

The Shadow Worker – Hidden Economy and Undeclared Labor in Macedonia, Albania and Kosovo

Policy Brief No.38, October 2016

1. Introduction

Often words such as “shadow”, “underground”, “informal”, “undeclared”, “grey”, and “unobserved” are interchangeably used with “hidden” to describe inevitably the same phenomenon but from a different perspective. To clarify - throughout the text “hidden” economy will be used to describe economic activities and practices which are legal (non-criminal) as to their nature but remain undeclared to the authorities unlike “Black” economy that refers to illegal (criminal) activities and practices. Although all these terms, encapsulated by the term “hidden” from here after, carry a negative connotation it must be noted that in the short to mid-term the hidden economy can aid societies and its

A factory worker has a second job at night as an unlicensed plumber for small household; an electrician installs a new water boiler and gets paid in cash while he avoids declaring that income to the tax authorities; an IT professional besides his minimum wage contract receives an additional ‘envelope’ wage; A single parent, mother of 2, in the employer’s benefit agrees to keep working on temporary service contract basis in order to keep her job and maintain basic sustenance level. These are all examples, or variations, of undeclared labor.

population to recover from severe economic crisis or transition, for example, from socialist to market

Key points

- **The large unemployment rate (24% in MK, 15.9% in Albania and 32.9% in Kosovo as of Q2 2016), is one of the most important indicators that give rise to hidden economic activities and practices.**
- **The main focus in tackling undeclared work, just as most Eastern European Countries, is on Labor Law violations. Measures aimed at improving detection and repressive measures are the dominant policy approach in these countries.**
- **Hidden salaries remain the most acute concern, with the employment income being partially or completely undeclared for almost half (44%) of employees in Macedonia (a rise from 40% in 2014), 36% in Albania and 37% of employees in Kosovo.**
- **Education matters in the informal economy. Only 56.8% of employees with primary education in Macedonia, 20.6% in Albania and none in Kosovo have acquired a written contract for their primary job compared to over 80% for employees with university degrees.**

based economy. However, in mid to long-term it jeopardizes workers safety net, increases inequality, unfair competition and economic imbalances.

There are wide regional and country differences in the size, scope and main sectors of operation of the undeclared economy in Europe which, according to

Eurofound figures, averages around “18% of EU GDP, ranging from below 8% of GDP (Austria) to over 30% of GDP (Bulgaria). Undeclared work is most prevalent in the construction industry, but is also widespread in household services, private security, industrial cleaning, agriculture, and the hospitality and catering industry.¹

Costs	Benefits
<p>For legitimate businesses:</p> <p>Causes unfair competition for legitimate businesses. Encourages ‘rate to the bottom’ as legitimate businesses evade to compete with shadow businesses.</p>	<p>Test-bed for business start-ups.</p>
<p>For undeclared businesses:</p> <p>Growth hindered because unable to access capital, secure business support or openly advertise. Pressured into exploitative relationships with legitimate businesses.</p>	<p>Can test-trade the viability of their business venture.</p>
<p>For undeclared workers:</p> <p>Lack access to credit and financial services, partly to limited credit history.</p> <p>No entitlement to labor rights (e.g. minimum wage, sick pay, redundancy rights).</p> <p>Higher barriers of entry to formal market due to inability to provide employment history.</p> <p>Cannot build-up rights to state pension and other contributory benefits, and access occupational pension schemes.</p> <p>Lack access to health and safety standards, as well as bargaining rights and voice.</p>	<p>Source of income.</p> <p>Reduces barriers to entry into work because much undeclared work is for close social relationships.</p>
<p>For customers:</p> <p>Lack legal recourse if a poor job is done, insurance cover, guarantees in relation to the work conducted, and certainty that health and safety regulations have been followed.</p>	<p>More affordable products or services for consumers.</p>
<p>For governments:</p> <p>Causes loss of revenue for the state in terms of non-payment of income tax, national insurance and VAT.</p> <p>Reduces money available to governments to pursue social integration and mobility.</p> <p>Loss of regulatory control over the quality of jobs and services</p>	<p>Puts brake on burdensome regulatory regimes.</p>

