

# The hidden economy in the Western Balkans in a time of crisis: Friend or foe





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SELDI policy brief no. 14, June 2022

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## KEY POINTS:

- The succession of crises, which hit the Western Balkans in the past couple of years have accentuated governance deficits in the local economies, such as systemic corruption and high levels of informality. The COVID-19 pandemic created further opportunities for abuses of labour rights and short-term financial support schemes. The post-pandemic recovery of 2021 was quickly dampened, by rising energy and food prices and the war in Ukraine.
- Given the region's continuing geopolitical ambiguity, the Kremlin's war in Ukraine creates unique instability for the Western Balkans, besides fuelling inflation and damping growth. As a result, there are considerable risks for backsliding in key governance reforms, despite the adoption of new strategies, programmes and measures aimed at tackling different forms of informality after 2020.
- According to the SELDI Hidden Economy Monitoring System, the prevalence of hidden practices continues to be high in the region. The 2022 Hidden Employment Index for the six Western Balkan countries ranges between 36% (in Montenegro) and 76% (in Kosovo\*). Compared to the 2019 values, the situation improved in Kosovo\*, Albania, Serbia and Montenegro, while a notable backslide is observed in Bosnia and Herzegovina, and in North Macedonia.
- The share of workers without written contract on the main job is the largest in Kosovo\* (19%) and in Albania (16%). In the rest of the countries the most prevalent form of undeclared work is envelope wages (cash in hand) (practiced by 35% of the employees in Bosnia and Herzegovina, 27% in Serbia, 22% in Montenegro).
- Governments in the region have undertaken a lot of different measures to tackle informality, ranging from dedicated initiatives to more general structural reforms within the framework of EU accession. Yet, the lack of unequivocal long-term political commitment to EU accession and related reforms across the region, makes sustainable progress on informality difficult.
- Governments in the region should also be more pro-active in utilising the available funding opportunities (IPA III, Western Balkans Investment Framework - WBIF, etc.) to focus in particular on increasing employment and tackling the different forms of undeclared work, in particular among the young and among marginalised groups (e.g. ethnic minorities).
- The European Commission and the Council could also prioritise more in-depth reforms and practical solutions for undeclared work in the annual Assessments of the Economic Reform Programmes, e.g. by ensuring more opportunities for good practice exchange with neighbouring member states and with the European Labour Authority. The efforts of the Regional Cooperation Council on tackling undeclared work and promoting wider economic reform deserve greater support and mainstreaming.

## INTRODUCTION

The hidden economy<sup>1</sup> is closely linked to corruption.<sup>2</sup> Empirical studies show that they fuel each other - a one-point rise in the index of corruption is associated with an increase in the level of hidden economy (in percent of GDP) by 0.253% points<sup>3</sup>. Thus, it can be concluded that the hidden economy and corruption are both a result and a symptom of bad governance. At the same time, both corruption and the informal economy are highly correlated with economic growth. Hence, the lack of robust economic growth in the past decade has reinforced backsliding in governance across the region. The Kremlin's war in Ukraine has dampened the strong post-pandemic recovery of the Western Balkans and has fuelled rising prices and economic uncertainty in the region, signalling further headwinds for governance reforms. At the same time, it could prompt a more geo-strategic approach of the European Commission and member states towards the region, speeding up economic integration, while reducing conditionality pressures on Western Balkan governments.

Evasion of taxes and social security payments is often explained by the motivation to compensate corruption-induced lost government spending through maximising own profits. Besides corruption, informality is also driven by the overall weak institutional and regulatory environment,

insufficient enforcement capacity of the public authorities, and low awareness of its negative social implications. The low level of trust in government and the perceived low quality of public services discourage tax compliance.<sup>4</sup>

The negative effects of the hidden economy not only persisted, but affected workers and businesses stronger during the COVID-19 pandemic: undermining competition, lowering funding of public services, reducing job security and safety at work, depriving workers of healthcare pension, coverage, maternity or annual leave.<sup>5</sup> The pandemic highlighted governance gaps and created further opportunities for abuses of labour rights and short-term financial support schemes. The pandemic however also showed the importance of working in the formal economy – a prerequisite for health insurance and government support – and put the topic back on the discussion table across the region. In the period after the onset of the pandemic governments in the region introduced multiple tax, VAT, labour law, digitalisation and e-governance measures, as well as the adoption of new strategies and programmes - all having as objectives to both counter the effects of the pandemic and to promote the transition towards declared work and business operations.

\* This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.

1 SELDI has chosen the use of the term "hidden" economy to denote that the intent of the business entities and workers involved in it are to deliberately try to hide some or all of their economic activity. It typically involves the hiding of both legal (grey economy) and illegal (black economy) activities. Yet, the most common definitions, including the one used by the European Commission, refer to the hidden economy as informal or undeclared economy, and define it as economic activities, which are legal in their nature but are fully or partially undeclared to the public authorities for the purpose of avoiding taxes or other regulations. We use in this and other SELDI papers the works "hidden", "undeclared", "grey", "informal", etc. interchangeably.

2 See also: SELDI (2020), [SELDI Policy Brief 11: Hidden economy in the Western Balkans 2020: Trends and Policy Options](#).

3 Borlea, S., Achim, M. (2017), Corruption, Shadow Economy and Economic Growth: An Empirical Survey across the European Union Countries.

4 European Commission (July 2021), [2021 Economic Reform Programmes of Albania, Montenegro, North Macedonia, Serbia, Turkey, Bosnia and Herzegovina and Kosovo\\*](#)

5 SELDI (2020), [SELDI Policy Brief 11: Hidden economy in the Western Balkans 2020: Trends and Policy Options](#).

## COVID-19 IMPACT

The spread of COVID-19 affected the economies of Western Balkan countries in varieties of ways, exposing their **structural weaknesses**. The pandemic has, for instance, led to a decline in both domestic supply and demand as well as imports and exports due to lockdowns and shutdowns of businesses, affecting mainly the SMEs. The Western Balkan economies, which rely on remittances from abroad for subsistence, have seen their flows declined due to the growing unemployment and restrictions on movements in the EU. Similarly, travel restrictions have hit hard the tourism sector, which contributed 15% of the GDP in the WB6 before the pandemic.<sup>6</sup> The 2021 Balkan Barometer revealed that 73% of Western Balkan citizens thought that the coronavirus posed high threat to the global economy, while 43% were concerned about losing their jobs in the next 12 months.<sup>7</sup>

