

Hit and Miss - The Dynamics of Undeclared Labor in Macedonia

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1. Introduction

Undeclared work, being one of the main manifestations of hidden economy, becomes the bull's-eye for many countries focusing on reshaping their social and economic policies in order to tackle this issue, especially since the onset of the economic crisis that hit Europe and the World in 2008. The most recent economic indicators coming from Europe show that this crisis has not concluded and European economies are yet to deal with its mid and long-term consequences. Macedonia and other Western Balkan countries are not exempt from this process, with job creation and policies targeting unemployment (28.2% as of Q2 2014) being a major concern and a focal point of political activity. Low growth prospects in the EU and sluggish economic conditions forecasted in 2014 are also limiting Macedonia's growth prospects, which at this point are still positive at around 4% GDP growth annually (4.3% as of Q2 2014).

In the following period, economic growth will dictate the unemployment rate while regulatory reforms targeted at labor policy, taxation, and inspections will dictate the extent of undeclared economy and, consequently, the risk of poverty and social exclusion that undeclared workers will be subjected to.

2. Definition and Causes

Within EC's Communication 98/219, undeclared work is referred to as "paid activities that are lawful as regards their nature but not declared to the public authorities, bearing in mind that differences in the regulatory system of Member States must be taken into account."¹ The challenge of understanding and measuring undeclared labor in each country, however, is significant, mainly due to having different definitions within each country's legislation, as well as due to the varied measurement methods available,

¹ Communication from the Commission (98) 219 final, 7 April 1998.

KEY POINTS

- According to results from CRPM's population survey, the proportion of employees with a primary employment receiving 'envelope' payments or temporary service contracts in addition to their salary is about **one-third of the employed population**.
- Almost 7% of employees work without a contract and are not being paid social security contributions. Combined with the abovementioned fact, this indicates **the salary of about 40% of employees with a primary employment is partially or completely undeclared**.
- **More than half of employers** confirm that signing contracts with 'hidden clauses' happens in their sector.
- Macedonia's **main focus** in tackling undeclared work, just as most Eastern European Countries, is on **Labor Law violations**). **Repressive measures** and others aimed at **improving detection** are the dominant policy approach.

and thus providing non-reliable data. Moreover, even though attempts at standardizing a statistical definition of undeclared labor have been made, there are still multiple “approaches to identifying informal working relationships using, ‘legalistic,’ ‘de facto,’ or ‘productive’ definitions.”² The first refers to “social security contributions or to employment status (self-employment vs. dependent employment),”² the second looks at various cases “when labor regulations are not applied, not enforced, or not complied with for any reason,”² while “productive definitions rely on characteristics of the employer and/or the employed, e.g. size of establishment or occupation of a self-employed person.”²

Furthermore, the ILO has long tried to address the challenge of measuring the size, contribution and classification of undeclared labor. Such challenge is particularly relevant when seen in the context of a country’s poverty measures, and ILO argues that there could be a connection “between working in the informal economy and being poor. This is because those who work in the informal economy are generally not covered by labour legislation or social protection and earn less, on average, than workers in the formal economy.”³

While there is no “aggregated data on undeclared work at EU level,”⁴ various attempts have been made to measure it, most commonly by using direct and indirect methods. “Indirect methods are based on the comparison of macroeconomic aggregates (such as national accounts, electricity consumption, cash transactions). Direct methods, on the contrary, are based on statistical surveys and have advantages in terms of comparability and detail, but tend to under-report the extent of undeclared work.”⁵

Table 1 - "Main causes of the increase in the undeclared economy"

Factors influencing the undeclared economy	Average values of 12 studies (influence on the undeclared economy, %)	Average values of empirical results of 22 studies (influence on the undeclared economy, %)
Increase of the tax and social security contribution burdens	35–38	45–52
Quality of state institutions	10–12	12–17
Transfers	5–7	7–9
Specific labour market regulations	7–9	7–9
Public sector services	5–7	7–9
Tax morality	22–25	–
Influence of all factors	84–98	78–96

Source: Schneider (2012) cited in Eurofound (2013), *Tackling undeclared work in Croatia and four EU candidate countries*, Eurofound, Dublin

However, some of the causes that lead to the growth of undeclared labor transcend most borders. Schneider has identified that “the major contributory factor is the increase in tax and social security burdens. This relates not only to the amount paid but also to the ease of, and difficulties involved in, paying such tax and social security contributions, thus suggesting that reductions in the undeclared economy are to be achieved by simplifying compliance.”⁶ (see Table 1) Tax morality, as a second major contributing factor is moreover a symptom of increased social security contributions rather than a cause of undeclared labor. In terms of socio-economic factors that might lead to entering the undeclared labor market, the literature identifies a set of “common characteristics in the prevalence of undeclared work: it

² Hazans, Mihails, (2011). *Informal Workers Across Europe - Evidence From 30 European Countries*. World Bank Working Paper Nr. 5912. Retrieved on 29.10.2014 from: <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-5912>

³ International Labour Office, (2002). *Women and Men in the Informal Economy: A statistical picture*. Retrieved from: <http://www.ilo.org/dyn/infoecon/docs/441/F596332090/women%20and%20men%20stat%20picture.pdf>

⁴ European Commission (EC). *Shadow Economy and Undeclared Work*. Retrieved on 15.10.2014 from: http://ec.europa.eu/europe2020/pdf/themes/07_shadow_economy.pdf