Table 1 - Cost & Benefits of Undeclared Work. Source: Colin C Williams (2014) “Confronting the Shadow Economy: Evaluating Tax Compliance and Behaviour Policies” <http://blogs.lse.ac.uk/politicsandpolicy/europes-hidden-economy-how-governments-can-bring-un>

¹ European Parliament News (02.02.2016) “European platform to tackle undeclared work.” Accessed 19.07.2016 <<http://www.europarl.europa.eu/news/en/news->

[room/20160129IPR11935/European-platform-to-tackle-undeclared-work](http://www.europarl.europa.eu/news/en/news-room/20160129IPR11935/European-platform-to-tackle-undeclared-work)>

Unavoidably the policy and economic landscape of the country in question creates particular sets of incentives which then produces specific costs and benefits of engaging with and/or in the hidden economy (See typical costs and benefits in Table 1).

This comparative policy brief provides an overview of hidden economy in general, and undeclared labor and tax evasion in particular, in Macedonia, Albania and Kosovo including its main causes and consequences. Additionally it offers a macroeconomic overview of the main characteristics considered to incentivize and maintain the hidden economy, while at the same time offering context in the form of processed survey data that also grasps the perceptions surrounding this very important issue. Furthermore, it delivers an outline of where this phenomenon might be headed, how these three countries compare and what measures are, and should be taken, to tackle it.

2. Macro-economic Factors and the Labor Market

The layout of the labor code, the unemployment rate (and its sub-categories), the national tax system represent the bulk of a complex web of factors

“Improving government performance to achieve social goals means switching from a tax-evading economy with no infrastructure and with mistargeted safety nets to a tax-paying formal economy with relatively small but efficient social safety nets. However, many of these reforms are not likely to be successful without a reduction in corruption and bureaucratic inefficiency.” (Alesina 1999) p.229

Source: Bank of Albania, “Albania’s Informal Economy: An Impediment to Economic Development” (2001), accessed 07.10.2016
<https://www.bankofalbania.org/web/pub/JanPeterOlters_240_1.pdf

determining the extent and structure of undeclared labor. Tightening the grip around hidden economy however is a double edged sword. On one hand by

government and its regulative bodies having loose control, in a way tolerating it, it allows significant loss of potential revenue and improvement of the quality and quantity of public goods and services.

On the other hand, if governments rush for using negative incentives (punitive measures, better enforcement) are used to tighten the grip on hidden economy it can produce very real and problematic side effects: reduced disposable income and higher labor costs would translate into decreased consumption, exports, and GDP. What can follow next is a decrease in formal employment on account of the hidden employment as companies struggle to increase price efficiency and productivity. Thus, monitoring and managing the hidden economy is a fine balancing act between the need for enforcement of present and future measures and satisfying the present needs of the overall economy in order for society to thrive and establish long term prospects.

High unemployment rate, youth and long-term unemployment fuels informality in Macedonia.

The most important and aggravating indicator related to the hidden economy in Macedonia is the fluctuating and high unemployment rate of 24% (Q2 2016). The extremely high rate of long-term unemployment (81.6% of the unemployed in 2015) suggests that a large share of the jobless have to engage in some form of hidden activity in order to achieve at least a basic level of subsistence. These undeclared workers are most likely to engage in industries and services where cash transactions are regularly performed, including a variety of handicraft services, the green bazaars, etc. The very high share of this subsistence sector of the hidden economy makes it even more difficult for the government to target other forms of undeclared employment, without infringing on the human rights of the former group. Many studies have confirmed the stubborn levels of undeclared work in Macedonia estimated to be at 34.9% of GDP.²

² Williams, C.C., Baric, M. and Renooy, P. (2013) *Tackling Undeclared Work in Macedonia*. Dublin: Eurofound.

Discretion in the application of rules and related corruption have a more important effect on the informal economy in Albania.

The unemployment in Albania is not as severe as in the other two countries but is still well above the EU average and stands at 15.9% (Q2 2016) and as such can certainly be a source of informality. There is very scarce information about the size of the undeclared economy. However by using different measurement methodologies the assessments range between 30 to 45% of the total GDP of Albania³ which is in line with Schneider's (2002)⁴ estimate and Albania's Statistical Institute (INSTAT) which estimate the informal economy at 1/3 of the country's GDP in 2000.⁵ According to the ILO approximately 27% of non-agricultural workers are wage employees in the informal economy, and this is mostly in the construction sector.⁶

High youth unemployment rate hurts economic growth in Kosovo.