Yet, following the height of the pandemic, from the second half of 2021 the Western Balkans saw a **faster-than-expected recovery**. This strong rebound was due to a combination of domestic reopening and favourable external conditions for the region's exports. However, the recovery was fragile, and has been seriously dampened by the onset of inflation and the broader economic uncertainty from the fallout of the war in Ukraine.<sup>8</sup>

Early warning signals from the **labour market called for close policy attention**. The unemployment rate increased in the first half of 2021 in most countries and has remained stubbornly high. Job losses from the recession and its aftermath have disproportionately

affected women and youth, which may set back efforts to raise the region's perennially low rates of labour force participation. Informal low-skill workers who lost their jobs might not have received much formal-sector government support and be at risk of poverty. The seasonal workers were also affected, although targeted wage subsidies and one-off cash assistance for vulnerable citizens have somewhat helped.<sup>9</sup>

Thus, the policy focus needs to shift back toward addressing the key structural constraints to job creation and economic transformation, including weak firm-level productivity, lack of market competition, limited regional economic integration, and weak institutions.<sup>10</sup>

## KEY HIDDEN ECONOMY TRENDS 2021-2022

SELDI's *Hidden Economy Monitoring System*,<sup>11</sup> which is closely related to the *Corruption Monitoring System*<sup>12</sup>, provides detailed survey data on the overall size, different aspects and the dynamics of the hidden economy in the region. The *Hidden Employment Index* reflects the existence of any of five practices common in the hidden economy:

- Working without a written contract with the employer;
- The "official" remuneration written in the contract is lower than the wage actually paid to the employee, as agreed upon verbally between the two parties;
- The employee has no social security coverage;

6 OECD (2020), *Covid-19 Crisis Response in South East European Economies*, pp 2-3.

7 Regional Cooperation Council (June 2021), *Balkan Barometer 2021*.

8 World Bank (2022), *Western Balkans Regular Economic Report: Spring 2022*.

9 Ibid.

10 Ibid.

11 CSD (2016), *Hidden Economy Indexes in Bulgaria 2002-2015: Results and Methodological Notes*.

12 SELDI (2017), *Sustainable Policy Impact through State-of-the-Art Research and Advocacy*.

- The base for the social security contributions paid is the amount written in the contract, and not the higher amount actually received;
- There is no health insurance on the main job.

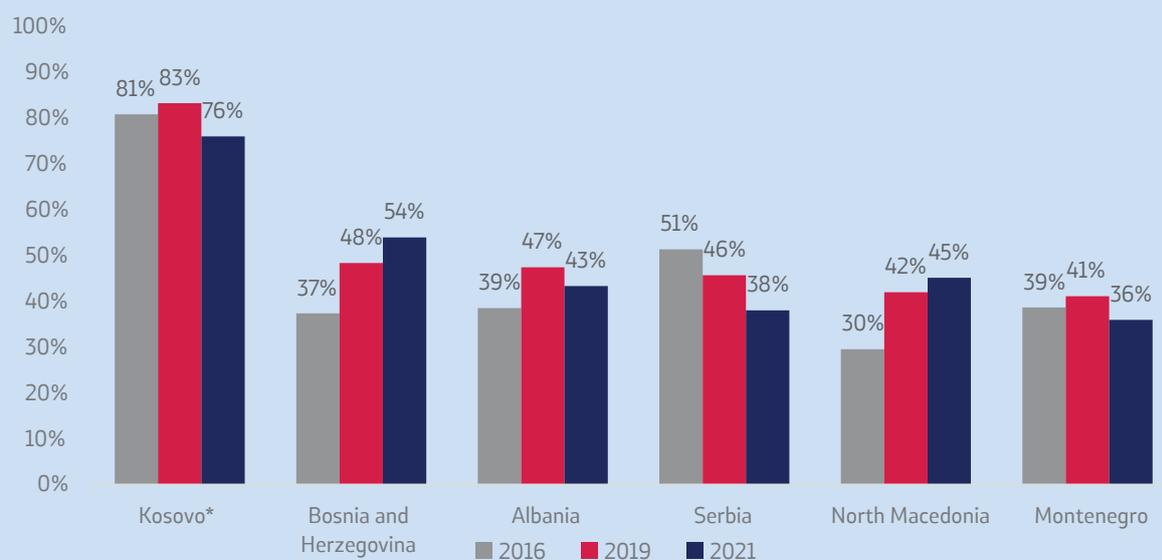
The *Hidden Employment Index* (part of the Hidden Economy Monitoring System) represents the percentage of respondents (of all engaged in a main job) who indicated their participation in at least one of the practices listed above.

The *Hidden Economy Monitoring System* data for 2021/2022<sup>13</sup> shows that hidden economy prevalence continues to be high in the region. Yet, Serbia registered a sizable drop in its Hidden Employment Index values of 13 percentage points since 2016, putting the country right behind Montenegro in terms of the lowest hidden employment among the six countries. Two other countries saw less impressive declines - Kosovo\*

and Montenegro. On the other hand, there was a notable backslide in Bosnia and Herzegovina and North Macedonia. Albania showed small improvements since 2019, its performance remains worse than in 2016.

Understanding the dynamics of the Hidden Employment Index requires exploring the changes in its components. Two of the most typical examples of hidden employment practices, which are included in the structure of the index, are **working without an employment contract** or **receiving higher remuneration** than claimed in the employment contract (envelope wages). While Bosnia and Herzegovina has the lowest percentage of respondents working on a main job without an employment contract, it is the country with the highest share of citizens reporting a difference between the remuneration documented in their contracts and the actual salaries they receive. At the same time Kosovo\* and Albania have much higher shares of employed without a contract, but the share of workers whose actu-

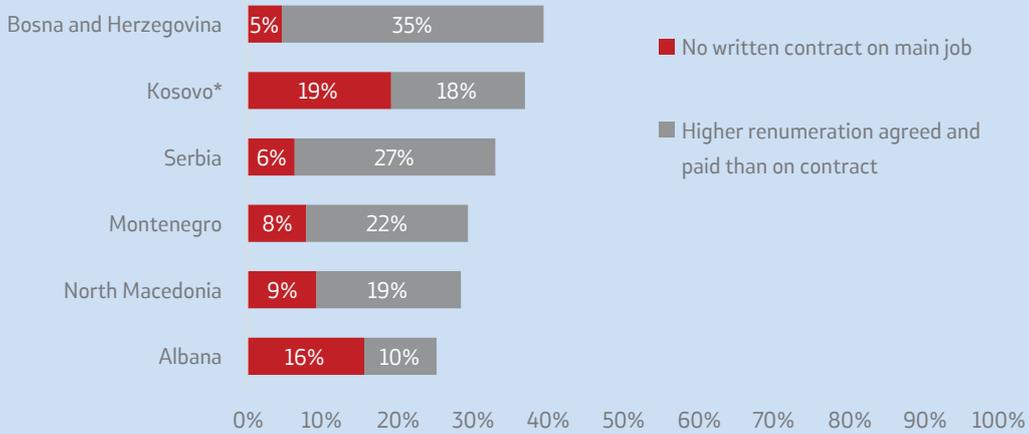
**Figure 1. Hidden Employment Index 2016-2021**