⁵ Ibid

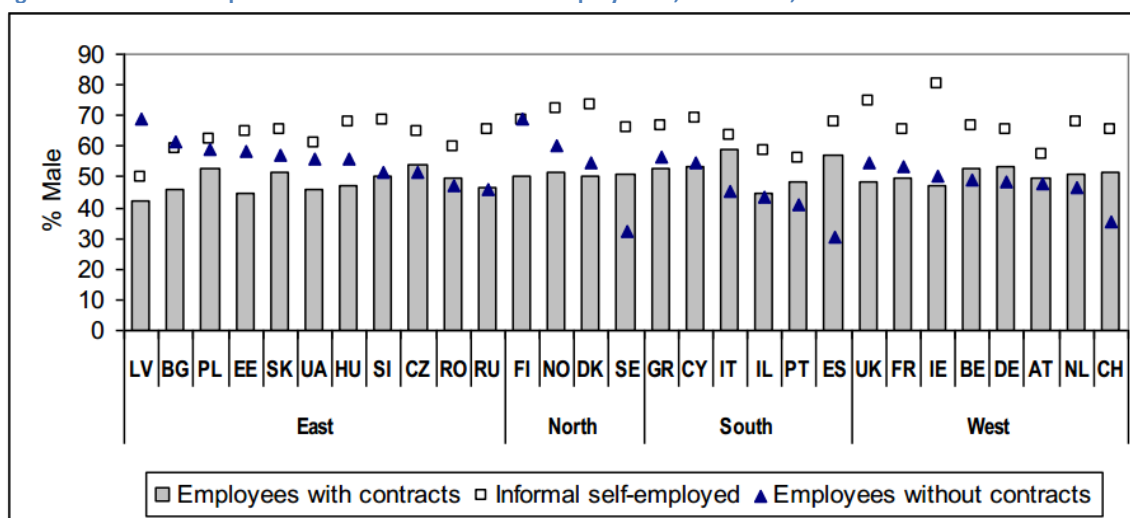
⁶ Eurofound (2013), *Tackling undeclared work in Croatia and four EU candidate countries*, Eurofound, Dublin.

is most prevalent among men, singles, people with short or craft education as well as workers employed in the construction sector and in the hospitality sector. It is more common in sparsely populated areas.”⁷

The most recent Eurobarometer survey on undeclared work in the EU⁸ has looked at the demand side of undeclared labor, including purchasing undeclared goods or services, the supply side, including amounts earned through undeclared labor, as well as perceptions and acceptance of the phenomenon. The findings of the surveys showed that “one in nine Europeans admit they are involved in acquiring goods or services where they have good reason to believe that they include undeclared work,”⁹ with the main motivation for making such purchases being the lower prices. From a supply point of view, “one in twenty five Europeans admit that they have undertaken undeclared paid work in the past year.”¹⁰ The main characteristics of undeclared workers have been found to fall within the categories mentioned above. “The findings suggest a greater tendency to supply undeclared work among 15-34 years old, people who struggle with household bills, the unemployed and students. Those who buy goods or services that might involve undeclared work are also more likely than average to be suppliers. As seen on the demand side, there is considerable regional variation, with respondents in Eastern and Central Europe and those in the Nordic countries most likely to report they have carried out undeclared paid work, whilst those in Southern Europe are least likely.”¹¹

The gender composition (See Figure 1) shows that the proportion of males is higher among the informally self-employed than among formal employees across all of Europe (excluding Italy, France and Spain). Some of the explanations focus on the higher risk tolerance of males or the social norms of what is considered a ‘non-female’ occupation.¹²

Figure 1 - "Gender composition of formal and informal employment, 2004-2009,



Source: Calculation with ESS data. Retrieved from World Bank, <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-5912>

In terms of perception, “Europeans as a whole do not perceive the risk of being detected when doing undeclared work to be particularly high. Just over half of Europeans think that people who carry out undeclared work are at a small risk of being detected by the relevant authorities, around one in five think

⁷ European Commission, (2012). *Tax Reforms in EU member States – Tax policy challenges for economic growth and fiscal stability*. Working Paper N.34, 2012. Retrieved on 15.09.2014 from: http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_34_en.pdf

⁸ European Commission (2014). *Undeclared Work in the European Union*. Special Eurobarometer Report 402, March 2014 Retrieved on 01.09.2014 from: http://ec.europa.eu/public_opinion/archives/ebs/ebs_402_en.pdf

⁹ Ibid, p.121

¹⁰ Ibid, p.121

¹¹ Ibid, p.121

¹² Hazans, Mihails, (2011). *Informal Workers Across Europe - Evidence From 30 European Countries*. World Bank Working Paper Nr. 5912. Retrieved from: <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-5912>

that a reason for undeclared work is that authorities lack control and around one in seven that the sanctions imposed if detected are too weak. The findings also show that those who themselves do (or know someone who does) undeclared work are particularly likely to perceive the risk as low.”¹³

The EU has been tackling hidden economy, with undeclared labor as an important part of it. Even though there is no coherent approach against undeclared work within the EU, there have been several measures, aiming to strengthen the fight against tax evasion, improve tax collection and to fight the main causes that attract workers into hidden economy. Such measures include the “Action Plan to strengthen the fight against tax fraud and tax evasion”¹⁴ and the “initiative on enhancing EU cooperation in the prevention and deterrence of undeclared work with the aim of enhancing cooperation at EU level between all enforcement bodies, such as labour inspectorates, social security, tax and migration authorities, whose aim is to track, prevent and sanction undeclared work.”¹⁵

3. Undeclared work in Macedonia

According to Novkovska (2008, 2013)¹⁶ in Macedonia the informal employment in agriculture, as a source of undeclared labor, is significant and ranges between 86.1% and 82.4% of total agricultural employment in the period of 2008-2012. This is in accordance with the results from the study by Stankovic and Stankovic (2012) where the sale of agricultural products at the ‘green bazaars’ was identified as an activity most directly affected by undeclared labor. In the same direction, another study (Risteski, 2009), that looks into the handicraft shadow economy, found that, overall, the access to undeclared goods and services, for a striking 90% of the respondents, was marked as easy or very easy. Most studies argue that undeclared activity is a reality in all sectors to a certain extent, however it is notably dominant “in labour-intensive, low-earning jobs in construction, transport, catering, the textile industry, domestic services, agriculture and trade. Risteski (2009) adds tourism, private renting, green market trade, car repairs, home maintenance and cosmetic services to the list. Nenovski (2012) stresses that the trade sector is particularly prone to undeclared economic activity due to the fact that it was dominated by small and medium-sized firms during the last twenty years.”¹⁷

Undeclared work is interrelated to part-time, temporary and seasonal jobs and mostly affects low earning, low skilled workers.¹⁸ Novkovska (2008, 2013) has also studied the level of undeclared jobs within the non-standard employment which consists of a) part-time, b) fixed-term and c) own-account jobs/self-employed. She concluded that 77% of informal employment were temporary jobs or non-standard, whereas 11% of formal employment were temporary or non-standard jobs. On one hand, this pattern was even more evident in the agricultural sector where 85% of jobs were either own-account and unpaid family workers. “Agricultural workers are simultaneously involved in informal and non-standard