Kosovo is a lower-middle-income country with has witnessed a modest economic growth rate since the end of the war in 1998-1999. It has about 1.8 inhabitants and a large diaspora population living in Western European countries. According to UNDP, one out of four Kosovars currently lives abroad and their remittances make up to one fifth of GDP.⁷ To that effect, the economy is heavily dependent on remittance payments from abroad and solid inflow of donor support.⁸

Kosovo is behind in terms of economic growth if compared to neighbouring and European

Survey Methodology

CRPM/IDM/D4D population survey 2016

The data presented below are based on three methodologically identical population surveys, representative regionally and demographically, conducted in May and June 2016 in Macedonia (1097 participants), Albania (1102 participants) and Kosovo (1100 participants). Additionally, results of the same population survey conducted in Macedonia in October 2014 are presented for a comparative overview of the changes over a two-year period. Face-to-face household surveys are one of the direct methods for assessing hidden economic activity and provide qualitatively different and more varied information compared to the traditionally used indirect approaches which usually present the hidden economy as % of the GDP. According to the survey results, the primary and secondary occupation landscape can be seen in Table 2.

Table 2 - Percentage of respondents who reported to have primary and (different types of) secondary occupation. Source: CRPM/IDM/D4D population survey 2016

	MK	AL	KS
Primary occupation	50.9	54.5	50.7
Secondary paid occupation	10.5	23.8	3.2
Activities related to household production	10.3	24.6	14.1
Paid services to friends/family	1.6	3.8	25.8
Unpaid services	5.2	7	25.1

³ ETF (2010), "Albania Country Information Note 2010 - 2012", ETF, Turin, <<http://www.etf.europa.eu>>

⁴ Schneider, Friedrich, 2002, "The Value Added of Underground Activities: Size and Measurement of the Shadow Economies of 110 Countries all over the World," Johannes Kepler Universitat Linz, Mimeo. (First version, June 2002).

⁵ According to Schneider's (2002) estimation method, the size of Albania's informal sector is comparable to those in Lithuania (30.3 percent), Croatia (33.4 percent), Bosnia

and Herzegovina (34.1 percent), Romania (34.4 percent), and Bulgaria (36.9 percent).

⁶ International Labor Organization (ILO), "Albania Decent Work Country Programme Document 2008–2010" (2008), accessed 07.10.2016, www.ilo.org/public/english/region/eurpro/.../dwcp_albania.pdf

⁷ UNDP. Kosovo Human Development 2014. September 2014, p. v.

⁸ World Bank. Republic of Kosovo: Kosovo Public Finance Review. June 2014, p. 1.

countries. It has the lowest gross domestic product (GDP) per capita at 2,900 Euros in 2013.⁹ In South East Europe, Kosovo has the highest poverty rate with almost 30 percent of population living below the poverty line and the highest unemployment rate at 30.9 percent.¹⁰ According to the official labor statistics it has remained well above 30 percent in the last four years. World Bank estimates indicate unemployment to be highest among youth exceeding 55 percent¹¹. Given the poor quality of education and limited job opportunities, it makes it difficult for youth to enter the labor market. As a consequence, many of them engage in low-skilled labor and/or informal economy. To many economists, the informal sector is disruptive to the national economy and a deterrent to development. According to Riinvest institute's interpretation of World Bank data the unemployment rate in Kosovo exceeds 30 percent, grey market reaches 40 percent of the country's GDP¹² and inequality of 26.7 (GINI index 2013).¹³ The state budget, therefore, loses more than 300 million euros annually (just accounting for lost potential VAT), that could have been otherwise used to improve the quality and quantity of public goods and services. Among many other things, it leads to loss of revenue, and reduces the availability of employment benefits and rights.¹⁴

Many authors (Loayza 1997, and Johnson, Kaufmann, and Shleifer, 1997) claim that economies with large informal sectors, such as in Macedonia, Albania and Kosovo, tend to be stuck in a vicious circle of low-quality public goods and a high degree of fiscal evasion. The authors have analyzed a substantial

number of Eastern European and former Soviet Union transitional economies and they found that businesses react to an increasing degree of politicization of private-sector activities with a tendency of withdrawing from the formal sector¹⁵, which implies that, without synchronous reforms to strengthen market-supporting institutions, macroeconomic stabilization is not sufficient for maintaining high economic growth. Friedman (2000) further enhances their finding by claiming that selective application of rules/rule of law, and the corruption that this system inefficiency produces, seems to have a more important effect¹⁶ than for e.g., higher marginal tax burden, which are frequently cited as a principal reason for large informal sectors.