**Source:** SELDI Corruption Monitoring System / Hidden Economy Monitoring System, 2021.

<sup>13</sup> Wherever not explicitly noted data throughout this policy brief is from the 2021 SELDI monitoring round but conclusions concern latest policy developments as of May 2022.

**Figure 2. Workers without written contract on the main job or receiving higher than the declared remuneration (2021, in %)**



Source: SELDI Corruption Monitoring System / Hidden Economy Monitoring System, 2021.

al remuneration differs from the contract is among the lowest in the region.

Both practices' prevalence of "no written contract" and "higher remuneration agreed and paid than on contract" remain similar to 2019 across the region. Albania marks a notable exception, where data shows a 25 percent-

age points drop of the share of the workers who declared higher remuneration paid than stated in the contract. At the same time, there was a 3% increase in the "no written contract" share in Albania showing a reverse trend from the rest of the region of transforming employment relations without any contract to at least partially declared work.

**Figure 3. Workers without written contract on the main job or receiving higher than the declared remuneration (% change 2021-2019)**

Negative numbers show decline (improvement), while positive numbers show increase.

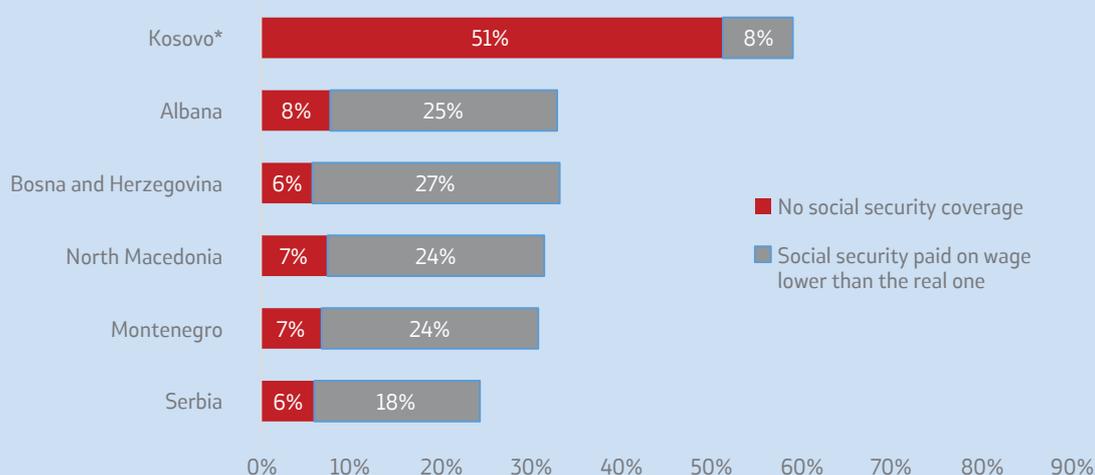


Source: SELDI Corruption Monitoring System / Hidden Economy Monitoring System, 2021.

**Social security related hidden employment practices** refer to respondents who report either not paying any social security contributions, or paying them on a lower than the officially declared basis. This indicator shows the level of trust in public institutions to uphold long-term contracts (on social security) and to preserve the value of personal contributions is very low across the region. Kosovo\* is the worst-performing country, while Serbia and Montenegro exhibit relatively better results.

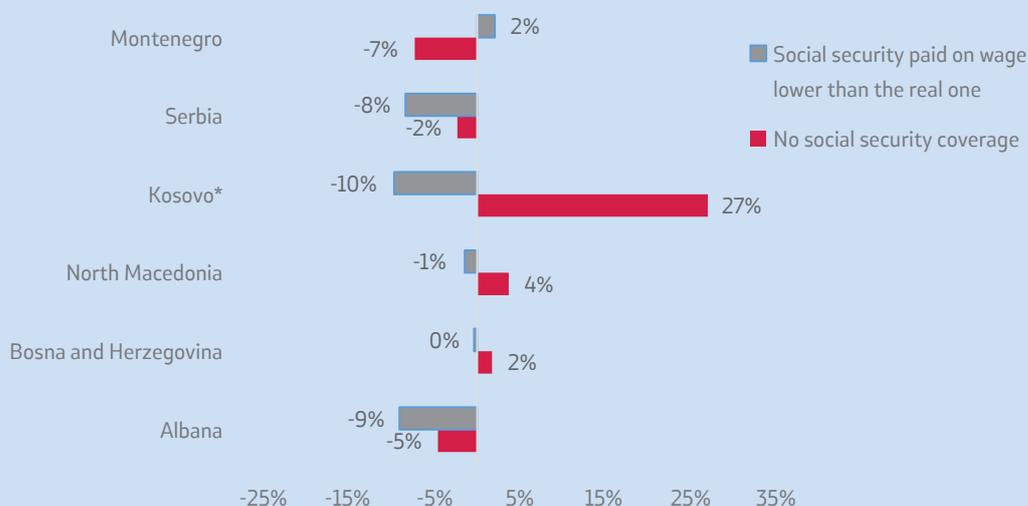
What is particularly worrying though is that with the exception of Serbia and Albania, no other country in the region marks sustained reduction in the practice of evading social security contributions. Kosovo sees the biggest regress in this respect, but other countries also show ambiguous results at best. This seriously undermines pension systems through the region and require immediate strong action.