¹³ European Commission (2014). *Undeclared Work in the European Union*. Special Eurobarometer Report 402, March 2014 Retrieved from: http://ec.europa.eu/public_opinion/archives/ebs/ebs_402_en.pdf, p.122

¹⁴ Communication from the Commission, COM(2012) 722 final, Brussels, 06.12.2012. Retrieved from: http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/com_2012_722_en.pdf

¹⁵ European Commission (EC). *Shadow Economy and Undeclared Work*. Retrieved on 15.10.2014 from: http://ec.europa.eu/europe2020/pdf/themes/07_shadow_economy.pdf, p.4

¹⁶ Novkovska, B (2013) Defining and Measuring Non-standard and Informal Employment in the Agricultural Sector. Paper presented at the *Sixth International Conference on Agricultural Statistics*.

Novkovska, B. (2008) Measuring Non-standard and Informal Employment in the Republic of Macedonia. Paper presented at the workshop *Measurement Informal Employment in Developed Countries WIEGO*, Kennedy School of Government, Harvard University, 31 October – 1 November 2008.

¹⁷ Dzhokova, Franic, Mishkov, C. Williams (2014), “Tackling the Undeclared Economy in FYR Macedonia” GREY Working Paper No. 3, University of Sheffield. P.17. Retrieved from: http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf

¹⁸ Stankovic, M. and Stankovic, B. (2012). *Social and economic aspects of the shadow economy in the Republic of Macedonia: A study*. Social Science Research Network [Online]. Available from: <http://ssrn.com/abstract=2162922> (Accessed 30 June 2014).

employment (Novkovska, 2013), putting them at greater risk of poverty and social exclusion.”¹⁹ On the other hand, according to the Labor Force Survey (LFS) conducted by ILO²⁰ 34.7% of non-agricultural self-employment (own-account work) is informal, out of which 48.6% are undeclared own-account enterprise owners.

Since the officially unemployed are more prone to undertaking jobs in the undeclared economy, analyzing the unemployment structure might provide hints as to where policies and measures should be targeted or better adjusted in order to achieve optimal efficiency. The passive unemployment historical data (Figure 3 & Figure 3a) from the Employment Agency (EA) show an abrupt change in 2012-2013, which is attributed to the change in the way the EA started registering the unemployed since 2012 i.e. as active jobs seekers

Figure 3 - Unemployment by Nationality of Active Job Seekers (% of total active job seekers)

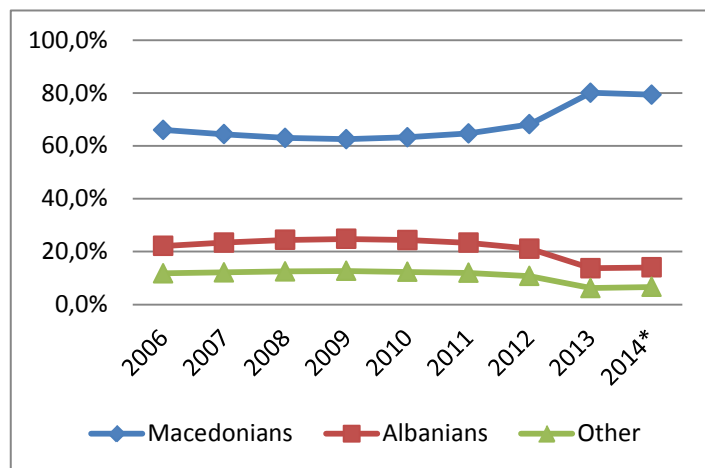
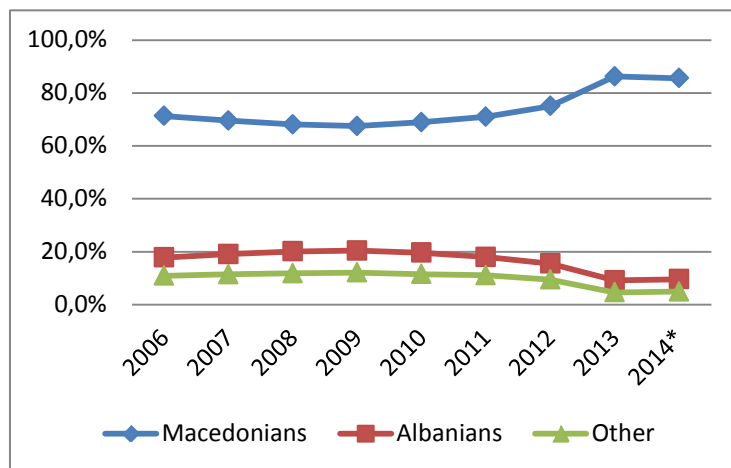


Figure 3a - Women's' Unemployment by Nationality (% of Active jobs seekers unemployment per gender)



Source: Employment Agency (EA) data, 2006-2014 July. Available at: <http://avrm.gov.mk/pregled-na-evidentirani-nevraboteni-lica-sporod-nacionalna-pripadnost.nspj>

(obliged to go to job interviews, trainings and regularly register at the EA offices once every 3 months), and the rest designated as passive job seekers. An in-depth look at the data can offer some insight into the scope of undeclared labor in Macedonia since the latter category of unemployed, the passive job seekers, are considered as more likely to be involved in undeclared activities. It has to be noted that the data is not substantially comprehensive since, as some studies show, 17.4% of the inactive population aged 25-40 were not registered as unemployed nor were employed,²¹ thus skewing the data towards underestimation.

Unraveling the data by ethnic background, while only available for active job seekers, reveals a mirror image between ethnic Macedonian job seekers and the job seekers from other ethnic communities. Macedonians currently represent around 80% of the 97,838 active job seekers, while Albanian and other ethnic communities represent 14% and 2% respectively. The data about women passive job seekers show a similar and even a more pronounced pattern. In retrospect, before the division of the registered unemployed into passive and active job seekers the distribution of the unemployed by nationality ran closely to the figures gathered by the national census of 2002 or more specifically, 64% Macedonians, 24-25% Albanians and 10-11% other ethnicities who were unemployed.