⁹ Ibid, p. ii.

¹⁰ Ibid, p. 1.

¹¹ World Bank, The World Bank Group in Kosovo, Country Snapshot (2015). Accessed 07.10.2016
<<http://www.worldbank.org/content/dam/Worldbank/document/eca/Kosovo-Snapshot.pdf>>

¹² Riinvest Institute, "To Pay or Not to Pay - A business perspective of Informality in Kosovo" (2013).
<http://riinvestinstitute.org/publikimet/pdf/BUSINESS_IN_FORMALITY_5mm_bleed_no_inside_ENG_FINALV_313964_38573.pdf>

¹³ The World Bank GINI Index data (2006-2013), Accessed 15.09.2016
<<http://data.worldbank.org/indicator/SI.POV.GINI?locations=XK>>

¹⁴ Colin C. Williams, "The undeclared sector, self-employment and public policy", International Journal of Entrepreneurial Behavior & Research, Vol. 11 Iss: 4, pp.244 – 257, accessed 28.09.2016

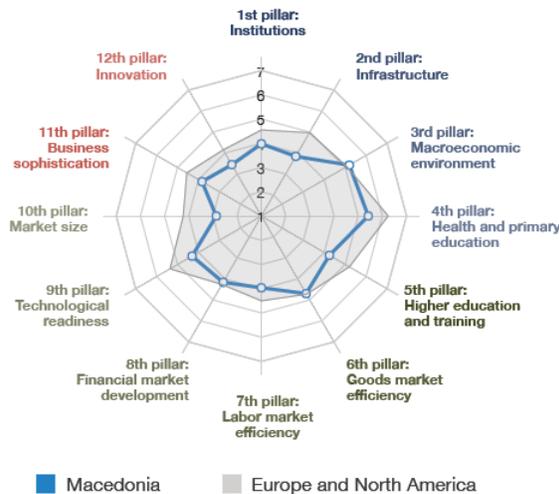
<<http://www.emeraldinsight.com/doi/pdfplus/10.1108/13552550510603289>>

¹⁵ Johnson, Simon, Daniel Kaufmann, and Andrei Shleifer, (1997), "The Unofficial Economy in Transition" Brookings Papers on Economic Activity, No. 2, pp. 159-221.

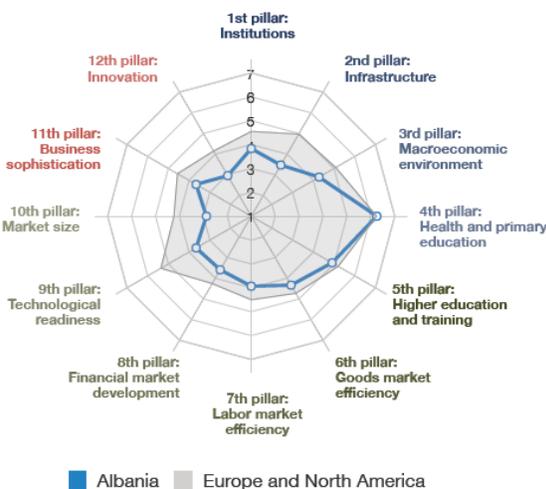
¹⁶ Friedman, Eric, Simon Johnson, Daniel Kaufman, and Pablo Zoido-Lobaton, (2000), "Dodging the Grabbing Hand: The Determinants of Unofficial Activity in 69 Countries," Journal of Public Economics, Vol. 76 (June), pp. 459-93. P.481.

Figure 1 - Macedonia's and Albania's rankings in the Global Competitiveness Index (2016-2017). Source: World Economic Forum http://www3.weforum.org/docs/gcr/2015-2016/Global_Competitiveness_Report_2015-2016.pdf.