**Figure 4. Hidden practices in social security coverage (2021, in %)**



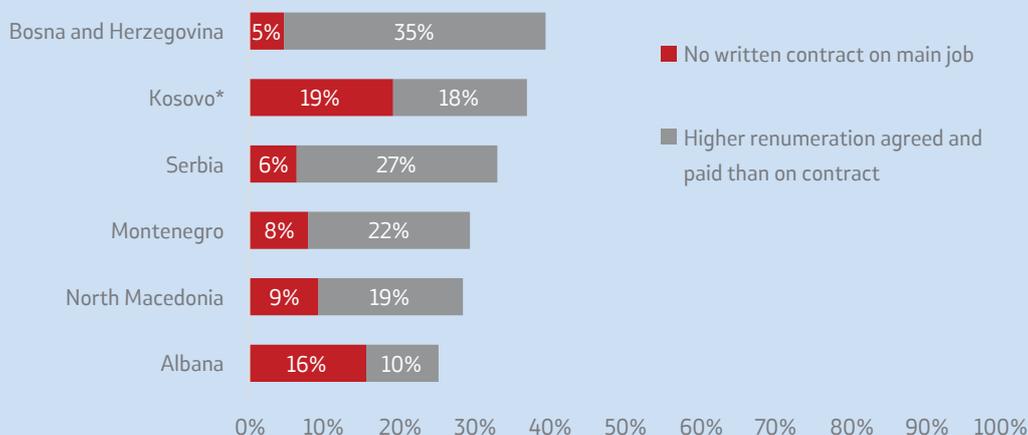
Source: SELDI Corruption Monitoring System / Hidden Economy Monitoring System, 2021

**Figure 5. Trends in social security coverage (% change 2021-2019)**



Source: SELDI Corruption Monitoring System / Hidden Economy Monitoring System, 2021

**Figure 6. Workers with no health insurance coverage on the main job 2016-2019, % of all engaged in a main job**



**Source:** SELDI Corruption Monitoring System / Hidden Economy Monitoring System, 2021.

Finally, the percentage of workers who have **no healthcare insurance** paid is particularly important in the context of the COVID-19 crisis. Naturally, in most of the countries there is a decline in the number of employed without health insurance since 2019 (Kosovo\*, Montenegro, Albania and Serbia) or at least the share of these cases remains relatively low over time (6% in Bosnia and Herzegovina in 2016 and 2021). The only exception is North Macedonia where this indicator is 7% in 2021 – a 3 percentage points increase since 2019 and a 4 percentage points increase since 2016 when North Macedonia had the lowest score from all six countries on this indicator.

## RISK SECTORS AND KEY FACTORS INFLUENCING THE LEVELS OF INFORMALITY

Some sectors in the Western Balkans are more at risk of informality than others. In Albania and Serbia two thirds of all agricultural workers are undeclared. This is mostly

due to the fact that many of the workers are family members who work without payment in family farms. In Bosnia and Herzegovina as well as Montenegro, the rate of informal agricultural workers is even higher, approximately 87% and 90%. After agriculture, the highest number of informal workers are observed in construction (35%) in Bosnia and Herzegovina. In Montenegro 91% domestic workers perform their duties informally, as well as 36% of those in construction.<sup>14,15</sup>

Informality in the Western Balkans can be attributed to a plethora of **causes**<sup>16</sup>, such as:

- low tax morale;
- high levels of poverty and unemployment (in particular among the youth and long-term unemployed);
- governance deficits in the business environment;
- lack of trust in the state and the public institutions, and high levels of corruption;
- high taxation and para-fiscal costs, in parallel to excessively coercive tax policy;

14 Regional Cooperation Council (2021), *Labour markets in the Western Balkans: 2019 and 2020*, p. 18.

15 E.g. the highest reported percentage of informal work was in trade activities (42,2%), followed by manufacturing (17,3%) and construction (16,6%) in Albania. European Commission (2020), *Commission Staff Working Document: Albania 2020 Report*, p. 89.

16 SELDI (2016), *Shadow Power: Assessment of Corruption and Hidden Economy in Southeast Europe*; and SELDI (2016), *Hidden Economy and Good Governance in Southeast Europe Regional Assessment Report*.

- insufficient inspections and audits;
- low quality of education and healthcare systems;
- red-tape, burdensome severance payment system, frequent changes of legislation and delays of VAT refunds.

Some of the 2020-2022 developments related to the key factors influencing informality are analysed in more detail below.

## Tax policy

Efforts to improve operational capacity of tax authorities, the **introduction of e-services** and computerisation of tax admin-

istrations have helped the fight against tax evasion and informal economy in all Western Balkan countries. In addition, as a response to the pandemic-induced economic recession, all WB6 countries have offered tax deferrals for SMEs. Albania and Kosovo\* have also introduced VAT exemptions to support companies throughout the lockdowns.<sup>17</sup> Still, challenges related to the tax collection, cross-institutional and cross-border exchange of tax information, needed updates of the legal base, and introduction of better risk management procedures persist.

### Box 1. Introduction of electronic invoices and payments in the Western Balkans

The fiscalisation process in Albania is being introduced in three phases.<sup>18,19</sup> The process is based on the use of electronic tax invoices, which the National Agency of the Information Society gathers in a central platform. The Albanian tax authorities are in charge of the administration of the exchanged data. The law is applied for entities that have a sales relationship with state institutions (since 1 January 2021); for non-cash transactions performed between taxpayers (since 1 July 2021), and for entities that have a sales relationship with private entities and final customers (since 1 September 2021).<sup>20</sup> Similarly, Montenegro adopted the Law on Fiscalization in the Trade of Products and Services applicable from 1 June 2021.<sup>21</sup> Taxable persons can now issue electronic invoices. A new provision allows taxpayers to submit monthly VAT returns solely electronically. The new excise module of the Customs Declaration and Excise Document Processing System (CDEPS) in North Macedonia shifted paper to digital procedures. The Public Revenue Office is facilitating voluntary compliance by issuing pre-filled annual tax returns through the electronic personal tax platform. The Kosovo Tax Administration has established a widespread use of e-filing and e-payment.<sup>22</sup> Kosovo\* has also started to give businesses so-called unique identifier numbers (UIN), which is a single identifier number used when dealing with several different public services, such as business and fiscal registration, VAT office and customs.<sup>23</sup>

Despite these initial steps, electronic payments under e-government services remain underdeveloped in the region. **The low technical and human capacity** for cross-

17 World Bank Group (2021), *Subdued Recovery: Western Balkans Regular Economic Report No. 19*, p. 18.

18 Law No. 87/2019 on Invoice and Circulation Monitoring System. This Law is partly harmonised with Directive 2014/55/EU on Electronic Invoicing in Public Procurement and Directive 2006/112/EC on the Common System of Value Added Tax.