¹⁹ Dzhekova, Franic, Mishkov, C. Williams (2014), "Tackling the Undeclared Economy in FYR Macedonia" GREY Working Paper No. 3, University of Sheffield. P.17. Retrieved from: http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf

²⁰ International Labour Organisation (2011a) *Statistical update on employment in the informal economy*. Geneva: ILO.

²¹ Janeska, V. (2013) Labor market and labor migration in the Republic of Macedonia – changes and current situation. Paper presented at the 6th IZA/ASE Workshop on EU Enlargement and the Labor Markets. Available from: http://www.iza.org/conference_files/EUEnlargement_2013/viewProgram?conf_id=2594 (Accessed 10.10. 2014).

The discrepancy might be an indication that there is a crossover of Macedonians towards active job seekers and an opposite movement, towards passive job seekers thus undeclared work, of the other ethnic communities. This pattern is even more evident for women (see Figure 3) with 86% of the women active job seekers being ethnic Macedonian. Furthermore, what it might indicate is either a movement of ethnic Macedonians from passive to active job seekers, or movement of all other ethnic minorities from active to passive job seekers, or even both. While more research is necessary in order to explain this discrepancy, it might be a starting point for better targeted measures and policies in the field of undeclared work.

4. Institutional Framework for Fighting Undeclared Work.

4.1 Ministry of Labour and Social Policy (MLSP)

On a national and regional level, the Ministry of Labour and Social Policy (MLSP) is the main body that regulates the activity of all labor market institutions as well as constructing the main pillars around the social security contributions. The MLSP drafts legislation, programs and measures within the field of labor market regulation (including undeclared labor) and implements and enforces policies through the EA, Social Assistance Agency²² and State Labour Inspectorate (SLI). These specialized units further cooperate with the Inspection Surveillance Council (ISC), State Market Inspectorate (SMI), Public Revenue Office (PRO) etc.

The Action Plan for the reduction of the grey economy (Ministry of Economy, 2013; MLSP, 2014) was drafted by MLSP and represents a consultative effort to coordinate and monitor the activities of several institutions and regulatory bodies into the field of tackling undeclared labor and its different facets while at the same time clearly delineating responsibilities among them. The plan is consisted of repressive and preventative measures as well as measures that boost commitment and tax morale (for examples see The policy approaches framework used in Table 2 (established initially by Williams and Rennoy, 2009) shows clearly some of the more prominent measures undertaken by the GoM in order to deter and prevent undeclared work. Illustrating the key features of the measures aimed at the undeclared economy is a good starting point for evaluation and modification of implemented measures and a cornerstone for future measures.

Table 2). However, deficiencies are present within areas such as:

- despite some recent measures towards fostering commitment and tax morale the focus is predominantly on detection and control
- “in order for the fight against undeclared work to become a joint effort of the public administration as a whole, the plan would need to go beyond simply reinforcing the main tasks of each body separately, and provide a more substantial basis for cooperation and coordination of measures through shared strategies and targets, as well as mechanisms for information sharing and joint reporting (see Dekker et al, 2010).”²³

4.1.1 Employment Agency (EA)

The EA is responsible for managing active measures of employment as well as employment programs, such as the self-employment program and development of SME’s, through its 30 local branches. Through these programs it also plays an important role in enabling formalization of businesses and labor in general. According to the EA, since the inception of the self-employment program (2007-2014), 5,835

²² <http://zsd.gov.mk/>

²³ Dzhekova, Franic, Mishkov, C. Williams (2014), “Tackling the Undeclared Economy in FYR Macedonia” GREY Working Paper No. 3, University of Sheffield. Retrieved from: http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf p.34

micro and small enterprises were initiated with 72% of them being sustainable and still functioning successfully. The EA also works towards enhancing its capacities by implementing the following projects:

- EU project "Supporting Youth Employment, Long-term Unemployed Women (II)"
- EU project "Supporting the Employment Agency for Implementing Active Measures and Services in the Labor Market"
- EU project "Strengthening Relevant Stakeholders Towards Social Inclusion on the Local Level"
- USAID project "Youth Network for Acquiring Skills for Employment"²⁴

4.1.2 State Labor Inspectorate (SLI)

The State Labor Inspectorate (SLI) is the main enforcement body of the labor legislation and thus is responsible for exercising control over undeclared work through its four departments: a) The Labour Relations Department, b) Safety and Health at Work Department, c) Department for Legal Matters in the field of Safety and Health at Work, and e) Department for Coordination, Training and Administrative Enforcement.²⁵ Additionally, the SLI has 30 local offices which are organized into three regional departments where they are equipped with a total of 107 inspectors (72 labor relations inspectors and 35 Occupational Safety and Health OSH inspectors). As the main body executing deterrence and repressive measures (improving detection, increasing penalties and risk perceptions) in the period 2006-2012 the SLI conducted: 40,000 inspections in 2008, 32,000 in 2009-10, 31,146 in 2011 and 34,275 in 2012²⁶. A drop of 78% of detected undeclared workers in 2009 is one indication that increased control of the SLI led to positive results even though some of this decrease can be attributed to the general decrease of employment due to the economic crisis of 2008.²⁷ As an illustration, out of the detected inconsistencies with the Labor Code the SLI also detected 2,918 undeclared workers in 2010, 1,269 in 2011 and 1,033 in 2012.²⁶

Despite its successes there are areas within the work of SLI that need improvement:

- **Joint inspections** – between Operational Safety and Health (OSH) and Labor Relations inspections constitute only 10-20% of all inspections. There is a lack of common targets for different departments as well as lack of formal coordination procedures and joined-up strategies.²⁸ An increasing impetus is notable in the sphere of joint inspections between the SLI and the Public Revenue Office (PRO) in the field of tax collection.
- **Poor organization** – visits are poorly organized due to lack of data, time and registers. Inspectors do not use any procedural manuals, checklists or templates in their visits.²⁹
- **Data sharing and connectivity** - is insufficient or non-existent. There is currently no registry that exists in the MLSP. "Some public institutions such as the Central Register of Enterprises, the Taxation Authority, the Employment Agency, the State Statistics Office, the Health Insurance Fund and the Pension and Disability Fund have computerized systems at their disposal. However inspectors are not provided access to these databases."³⁰ Having said that, steps are taken

