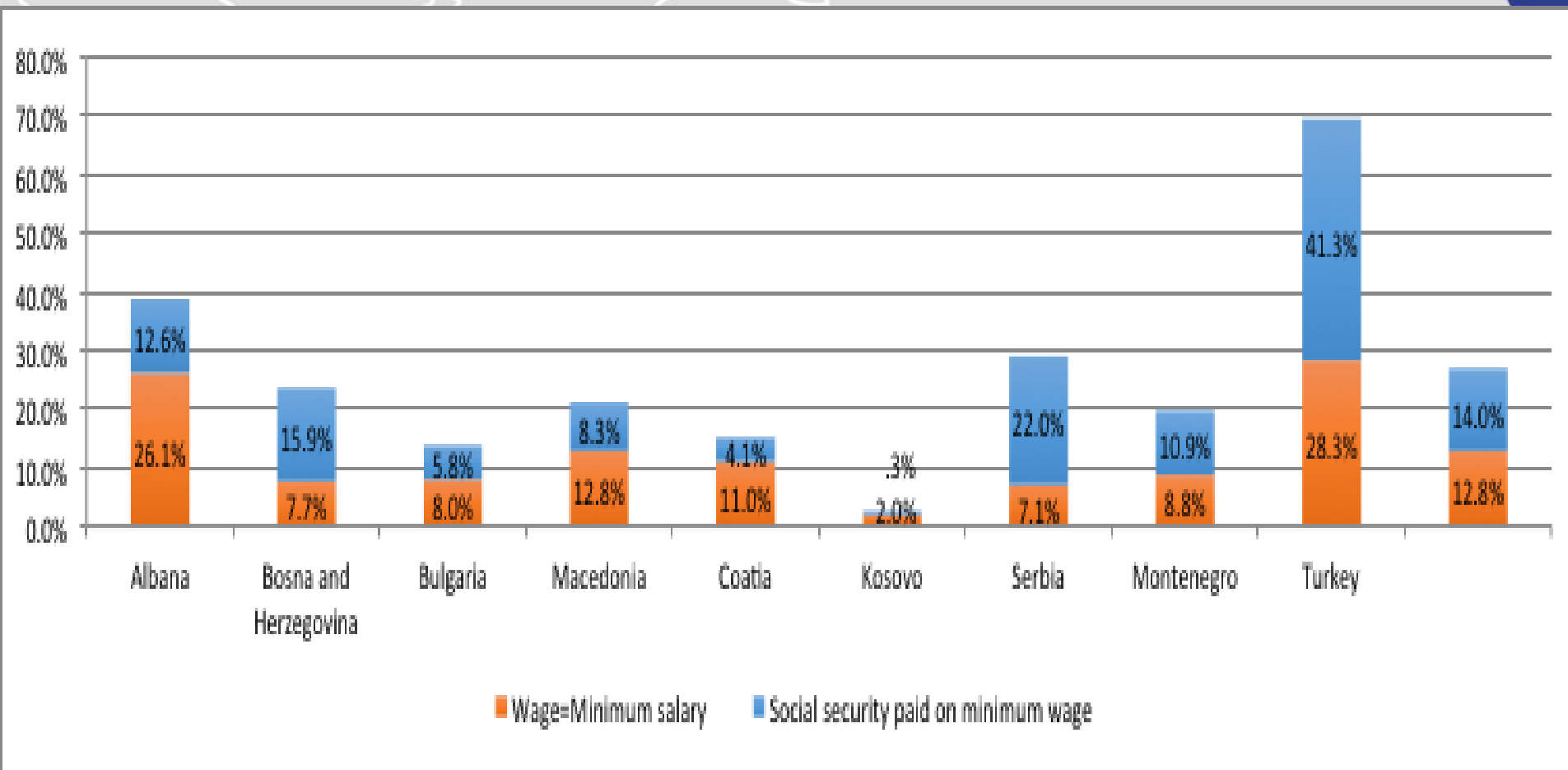
Where Hidden Economy Occurs?