19 KPMG (27 January 2020), *New Law on Invoice and Circulation Monitoring System*.

20 European Commission (2021), *Commission Staff Working Document: Albania 2021 Report*.

21 Vijesti (June 2021), *Montenegrin Employers Federation: Fiscalization will not suppress the gray economy*

22 European Commission (2021), *Commission Staff Working Document: Kosovo 2021 Report*.

23 Ibid.

institutional and cross-border exchange of information presents a particular challenge. Essentially, none of the WB6 countries has achieved advanced integration and exchange of information in relation to risk assessment and compliance between the different enforcement authorities within the countries and with their EU counterparts. This makes prevention and deterrence of the many practices of informality in the WB6 very difficult.

Another notable development has been the **updated VAT and tax policy** of the countries from the region, aimed to tackle tax evasion and increase revenue mobilisation. Bosnia and Herzegovina's Joint Socio-Economic Program (2020-2022) aims to lower the tax burden and reform unemployment benefit schemes.<sup>24</sup> Albania increased the VAT threshold for all companies, including freelancers, from ALL 2 million (EUR 16,275) to ALL 10 million (EUR 81,000) in the beginning of 2021 in a move to reduce the tax burden on smaller entities. Companies with turnover of less than ALL 14 million (EUR 113,931) do not have to pay any profit tax, and those with higher turnover have a profit tax rate of 15%.<sup>25</sup> During the pandemic North Macedonia amended the Law on VAT by introducing a preferential tax rate of 5% on craft activities and electricity, as well as a preferential rate of 10% on restaurants and catering services (excluding alcoholic beverages) in order to counter the negative consequences of COVID-19 and to promote the retaining of staff in the formal economy.<sup>26</sup> These measures do not seem to have produced sizable impact, and in fact might have made implementation more difficult due to the multiplicity of regulations. Montenegro introduced a reduced VAT rate of 7% for some activities, notably in the

hospitality sector through legal amendments from July 2020 and May 2021. Still, such exemptions are highly unlikely to produce any effects on informality but would result in temporary support for the respective businesses. At the same time though, returning to the established VAT rates would mean higher inflation, which might not be politically feasible in the high inflation period in 2022 – 2023, locking down countries in unsustainable tax cuts. Serbia adopted amendments to the Law on Income Tax and the Law on Corporate Tax. The amendments to the Law on Income Tax increased the threshold for non-taxed monthly income, which could stimulate the declaration of lower-skill jobs. The changes could also reduce income inequality, which might result in higher trust in government policies and reduced informality. The reformed tax system<sup>27</sup> introduced heavier fines for tax avoidance and exempting new businesses from income tax and social security contribution for their first year of operating. All in all, these tax changes in Serbia have coincided with the largest registered drop in informal employment since SELDI started keeping records in 2001. Yet, Serbia and the rest of the countries in the region need to continue their efforts in reducing informality, as it remains relatively high.

### Labour and education policy

The quality of the labour law, the minimum and the average wages, the protection of the workers' labour and human rights, as well as the frequency and efficiency of inspections are among the most important factors influencing the levels of informality. The labour law legislative framework in the Western Balkans is **only partially aligned**

<sup>24</sup> World Bank Group (2021), *Subdued Recovery: Western Balkans Regular Economic Report No. 19*, p. 43.

<sup>25</sup> European Commission (2021), *Commission Staff Working Document: Albania 2021 Report*, p. 100.

<sup>26</sup> European Commission (2021), *Commission Staff Working Document: North Macedonia 2021 Report*.

<sup>27</sup> A new tax administration transformation programme 2021-2025 was adopted by the government on 20 May 2021.

**with the *EU acquis*.** Yet, all of the countries from the region are working towards improving their labour laws. North Macedonia is preparing an update of its legal base through comprehensive consultations with stakeholders. Montenegro is striving to align its anti-discrimination law with the *EU acquis*, including through the Law on Social and Child Protection, adopted in May 2021.<sup>28</sup> And in Albania, the amended Labour Code is already under implementation.<sup>29</sup>

Kosovo\*, the country with the highest informality in the Western Balkans, continues to face structural labour market challenges stemming from the mismatch between the rapid growth of the working-age population and job creation, the persistently low participation of women and the precarious employment opportunities (fewer than half of employees have permanent work contracts). As many as 10% of children in Kosovo\* are involved in work, of whom 6.8% work in hazardous conditions – a problem particularly evident among the Roma and Ashkali communities.<sup>30</sup> An additional cause of informality is that people have a low-level of financial skills, little or no access to technology, and sometimes lack of knowledge how to navigate the market. For example, only 40% of the adults and 75% of the SMEs in Albania have a bank account. Combined with difficult tax processes, doing business informally remains attractive.<sup>31</sup>

According to the latest available PISA ranking<sup>32</sup>, the WB6 have all achieved some progress in the field of **education** in recent years, which could potentially contribute to lower informality levels in the future.

However, all of the countries ranked below the OECD average in PISA 2018 ranking, mostly due to lack of training for teachers or otherwise only partial implementation of the education policy changes. All the WB6 countries also need to increase the participation in education of vulnerable children, such as those from ethnic minorities like Roma, as well as children living in rural areas. The COVID-19 pandemic clearly demonstrated that efforts to enhance digital services in education should be accompanied by steps to prevent the further marginalisation of such vulnerable groups, due to lack of digital skills and access to technologies.

## Health care

The COVID-19 pandemic has put the public health care systems in WB6 under a lot of pressure, exacerbating many of the already existing problems, despite material and financial help from the EU and the World Health Organization (WHO). In many WB6 countries access to health care remains unequal, and many health care professionals are emigrating elsewhere from the region, causing a brain drain. The 2021 EC reports note that most Western Balkan countries are at the early stage of preparation in the field of consumer protection and public health, and legislation on serious cross-border health threats including communicable diseases is not yet aligned with the *EU acquis*.<sup>33</sup> Thus, the unsatisfactory state of the healthcare system continues to contribute to the low trust in the institutions and the quality of public services – and consequently leads to an increase in the informal economy.

28 European Commission (2021), *Commission Staff Working Document: Montenegro 2021 Report*, p. 88.

29 European Commission (2021), *Commission Staff Working Document: Albania 2021 Report*.

30 European Commission (2021), *Commission Staff Working Document: Kosovo\* 2021 Report*, p. 87.

31 World Bank Group (2021), *Subdued Recovery: Western Balkans Regular Economic Report No. 19*, p. 42.

32 PISA is the OECD's Programme for International Student Assessment. PISA measures 15-year-olds' ability to use their reading, mathematics and science knowledge and skills to meet real-life challenges.