²⁴ Employment Agency, 2014. *Operational Plan for Active Policies and Measures for Employment* <http://avrm.gov.mk/content/Programaza2014.pdf>

²⁵ <http://www.mtsp.gov.mk/drzaven-inspektorat-za-trud.nsp>

²⁶ SLI Annual Report (2012), Retrieved on 10.01.2014 from: http://dit.gov.mk/godisnilzvestai_full.php?id=2012

²⁷ Mojsoska-Blazevski, N. (2011) *Supporting strategies to recover from the crisis in south eastern Europe: Country Assessment Report: The former Yugoslav Republic of Macedonia*. Geneva: ILO. Retrieved on 10.05.2014 from: http://www.ilo.org/wcmsp5/groups/public/@europe/@ro-geneva/@sro-budapest/documents/publication/wcms_167032.pdf

²⁸ Williams, C.C., Baric, M. and Renooy, P. (2013) *Tackling Undeclared Work in FYR Macedonia*. Dublin: Eurofound.

²⁹ International Labour Organization, (2011). *Labour Inspection Country Profile: Macedonia*. Retrieved from: http://www.ilo.org/labadmin/info/WCMS_114938/lang-en/index.htm

³⁰ Ibid

towards implementing network software allowing the SLI access to pertinent data from relevant institutions such as the EA, the PRO, the Central Registry etc.

4.2 Public Revenue Office (PRO)³¹

The progress reports of the European Commission (EC) (2010 - 2013) consistently point out to deficiencies in the operational capacity of the Macedonian tax administration and specifically refer to:

- Limited tax investigation and intelligence capacity
- Weak auditing and enforced collection capacity
- The IT infrastructure requiring further improvement

In the past few years the country has undertaken several administrative and legislative improvements in order to address these shortcomings.

“The PRO’s specialization and enforcement capacity were further improved by the establishment of a ‘Centre for debt collection’, a ‘Centre for seized goods’ and a ‘Tax Academy for training’ (EC, 2011b). In addition, a forensic (not yet operational) laboratory has been established for tackling high-risk tax fraud (EC, 2013).”³² By the end of 2014 the crossover to GSM fiscal cash registers, which gathers transactions data in real time from the point-of-sale to the PRO, should enhance the investigative powers of the PRO and other interconnected agencies and registers. “In 2012, administrative cooperation between the PRO and key investigative bodies was extended through signing of a memorandum for electronic data exchange with the Financial Police and the Financial Intelligence Unit (EC, 2012).”³³

Other numerous departments also share responsibilities on different aspects of tackling undeclared labor and deserve to be mentioned such as the State Market Inspectorate (SMI), the Health and Sanitary Inspectorate, the Central Register, the Centers for Social Work, the State Statistical Office (SSO), also including agencies such as customs, border police, financial police and immigration bodies.

5. Review of Types of Approaches and Measures Applied in Macedonia

The policy approaches framework used in Table 2 (established initially by Williams and Rennoy, 2009) shows clearly some of the more prominent measures undertaken by the Government of Macedonia (GoM) in order to deter and prevent undeclared work. Illustrating the key features of the measures aimed at the undeclared economy is a good starting point for evaluation and modification of implemented measures and a cornerstone for future measures.

Table 2 - Policy framework adapted from Williams and Renooy (2009) used in GREY Working Paper No.3 and updated (text in green color).

Approach	Method	Type of implemented measure
Deterrence (pursue and punish)	Improving Detection	<p>Labour Inspections</p> <ul style="list-style-type: none"> ➤ Establishment of a Misdemeanour Body within the Ministry of Labour and Social Policy consisting of two commissions – one for labour relations and one for occupational safety and health (2009/10) ➤ Strengthened rules for registered unemployed, e.g. required verification of job search activity (2012) ➤ Creation of the Inspection Surveillance Council (2012-2014) which is to coordinate the efforts and resources of all inspection and oversee their work.
		Control over the payment of income tax and social contribution

³¹ The PRO will be discussed in more detail in the following Policy Brief focusing on tax evasion and fraud.

³² Dzhekova, Franic, Mishkov, C. Williams (2014), “Tackling the Undeclared Economy in FYR Macedonia” GREY Working Paper No. 3, University of Sheffield. P.17. Retrieved from: http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf

³³ Ibid

	<ul style="list-style-type: none"> ➤ Establishment of 'Centre for debt collection', 'Centre for seized goods', 'Tax Academy for training' and a 'forensic laboratory' within the Public Revenue Office to tackle high-risk fraud and tax evasion (2011) ➤ Strengthened administrative cooperation and mutual assistance through electronic data exchange (Public Revenue Office, State Labour Inspectorate, etc.) (2012 and 2013) ➤ Temporary service contracts reform (07.2014) to tackle avoidance of social contributions ➤ Implementation of GPRS fiscal cash registers reform over all businesses which will provide direct link and oversight by the PRO.
<p>Increasing penalties Increasing perception of risk</p>	<ul style="list-style-type: none"> ➤ Obligation of the employer within 15 days to officially employ an undeclared worker upon detection by a labour inspector, as well as to pay to the worker three gross wages (2011)
<p style="writing-mode: vertical-rl; transform: rotate(180deg);">Enabling formalisation / compliance</p>	<p>Preventative (Deter Entry)</p> <p>Simplification of regulatory compliance</p> <ul style="list-style-type: none"> ➤ Simplifying regulations for starting a business ('one-stop-shop' system) (2009); ➤ Decentralisation of the tax service payments, e.g., opening of local 'Service Points' (2011) ➤ Encouragement of electronic filing of tax returns and electronic payment of the corporate income and VAT taxes (2013/14) <p>Direct tax incentives</p> <ul style="list-style-type: none"> ➤ Reduction and equalisation of the corporate and the personal income tax rate ('flat-tax rate') at 10% (2008) ➤ Tax rate of 1.5 % on total income for small businesses with an annual turnover of up to 3 million MKD (2008) ➤ Tax relief for reinvested profit (for investments over 100,000 Euros) (2008/09) ➤ Zero corporate income tax for non-distributed profits (2011) <p>Incentives for involvement in official employment and business operations</p> <ul style="list-style-type: none"> ➤ Tripartite Collective Agreement for social dialogue (2009) ➤ Harmonisation of the minimum and maximum social contribution base with the amount of the individual gross wage (2009) ➤ Progressive reduction in the compulsory social contribution rate to 26.5% (2011) and the pension contribution rate to 18% of the gross wage (2010) ➤ Adoption of the 'Minimum Wage Law', setting the national minimum wage at 36.9% of the national average gross wage for the given branch for the previous year (2012) ➤ Decrease in the maximum period of remuneration for unemployment from 60 to 18 months (2012) ➤ Provision of microfinance to business start-ups (particularly SMEs) (2012/13) ➤ Reduction in the cost of seasonal workers by easing the requirements for severance pay (introducing trial work in seasonal jobs and reducing the time for a firing notice) (2013)
	<p>Curative (encouraging movement out of the shadow economy)</p> <ul style="list-style-type: none"> ➤ Lower tax base for registered individual farmers (20% of the national average net wage (2008) ➤ Farmers with an annual income <300,000 MKD are exempted from paying an income tax (2008)
<p>Fostering commitment</p>	<p>Public campaigns and rising awareness initiatives</p> <ul style="list-style-type: none"> ➤ Hotlines for reporting undeclared work and labour-related irregularities (Ministry of Labour and Social Policy, National Employment Agency, Pension and Disability Insurance Fund and State Labour Inspectorate) ➤ Checklist for employers and employees of their respective legal rights and obligations (web page of the State Labour Inspectorate) ➤ Awareness raising campaign targeted at youths to promote successful transition from school to decent work. ➤ "Ask for a Receipt" awareness campaign to foster tax compliance. ➤ Campaign of 'public shaming' by the PRO publishing a black list of unpaid debts and late paying debtors on a monthly basis (2014)

Source - http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf p.41.

An array of approaches and policy measures is available for the purpose of tackling the hidden economy. They are generally preconditioned by the understanding of the underlying causes of hidden economic activities and hence, can be divided into two main views. The **neo-liberal view** argues that the undeclared economy is a direct result of high taxes, over-regulation of the economy and too much government interference in the realm of welfare provision. Therefore, economies should pursue tax reductions, deregulation and minimal state intervention to prevent the growth of undeclared economy. And a **social democratic** view arguing that the undeclared economy is a by-product of the deregulation of economies and reductions in state welfare provision, and that one should therefore bolster state expenditure on the labour market and welfare provision to tackle the undeclared economy.³⁴

However, as implied by Williams and Rennoy (2013) in a statistically significant correlation does exist between the size of undeclared economies and the level of state expenditure on labour market interventions, expenditure levels on social protection, the level of state redistribution via social transfers, and inequality. “Welfare regimes with greater labour market intervention, higher levels of social

Table 3 – Relationship between size of undeclared economy and work and welfare regimes.

	Undeclared work as % of GDP	
	r_s	R^2
Implicit tax rate	-0.266	0.102
Labour market expenditure	-0.599**	0.235
Social protection expenditure	-0.700**	0.467
State redistribution via social transfers	-0.642**	0.457
Inequalities (Gini coefficient)	0.448**	0.227

Source: Colin C. Williams, Piet Rennoy, (2013)

<http://www.eurofound.europa.eu/publications/htmlfiles/ef13243.htm>

protection, redistribution via social transfers and greater equality tend to have smaller undeclared economies ... it tentatively suggests that the undeclared economy will be reduced not only by pursuing targeted policy measures but also by modernising its work and welfare regime through higher levels of expenditure on state intervention in the labour market and social protection, coupled with redistribution via social transfers so as to improve social equality.”³⁵

6. Undeclared Labor in Macedonia – Survey Data

This section presents data from the population³⁶ and business³⁷ surveys conducted in the framework of the project “Promoting Good Governance and Economic Rights through Empowering Macedonian Civil Society to Monitor and Tackle the Hidden Economy in Macedonia Data” refer to the type of employment, (in)formality of employment, payment of salary, social and health insurance contributions.

In a situation where there is high unemployment rate, any job position is welcomed regardless of the working environment and respect of labour rights. Hence, workers tend to accept various labour arrangements that go against their interest, at least on the long run, such as working without a job contract or with a contract with ‘hidden clauses’. While the former situation was rarely noted in relation to a primary occupation, it was rather common in relation to secondary occupation. The latter situation, on the other hand, was more prominent referring to a secondary occupation.

³⁴ Colin C. Williams, Piet Rennoy, (2013) “Tackling undeclared work in 27 European Union Member States and Norway: Approaches and measures since 2008.” (Eurofound, 2013) Retrieved on 22.04.2014 from: <http://www.eurofound.europa.eu/publications/htmlfiles/ef13243.htm> p.25

³⁵ Williams, C.C., Baric, M. and Renooy, P. (2013) *Tackling Undeclared Work in FYR Macedonia*. Dublin: Eurofound. http://eurofound.europa.eu/sites/default/files/ef_files/pubdocs/2013/248/en/1/EF13248EN.pdf p .22

³⁶ National representative field-based survey on a sample of 1116 respondents, representative in terms of regional and demographical distribution. Survey performed during 10/2014.