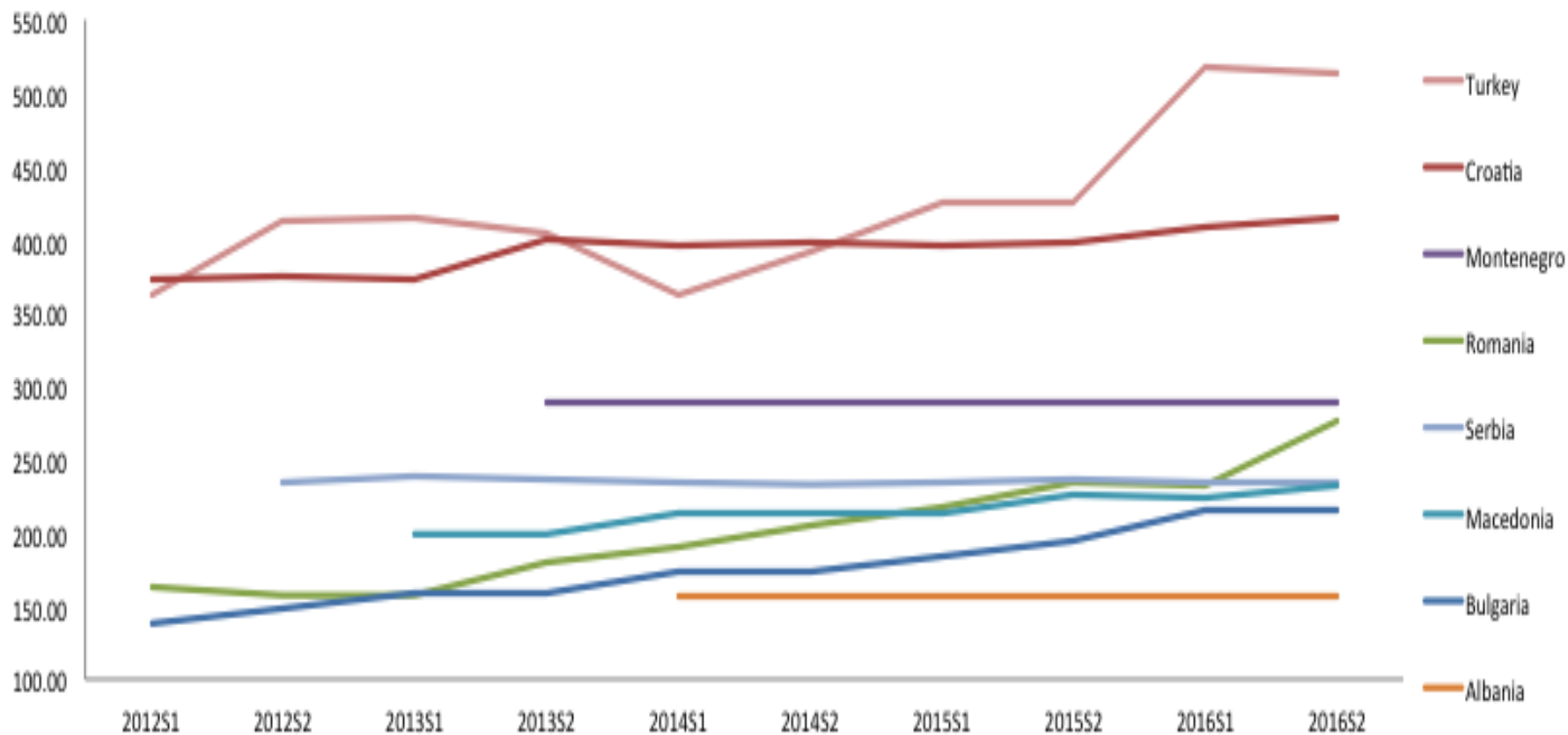
Wage premium of formal vs. hidden economy