33 European Commission (2021), *Commission Staff Working Documents*.

## NATIONAL POLICIES AND MEASURES

### Need of a holistic approach

The governments of the Western Balkan countries have all undertaken measures aimed at tackling informality, but not all of them can be characterised as comprehensive, consistent, or fully efficient. In general,

a fragmented and uncoordinated approach across the multifarious government bodies responsible for tackling undeclared work and a limited involvement of social partners, as well as an incomplete range of policy measures are used. To resolve this, it is recommended that the governments apply a holistic integrated strategic approach.

### Box 2. Definition of a “holistic integrated strategic approach”

An approach, where the whole government tackle undeclared work, by joining-up on the policy and enforcement level of both strategy and operations the fields of labour, tax and social security law, and involve and cooperate with social partners and other stakeholders. This approach involves using the full range of direct and indirect policy measures available to enhance the power of, and trust in, authorities respectively. The objective is to transform undeclared work into declared work in an effective manner.

**Source:** Williams, C.C. (2016) *Developing a Holistic Approach for Tackling Undeclared Work: background paper*, European Commission, Brussels.

Developing a whole government coordinated approach is comprised of four sub-components:

- cross-government coordinated strategy;
- coordinating operations across government;
- cross-government coordination on data mining, matching and sharing, and
- improving the involvement of social partners.<sup>34</sup>

According to a 2021 survey among labour inspectorates and tax authorities, in the Western Balkans the different government departments are responsible for different aspects (e.g., tax authorities for tax compliance, labour inspectorates for labour law and social insurance bodies for social security compliance). However, in order to improve the cross-institutional cooperation,

44% of enforcement authorities are discussing the adoption of joint or concerted operations as a strategic objective.<sup>35</sup>

In addition, in order to transform undeclared into declared work, direct controls that deter engagement in undeclared work by increasing the risks of detection and penalties (i.e. “sticks”) should be used in parallel to incentives to make declared work easier and more beneficial (i.e. “carrots”). The adoption of this strategic objective is underway among nearly all enforcement authorities surveyed in the Western Balkans. Over a quarter (30%) had fully adopted the objective of transforming undeclared work into declared work, 20% were pursuing pilot initiatives in this regard, and 40% were discussing its adoption. However, self-reported progress towards doing so is greater in tax authorities than in labour inspectorates.<sup>36</sup>

<sup>34</sup> Regional Cooperation Council, Western Balkan Network Tackling Undeclared Work, Prof. Colin C Williams (May 2021), [Towards a Holistic Approach for Tackling Undeclared Work in the Western Balkans: A Self-Assessment Survey](#)

<sup>35</sup> Ibid.

<sup>36</sup> Ibid.

## Inspections and sanctions

Most countries faced challenges related to the **slowdown of inspection activities** during the COVID-19 pandemic (e.g., Albania experienced 43% decrease of labour inspections from 2019 to 2020). Another barrier is the insufficient staff working at inspectorates. In 2020, the structure of the Albanian State Inspectorate of Labour and Social Services (SLISS) was revised with the establishment of a new Department of Risk Assessment. However, further steps should be taken to strengthen the capacities of the SLISS when it comes to human resources, regular training and adequate means, including vehicles, to perform duties

and to enhance coordination with social partners to promote decent work.<sup>37</sup> Although the capacities of the State Labour Inspectorate in North Macedonia improved with the employment of five additional inspectors, its overall performance remains low.<sup>38</sup> In Serbia, labour inspections have focused on tackling undeclared work, but do not yet have a significant impact. The law on inspection oversight still needs to be amended to comply with the relevant International Labour Organization Conventions ratified by the country, notably to ensure that labour inspectors are empowered to enter workplaces freely and without giving prior notice.<sup>39</sup>

### Box 3. A good practice from Albania: online labour inspection platform

In Albania, the State Labour and Social Services Inspectorate introduced in mid-2020 an online inspection platform to prevent abusive behaviour by labour inspectors and improve the efficiency and effectiveness of the inspections. The platform also aims to increase the interaction with employers, set standards for inspection practices, and enable inspection planning based on risk assessments. As of June 2021, it included data from 34,500 inspections. The operation of the platform resulted in:

- 45% more undeclared work transformed into declared work (without punitive measures);
- 14% more complaints addressed for resolution (thus increasing the trust in the institutions);
- 86% more immediate interventions occurred (with concrete measures taken by businesses after inspection) and flagrant violations of legal provisions corrected;
- 21% less sanctions occurred for the violation of legal provisions, and 0.6% fewer cases of major accidents at work.

Through the data that the platform contains, risk analysis and assessment of business entities can be carried out, making inspections more effective. The platform also enables job evaluation through online monitoring and allows training needs of labour inspectors to be identified and addressed.

**Source:** Regional Cooperation Council, Colin C Williams (June 2021), *Online Labour Inspection Platform, Albania*.

<sup>37</sup> European Commission (2021), *Commission Staff Working Document: Albania 2021 Report*.

<sup>38</sup> European Commission (2021), *Commission Staff Working Document: North Macedonia 2021 Report*, p. 82.

<sup>39</sup> European Commission (2021), *Commission Staff Working Document: Serbia 2021 Report*, p. 99.

## Reducing the effect of the pandemic on (informal) workers

Many of the new government measures adopted in 2020-2022 targeted not only decreasing informality but also **reducing the effect of the pandemic on (informal) workers**. Kosovo\*, North Macedonia and Bosnia and Herzegovina extended their social assistance programs to poor people who were not eligible to other types of financial assistance. Kosovo\* created a new type of temporary assistance to people who lost their jobs due to the pandemic. Montenegro, in turn, provided one-time financial support to everyone registered with Public Employment Services who did not receive other types of assistance. Albanian, Kosovo\* and Montenegrin governments, therefore, incentivized making work contracts formal. In July 2020 the Albanian government increased its labour market spending by approximately 50% to adopt two temporary employment programmes for those, who became unemployed due to the pandemic lockdown measures. One of these programmes is meant for people, who **declared themselves as informal workers**.<sup>40</sup> However, even with these measures, many of the informal workers remained out of these schemes and became increasingly economically vulnerable.<sup>41</sup>