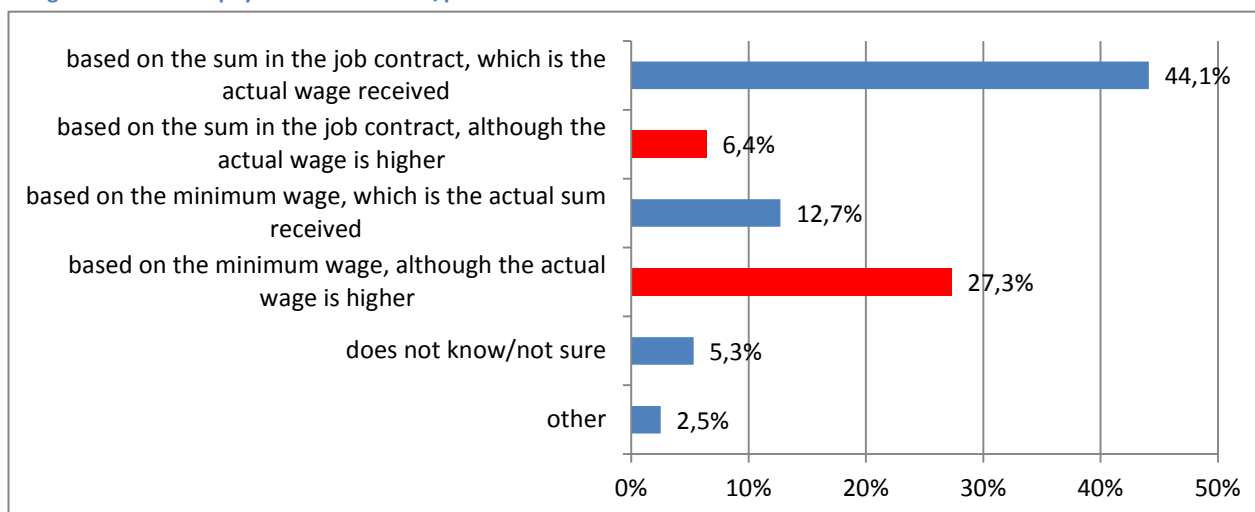
³⁷ Survey among representatives of 70 companies, representative in terms of regional distribution, primary sector and company size. Survey performed during 10/2014.

Nearly half of all survey respondents (48%) indicated they were employed with a primary occupation. The vast majority of them (84%) have a written job contract with the employer, while 6.6% reported they work without a contract and 9% are self-employed. Typically, those working without a contract are employed in the private sector.

Additionally, more than half of the interviewed employers (all from the private sector) for the business survey confirmed that in the sector they work, there are employees working without a contract, though the estimated percentage differs widely, ranging from 5% to 50% of the employees. While one-third responded that this happens all the time or in most cases, 30% claimed it happens sometimes, while one-quarter that this does not happen in their sector. In general, it is obvious that this practice is not unusual among companies, although its scope is difficult to be determined.

As ‘envelope payments’ represent another characteristic of undeclared labour, respondents of the population survey were also asked whether during the past month they have received part of the salary on their banking account, while another part in cash. 9.7% responded positively, though the amounts of the ‘envelope payment’ reported varied greatly, ranging from 500 denars to 25.000 denars (from 10€ to 400€), with the majority receiving 2.000-6.000 denars in cash (from 30€ to 100€). One has to contrast these numbers with the average net salary in Macedonia, which is 21,217³⁸ MKD (345€), in order to better understand the implications.

Figure 4 - Basis for payment of the social/pension insurance



Source – National Population Field Survey, conducted during 10/2014 with a representative sample size: 1116 respondents

Bearing in mind the sensitivity of the issue, and the tendency to underreport certain practices which are known to be illegal, another formulation was used as a control question, i.e: ‘What is the basis for your social/pension insurance payments?’ responses indicated a much more concerning trend. Specifically, 27.3% reported to have their social/pension insurance paid at the minimum wage level (which in 2014 was 8,800 MKD or 143€), although their actual wage is higher, and 6.4% on the basis of the sum included in the job contract, although their actual wage is higher (see Figure 4). Considering that the sum on which social security contributions are paid should correspond to the sum transferred to the banking account, it is assumed that the remaining of the salary has been paid in cash or through a temporary service contract. **This indicates that the proportion of employees receiving envelope payments, including the additional temporary service contracts as an instrument of avoiding social security contributions, is about one-third of the employed population.**

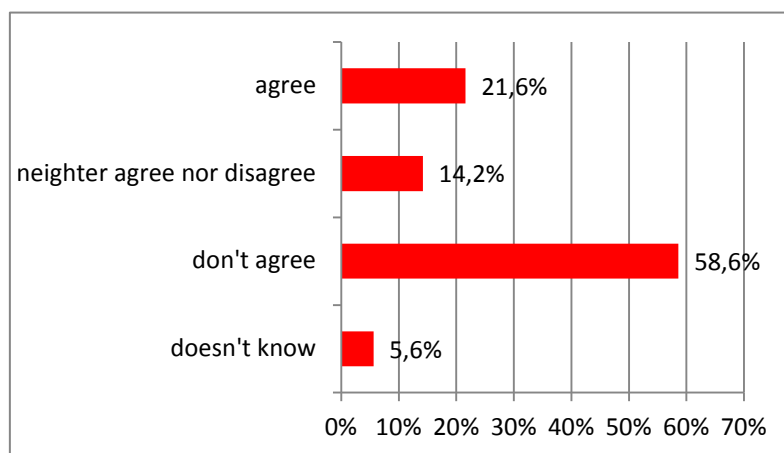
³⁸ State Statistical Office (SSO), Average Net Salary per Worker in Macedonia 07/2014, retrieved from: http://www.stat.gov.mk/PrikaziSoopstenie_en.aspx?rbtxt=40

The rather concerning indicator on incomplete social security payments, combined with the notion that 7% of respondents (almost exclusively from the private sector) reported that their pension insurance is not being paid at all, indicates that **the salary of about 40% of employees with a primary employment is partially or completely undeclared**. Interestingly, even half of respondents who declared as self-employed do not pay their insurance based on the actual wage received. The reasons could be based on the notion that social insurance contributions are too high, which is shared among 40% of company representatives surveyed.

The practice of signing contracts with ‘hidden clauses’ was also confirmed by company representatives, half of which noted that it happens in their sector and encompasses from 5% to 50% of employees, depending on individual observations. Overall, more than half of employers responded it happens in most of the cases or sometimes, a fact indicating the issue is quite prevalent among Macedonian companies.