Role of minimum wage



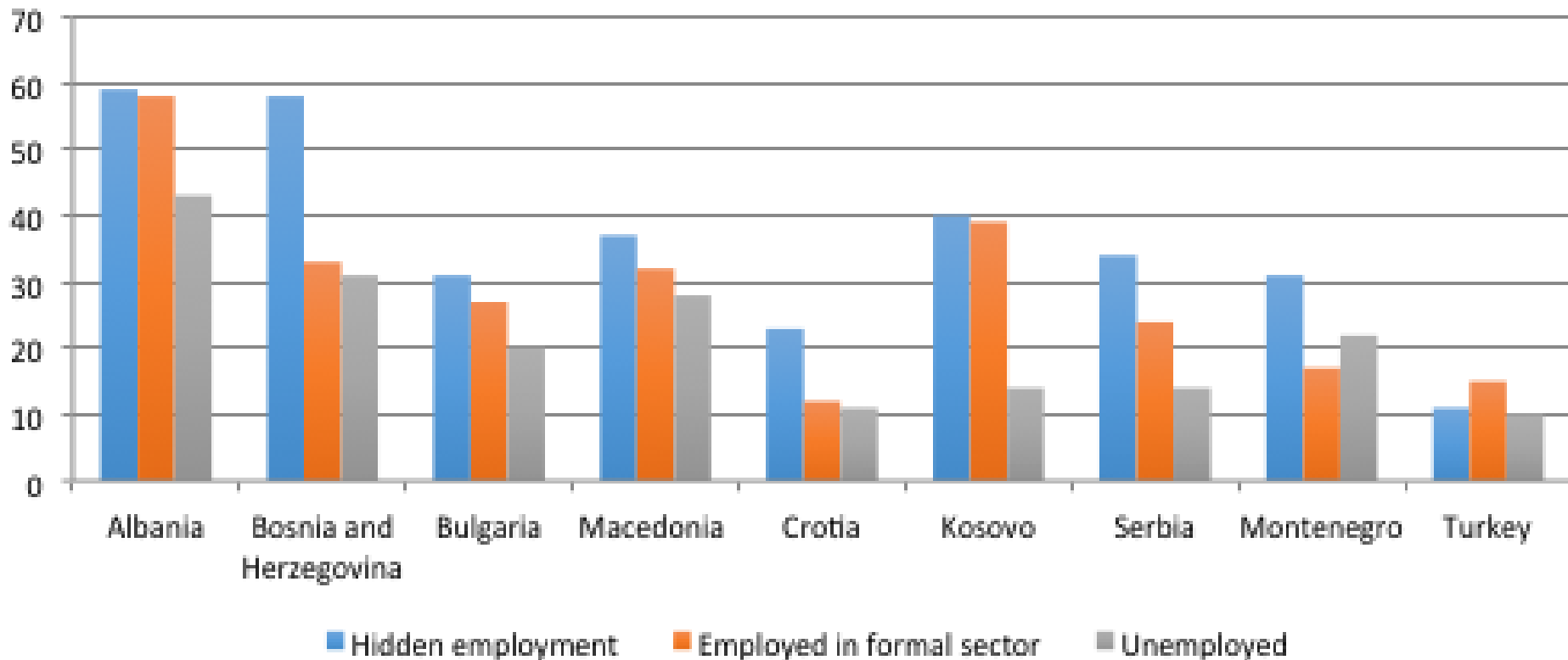
Minimum wage dynamics



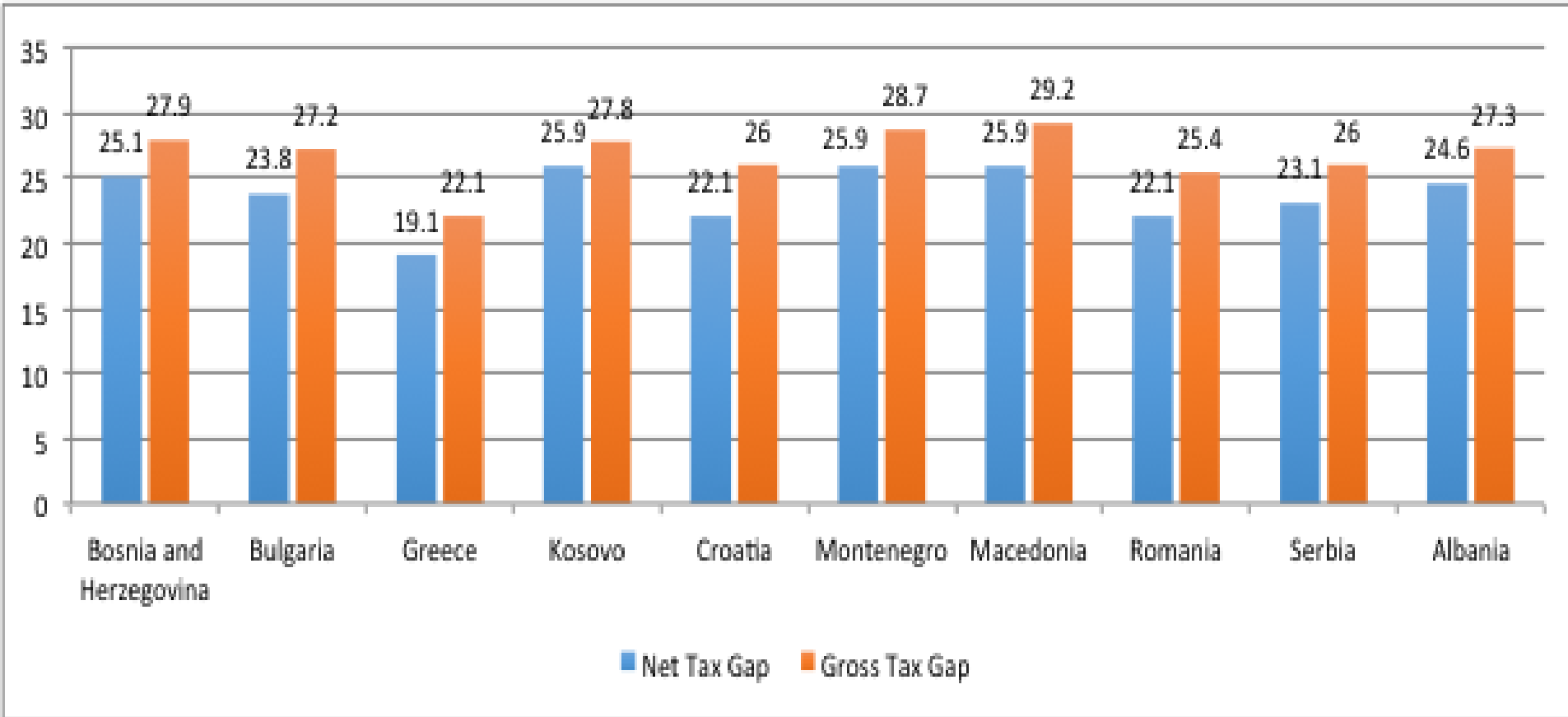
Demographics of hidden employment

- slightly younger (2 years on average),
- male (62%) – more than average employed
- work more (longer) at job and at home (and private farm),
- tend to know more people also part of the hidden economy
- are more relaxed (not judgmental) towards morale in society
- subjective feeling of happiness is slightly lower than the country average, but this does not affect subjective positioning of self in hierarchy of the society.
- The only exception is Macedonia, where hidden employment significantly hinders self-esteem in terms of where one sits in the society

People in hidden employment are subject to higher corruption pressure



Tax gap estimates



Non-observed economy and SSE

- Immense differences also in GDP calculation with respect to hidden economy – between 2 % to 4 % (Turkey and Montenegro) and 31% and 33 % (Albania and Bosnia and Herzegovina) – hence synchronization needed
- Unclear how SSE relates to non-observed economy imputations (if SSE is applied to observed GDP or the whole) – adjustments needed

Policy Recommendations

- Countries should plan and implement **holistic legalisation programs, sequencing** complex measures to **move** undeclared or partially declared businesses **towards** full compliance, aligning with the principles of **fair transition** or **procedural justice**, **employment protection** and **mitigating the negative effects** of hidden economy. These programs would obviously differ from country to country, but would employ both direct and indirect controls and would target both the supply and demand sides of hidden economic activities (labour, sales).

Policy Recommendations

- All **National Statistical Institutes** should implement carefully the Eurostat/OECD methodology for **non-observed economy adjustments to GDP** and publish timely and comprehensive descriptions of imputations by non-exhaustiveness type and economic sector.
- The use of **mirror statistics** under well-defined algorithms might contribute both to the **fairness of enforcement process** and to quick full compliance in terms of imports and exports.