## New strategies and programmes. Regularisation and awareness measures

Some **positive developments** in the national policy-making, beyond the measures

directly linked to the pandemic, could also be recognised. Republika Srpska has taken steps towards fighting informality by lowering its labour tax burden, simplifying its registration procedure for companies by setting up online platforms and offices, where a company can be easily registered. Support programs and revolving credit schemes are set up for SMEs. The same types of changes are under way in the Federation of Bosnia and Herzegovina.<sup>42</sup> The Ministry of Labour and Social Welfare of Montenegro, supported by graduate students, started a campaign called "Stop informal economy", focusing on the tourist sector.<sup>43</sup> The same ministry also launched a campaign on the importance of issuing fiscalized invoices with a QR code, informing customers that they are not obliged to pay the issued invoice without QR code.<sup>44</sup> The campaign "Take a receipt and win" continued in 2021 in Serbia.<sup>45</sup> A regularisation scheme became operational in Kosovo\* in 2020, where previously employed unregistered employees were provided with short-term financial assistance during the coronavirus pandemic, if they employ the workers on a declared contract for at least one year.<sup>46</sup> On 6 May 2020, the Finance Minister reported that 10,597 new employees have so far registered, which is an increase of 2.6% in total official employment.<sup>47</sup>

Many of the Western Balkans countries updated existing or adopted **new strategies and programmes** to tackle informality. Among the most ambitious ones is the Economic Plan "Europe Now", launched on 1 January 2022 in Montenegro, which foresees:

40 European Commission (2020), *Commission Staff Working Document: Albania 2020 Report*, p. 90.

41 World Bank Group (2021), *Subdued Recovery: Western Balkans Regular Economic Report No. 19*, pp. 41-42.

42 Ibid, 44.

43 Ibid, 43.

44 Government of Montenegro (August 2021), *Minister Milojko Spajić: You are not obliged to pay invoice without a QR code*

45 Website of the campaign "Take a receipt and win" in Serbia.

46 Regional Cooperation Council, *Western Balkan Network Tackling Undeclared Work (July 2020)*, *COVID-19 and Undeclared Work: Impacts, Challenges and Policy Responses*.

47 Balkan Insight (2020), *Kosovo business complain government's support package falls short*.

- Increase of the minimum wage from EUR 250 to EUR 450 in net amount;
- Reduction of costs for employers through lower tax burden on labour;
- Introduction of progressive taxation as a more efficient model of taxation;
- Introduction of income tax of 0% for part of the salary (up to EUR 700) on a gross basis;
- Introduction of an increased income tax rate of 15% on the gross base above EUR 1,000;
- Abolition of the obligation to pay contributions for compulsory health insurance.<sup>48</sup>

Kosovo\* adopted Revised Strategy and Action Plan for combating the informal economy, money laundering, financing of terrorism and financial crime (2019-2023) in continuation to the earlier 2014-2018 document. The new plan focuses on simplifying the laws, enhancing monitoring and inspections,<sup>49</sup> improving communication between governmental bodies, providing loans to businesses when they submit tax declarations, as well as lowering the costs of electronic payments.<sup>50,51</sup> North Macedonia adopted its Strategy for the Formalization of the Informal Economy 2018-2022, and Action Plan 2020-2021.<sup>52</sup> The Serbian National Programme for Countering the Grey Economy 2015 was extended to run until 2020. There are also plans to digitalise governmental services, registration of businesses and employees (the Law on fiscalisation was adopted in December 2020).<sup>53</sup> However, in Bosnia and Herzegovina, the Federal Development Strategy

(2021-2027) planned to target informality, still awaits approval.

## THE ROLE OF THE SOCIAL PARTNERS

The social partners (employers' organisations and trade unions) could also have a substantial role in tackling undeclared work and the hidden economy, *inter alia* by aiding enforcement and supporting preventive actions. The social partners could engage on many levels, for example by raising awareness, referring cases of undeclared work to labour inspectorates and judicial authorities, negotiating collective agreements, supporting workers by protecting them in undeclared work situations, monitor the labour market trends, providing policy and legal advice through consultations and working groups, and excluding businesses that have been sanctioned from supply chains.<sup>54</sup> The figure below presents the range of initiatives that social partners in the Western Balkans have adopted to tackle the undeclared economy.<sup>55</sup>

However, the social partners' potential remains underutilised, despite the fact that all Western Balkan economies have public bodies established for social dialogue (usually a tripartite Social and Economic Council). The majority of the social partners perceive they have only irregular ad hoc involvement with the public authorities tasked with tackling undeclared work. No social partner confirmed that there is full tripartite agreement and consultation on

48 Mondaq (30 November 2021), Montenegro: Montenegrin Government Proposes Ambitious Economic Plan "Europe Now"

49 World Bank Group (2021), *Subdued Recovery: Western Balkans Regular Economic Report No. 19*, p. 43.

50 European Commission (2020), *Commission Staff Working Document: Kosovo\* 2020 Report*, p. 55.

51 European Commission (2021), *Commission Staff Working Document: Kosovo\* 2021 Report*, p. 85.

52 World Bank Group (2021), *Subdued Recovery: Western Balkans Regular Economic Report No. 19*, p. 43.

53 *Ibid*, 45-46.

54 European Platform tackling undeclared work, Stefanov R., Mineva D. and Terziev, P. (2019), *Social partners and their key role in tackling undeclared work: 12 success stories*

55 Regional Cooperation Council, Western Balkan Network Tackling Undeclared Work; prof. Colin C Williams (May 2021), *Improving Social Partner Involvement in Tackling Undeclared Work: A Toolkit*

**Figure 7. Social partners' policy initiatives to tackle undeclared work**

Raising awareness and making calls for action, 94%	Establishing relevant contacts through their networks, 88%	Taking part in consultations and working groups, 82%	Performing research on undeclared work, 71%	Negotiating collective agreements, 71%	Supporting employers by protecting them from unfair informal or unregistered competitors, 59%
Raising awareness and changing behaviours by providing information, 88%	Providing policy and legal advice, 82%	Providing policy advice on where enforcement authorities should focus their efforts, 76%	Referring cases of undeclared work to enforcement and judicial authorities, 53%	Cooperating across borders in the fight against informal work, 53%	Providing technical support to enforcement authorities in developing information tools, data mining and risk assessment, building websites and social media platforms 41%
			Supporting workers in undeclared work situations, and aiding transition into declared work, 53%	Conducting workplace inspections, 35%	Serving as access points to corporate databases, 29%

**Source:** Regional Cooperation Council, *Western Balkan Network Tackling Undeclared Work*; prof. Colin C Williams (May 2021), *Improving Social Partner Involvement in Tackling Undeclared Work: A Toolkit*.