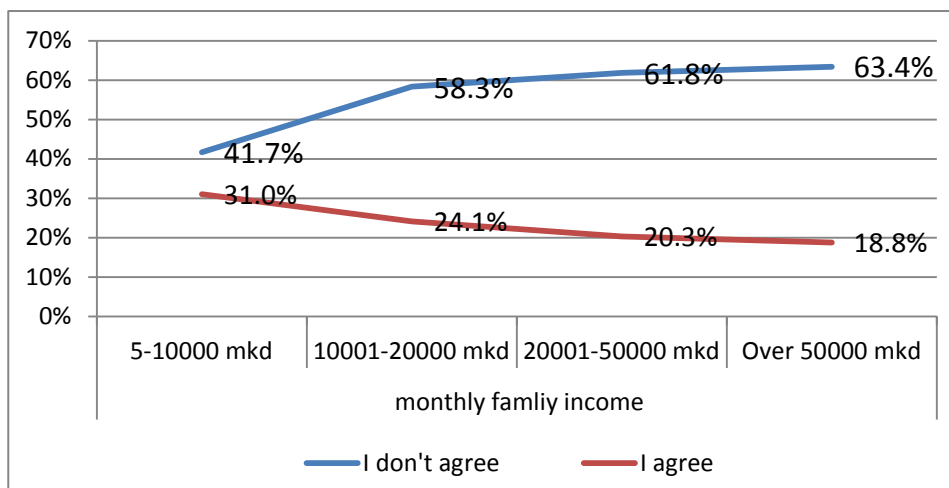
Whatever the motivation for such decisions, the reason for this situation does not only lay within employers, but also employees. Assessing their level of agreement with different statements related to the hidden economy, it is evident that the current level of satisfaction with the wage for many workers is much more important than the long-term security implied with the social insurance. Specifically, **21.6% responded that they would rather be an undeclared worker with a higher wage, than a declared one with a lower wage** (see Figure 5).

Figure 5 - Level of agreement with the statement ‘I would rather be an undeclared worker with a higher wage, than a declared one with a lower wage’



This opinion, however, appears to be related to the financial situation of the individual/family. Individuals assessing themselves as poor were more likely to prefer a higher wage than a socially secured lower wage, compared to the ones assessed as being in the middle or rich. Observed through the family income lenses, respondents with a monthly income of 5.000-10.000 MKD were more likely to accept undeclared work than those with income over 20.000 MKD (Figure 6). This goes in favor of the argument that the problem of undeclared work is in great deal related to the high poverty levels and is actually a coping mechanism used by individuals when trying to make ends meet with the finances they have. Nevertheless, this type of opinion and consequent behavior enhances the risk of economically disadvantaged groups to become even more at risk when in need of social security net.

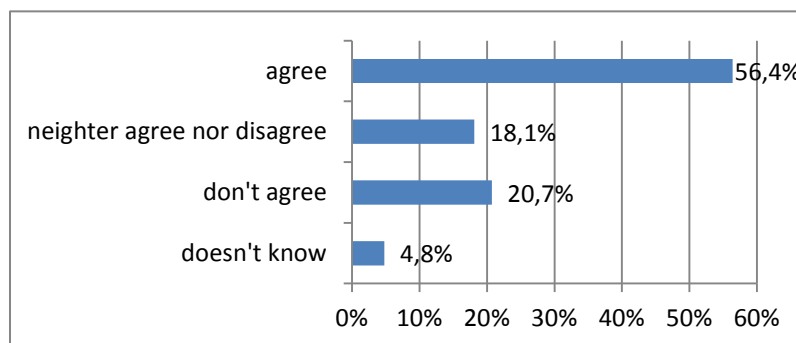
Figure 6 - (Dis)agreement with the statement ‘I would rather be an undeclared worker with a higher wage, than a declared one with a lower wage’ and monthly family income



Source - National Population Field Survey, conducted during 10/2014 with a representative sample size: 1116 respondents

Additional explanation for accepting undeclared work might be fact that the state-level security schemes are perceived by the majority of the population as not providing sufficient sense of security (Figure 7). Hence, they would prefer a temporary security which comes with a higher wage, rather than a diffident assurance of a longer term security grounded in the public security system. This once again confirms the importance of trust within institutions and the system in general, as a form of 'psychological contract' between the citizen and the state, important for the tax morale.

Figure 7 - Level of agreement with the statement 'State health and pension insurance do not provide sufficient sense of security'



Source - National Population Field Survey, conducted during 10/2014 with a representative sample size: 1116 respondents

When it comes to secondary / additional occupation the situation is more concerning, bearing in mind that in the vast majority of cases (80%) it is being performed without a contract. In case of a contract, it is fixed term, authorship agreement or another temporary agreement. In line with this, social and health insurance are also not being paid in 80% of the cases and over 50% of respondents do not report and/or pay personal income tax for their additional activity.

7. Conclusion

Undeclared work is one of the main manifestations of **hidden economy affecting people within a variety of socio-economic environments**. As an EU candidate country, with an unemployment rate of 28.2%, undeclared work estimated by some studies at 34.9% of GDP³⁹ and rising inequality (43.2 GINI index, 2009 est.), Macedonia has begun addressing the issue by creating an institutional framework for fighting undeclared work under the cap of the Ministry of Labour and Social Policy (MLSP), and State Labour Inspection (SLI) as its main enforcement body. There are other government bodies which are involved in the process and which are an inseparable part of this network of policies and measures, such as the Employment Agency, Inspection Surveillance Council, or Public Revenue Office (PRO). However, for the time-being, coordination, interconnectedness, and efficient data sharing is weak among them.

Macedonia, as most EU 27 countries, employs measures addressing undeclared work which focus predominantly on **repressive measures** despite some recent measures towards enabling formalization of labor (self-employment program) and fostering commitment. However, as shown in the survey conducted by CRPM, the proportion of employees receiving **'envelope' payments, or payments through temporary service contracts, is about one-third of the employed population. This, combined with the notion that about 7% work without a contract indicates that the salary of about 40% of employees with a primary employment is partially or completely undeclared.** The data shows that the space for improvement is vast and much more can be done. Improved data sharing and coordination among government bodies is of utmost importance in combatting undeclared labor, together with an increase in the number of incentives for suppliers to join the declared economy and measures to increase public awareness on the risks and downsides of joining undeclared labor market.

However, in order to effectively implement measures and improve operational capacities of the government institutions, more research is required on the conditions that lead to the existence of hidden economy in Macedonia in general, and on undeclared labor in particular, in order to capture the country specifics and better explain discrepancies within available data such as the one concerning active and passive job seekers.

³⁹ Williams, C.C., Baric, M. and Renooy, P. (2013) *Tackling Undeclared Work in FYR Macedonia*. Dublin: Eurofound.