Edition	2012-13	2013-14	2014-15	2015-16	2016-17
Rank	80 / 144	73 / 148	63 / 144	60 / 140	68 / 138
Score	4.0	4.1	4.3	4.3	4.2



Edition	2012-13	2013-14	2014-15	2015-16	2016-17
Rank	89 / 144	95 / 148	97 / 144	93 / 140	80 / 138
Score	3.9	3.8	3.8	3.9	4.1



World Economic Forum annual global competitiveness indexing, based in accordance with their established 12 pillars/factors (See 1), sheds some light of the policy landscape that unavoidably has an impact on the informal economy in a regional and temporal context. Macedonia experienced worsening of the indicators which brought her ranking 8 positions (68th) in the period of 2016-2017. Largest space for

improvement remains in the pillars: infrastructure, market size, technological readiness and innovation. Unlike other years, mostly due to the prolonged political crisis, **policy instability now represents the most problematic factor for doing business in Macedonia** followed by access to financing, inadequately educated work force, and poor work ethic in national labor force. Albania improved its ranking by 13 positions (80th) and shares the same space for improvement as Macedonia - infrastructure, market size, technological readiness and innovation. However **the most problematic factors for doing business in Albania start with corruption at the top and followed by tax rates, inadequately educated work force, access to financing, and once again, policy instability.** These rankings, year by year, provide a general picture of potential or contemporary elements of undeclared labor and tax evasion and help researchers target the sources and manifestations of hidden economic activities.

3. Undeclared Labor – Survey results

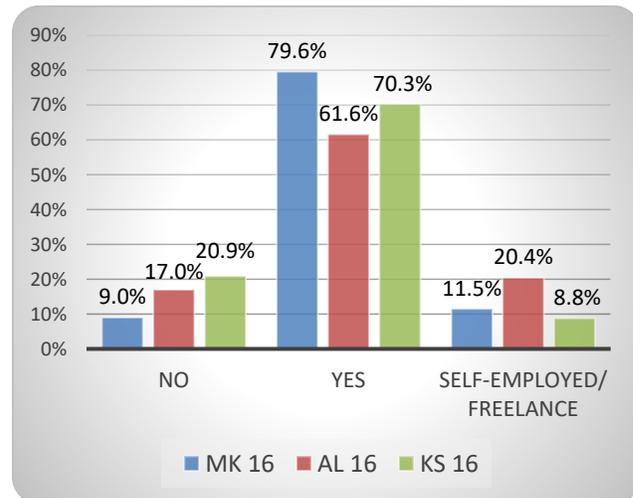


Figure 2 - Do you have a written contract for your primary job (Q.3)? Source: CRPM/IDM/D4D survey 2016 (population).

Almost half of all employees in Macedonia have part of their salary hidden, and every fifth employee in Kosovo and Albania work without a written employment contract. Written employment contracts represent an important instrument with which employees acquire legal protection under the labor law and ensure payment of social and healthcare contributions. The lack of a written contract thereof represents a source of employee insecurity and an

incentive for hidden economic activities such as undeclared labor coupled with unfair competition among employers which usually follows hidden economic activities. The international Labor Organization has also concluded that “On average, compared to formal workers, informal workers have lower earnings and face higher risks, are less likely to enjoy economic opportunities and legal protections, and are less able to exercise economic rights and collective voice.”¹⁷ Figure 2 shows that **9% of all Macedonian employees work without a contract (a rise from 7% in 2014)**, and are not being paid any social security contributions whatsoever.

The percentage of these employees **in Albania and Kosovo is double and represents 17% and 21% respectively** of all employees. Using the absolute values for no contract responses from Figure 2 and compiling them with the data from Figure 4 below indicates that the percentage of hidden salaries remains the most acute concern, with the **employment income of around 1/2 of employees in Macedonia (44%, a rise from 40% in 2014), 36% in Albania and 37% Kosovo being partially or completely undeclared.**¹⁸

Secondary/additional employment plagued by absence of written contracts

When it comes to secondary / additional occupation, including the self-employed, the situation is more concerning with the vast majority of secondary occupations in Macedonia and Kosovo (around 90%), being performed without a written contract. In cases where contracts do exist, they are usually fixed term, authorship agreement, or another type of temporary service contract. Albania seems to fair better than the other two countries with still sizeable 55.6% of employees with secondary occupation not having a

written contract (including the self-employed).