sector specific inspection targets, information exchange and awareness raising. Only a few noted that there is a regular engagement in joint actions (e.g. information and awareness raising). Among the key reasons for this sub-optimal cooperation is the lack of trust and understanding on both sides regarding the methods and tools needed to counter the hidden economy.<sup>56</sup> Social partners assert that they have some involvement in the body/bodies responsible for tackling undeclared work in Albania, Bosnia and Herzegovina, Kosovo\* and Montenegro, but trade unions in North Macedonia and Serbia note that they have no involvement in these bodies.<sup>57</sup> Still, since 2020, the social partners have slowly started to adopt cooperation with state authorities as

one of their strategic objectives. The social partners in Albania, Montenegro and Serbia have even allocated staff to the task of building such partnerships.<sup>58</sup> In 60% of the labour and tax authorities in the Western Balkans there is either discussion taking place on establishing partnership building with social partners as a strategic objective or a decision has been taken to implement such an action.<sup>59</sup>

## POLICY RECOMMENDATIONS

The war in Ukraine has created the **perfect storm** for the Western Balkans, fuelling inflation, dampening growth and increasing economic uncertainty. Just like the pandemic before that, the war exposed the

<sup>56</sup> Regional Cooperation Council, *Western Balkan Network Tackling Undeclared Work*; Prof. Colin C Williams (May 2021), [Improving the Involvement of Social Partners in Tackling Undeclared Work: A Learning Resource](#)

<sup>57</sup> Regional Cooperation Council, *Western Balkan Network Tackling Undeclared Work*; Prof. Colin C Williams (March 2021), [Evaluating the Involvement of Social Partners in Tackling Undeclared Work in the Western Balkans](#)

<sup>58</sup> Regional Cooperation Council, *Western Balkan Network Tackling Undeclared Work*; Prof. Colin C Williams (May 2021), [Improving Social Partner Involvement in Tackling Undeclared Work: A Toolkit](#)

<sup>59</sup> Regional Cooperation Council, *Western Balkan Network Tackling Undeclared Work*, Prof. Colin C Williams (May 2021), [Towards a Holistic Approach for Tackling Undeclared Work in the Western Balkans: A Self-Assessment Survey](#)

existing governance deficits across countries in the region, in particular such related to high corruption and informality. Reducing the fallout of the war and the pandemic calls for an urgent strategic re-commitment between the EU and the WB countries. Such strategic re-commitments should not come at the expense of watering down EU conditionalities in the area of governance and the rule of law.

In the area of informality, Serbia demonstrated there is a way to achieve **sizeable impact**, as it managed to produce the highest reduction in informal employment on (SELDI) record. Yet, achieving sustainability in reducing the high prevalence of informal practices would require both inspections and sanctions and prevention and treatment. **Voluntary disclosure schemes** (governments deciding to waive penalties to those firms that disclose their past undeclared practices) need to be combined with follow-up **regularisation schemes** (the penalty is reduced or waived only if the company agrees to employ the undeclared or under-declared worker for a specific period of time). The labour and tax authorities could also expand their toolbox of policy measures by running **awareness campaigns**, establishing telephone hotline or web-based **reporting mechanisms** to report abuses, and **publishing a list of businesses** claiming short-term financial support and proportion of staff temporarily suspended.<sup>60</sup> To improve **cooperation between enforcement authorities and social partners**, there is a need for both en-

forcement authorities and social partners to: (i) adopt building such partnerships as a strategic objective of their organisation; (ii) identify the forms of cooperation desired; (iii) develop cooperation, and (iv) manage the resultant partnerships.<sup>61</sup>

The countries should also be more pro-active in **utilising the available funding opportunities** (IPA III<sup>62</sup>, Western Balkans Investment Framework - WBIF<sup>63</sup>, etc.) for strengthening their business operations, infrastructure, education, labour and tax legislation and procedures, and the quality of governance.<sup>64</sup> The Economic and Investment Plan (EIP) for the Western Balkans is among the available policy solutions, presenting a major EU investment program for the post-COVID-19 recovery. If used to its full potential, it could ensure the implementation of multiple beneficial initiatives, such as the promotion of youth internships and jobs that will shorten the transition from education to labor markets.<sup>65</sup> The countries, however, should take precautions and measures to ensure that the national and foreign funding under such programmes do not fall into the hands of politically-connected persons or companies.

Moreover, the **European Commission and the Council** could also promote more in-depth reforms and decrease hidden economy levels through the provision of stronger messages, and more concrete and practical solutions in the Assessments of the Economic Reform Programmes (ERP)<sup>66</sup>,

60 European Platform tackling undeclared work (May 2021), [COVID 19: combating fraud in short-term financial support schemes](#).

61 Regional Cooperation Council, Western Balkan Network Tackling Undeclared Work; prof. Colin C Williams (May 2021), [Improving the Involvement of Social Partners in Tackling Undeclared Work: A Learning Resource](#)

62 IPA website. The [Economic and Investment Plan for the Western Balkans 2021-2027](#) is mobilising up to EUR 9 billion of funding in IPA III EU grants and up to EUR 20 billion of investments (Western Balkans Guarantee Facility).

63 Website of the [Western Balkans Investment Framework \(WBIF\)](#).

64 SELDI (2020), [SELDI Policy Brief 11: Hidden economy in the Western Balkans 2020: Trends and Policy Options](#)

65 European Western Balkans portal (26 November 2021), [Economic and Investment Plan is opportunity for implementation of Youth Guarantee in the Western Balkans](#).

66 European Commission (22 April 2021), [Assessments of 2021-2023 Economic Reform Programmes](#).

as well as in the annual Joint Conclusions and policy guidance<sup>67</sup>. The (potential) candidate countries could further benefit from the **legal and procedural know-how** of the Member States in applying efficient measures. This could be achieved through best practice exchange visits, as well as adoption of some of the measures identified in the virtual library of the European Platform tackling undeclared work<sup>68</sup>, as well as in the practices described by Eurofound<sup>69</sup>, the International Labour Organization (ILO),<sup>70</sup> and the Western Balkan Network Tackling Undeclared Work.

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67 Council of the European Union (12 July 2021), *Western Balkans and Turkey: Joint conclusions of the economic and financial dialogue*

68 European Labour Authority, *European Platform tackling undeclared work*.

69 European Foundation for the Improvement of Living and Working Conditions (**Eurofound**).

70 SELDI (2020), *SELDI Policy Brief 11: Hidden economy in the Western Balkans 2020: Trends and Policy Options*





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