Policy Recommendations

- **Prioritize and sequence reforms on tax gap areas**, which have **the strongest negative social impact** (for example, health care security evasion in Kosovo, non-existent labour contracts in Turkey, and excise duty evasion in Bosnia and Herzegovina and Albania). Businesses and citizens should be **widely consulted** on these areas, so that society at large feels **engaged** in needed reforms and raise their **trust in institutions**. Conduct **regular tax gap assessments** (including per type of tax), following a common methodology and adjust policies according to findings.

Policy Recommendations

- Design policies to **target formalization of the whole economic value chain** (or significant parts of it) and **clusters of economic actors and relationships**, as opposed to focusing on case-by-case legalisation, by increasing penalties and direct control of non-compliance. Reforms should tackle the social embeddedness of hidden economy, its cultural and educational predetermination.

Policy Recommendations

- In remittance-incentive countries (e.g. Macedonia, Kosovo and Bosnia and Herzegovina), stakeholders should design schemes to **reduce the cost of transferring remittances**, and **match domestic entrepreneurship development schemes and foreign donor programs**, offering special incentives for legalising workers abroad.
- **Rely more on technology** (electronic payments, cash registers with fiscal memories linked in real time to revenue agencies, electronic filing of tax forms, points of single contact, etc.), automation and algorithms (risk profiling and sampling for inspections), and **less on personal judgement**.

Policy Recommendations

- Policies tackling the hidden economy should be linked to those **countering corruption and improving law enforcement**, while embedding them all in the overall economic growth strategy of the country. Countries in **SEE need to double their annual average real GDP per capita growth rates at least**, if they are to achieve and sustain lasting governance change.
- Countries in SEE should **cooperate** with each other, especially on **cross-border issues** linked to hidden economy - trade and travel.

Thank you!