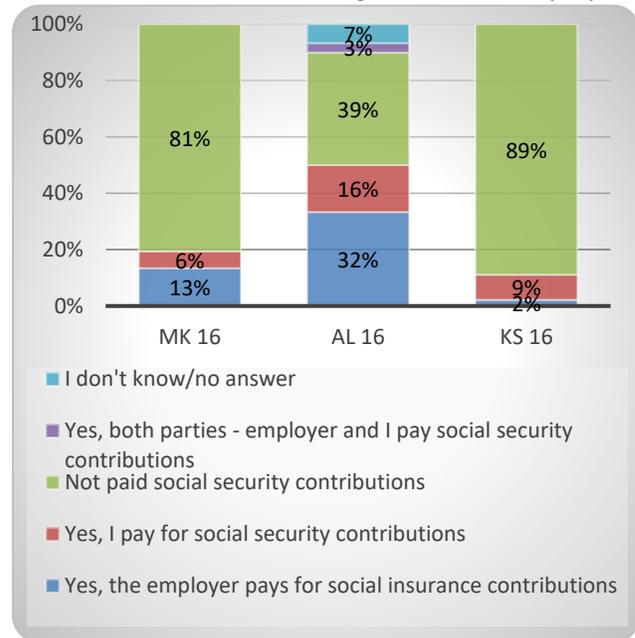


Figure 3 – “Who pays your social security contributions? (Q.13)” CRPM/IDM/D4D survey 2016 (population).

In line with this, social security contributions are also not being paid in more than 80% of the cases in Macedonia and Kosovo, and 39% in Albania. Additionally, healthcare insurance for secondary employment is not paid by 77.3% of employees in Macedonia, and 100% in Kosovo.

Secondary/additional employment characterized by extremely low levels of payment of social security, healthcare contributions and personal income tax

Albania again fares much better in this respect due to the different payment system for social and healthcare contributions where comparatively just 1/3 of secondary employment employees not having it paid. **Around 60% of respondents in Macedonia and Albania, and almost 90% in Kosovo do not report and/or pay personal income tax for their additional activity.**

¹⁷ ILO (2013) *Labour inspections and undeclared work in the eu*. Accessed on 25.08.2016

<http://www.ilo.org/wcmsp5/groups/public/---ed_dialogue/---

[lab_admin/documents/publication/wcms_220021.pdf](http://www.ilo.org/wcmsp5/groups/public/---lab_admin/documents/publication/wcms_220021.pdf)>

¹⁸ The different percentages for the category “No Contract” in Figure 4 vs Figure 2 can be accounted to the use of the absolute

values from Figure 2 or question Q.3 from the survey into the percentage calculation of the values in Figure 4 or question Q.7A from the survey. Simply adding the “No Contract” percentages from Figure 2 to Figure 4 would not have been methodically correct.

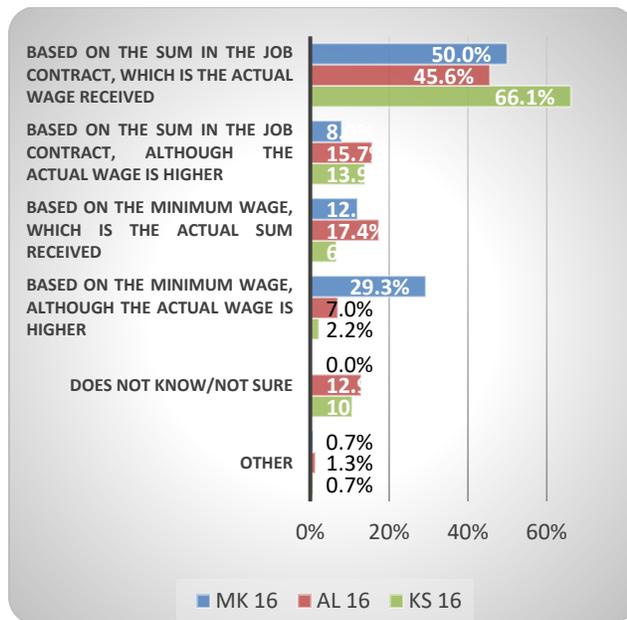


Figure 4 - What is the wage amount on which your social security contributions are being paid by your employer (Q.7A)? Source: CRPM/IDM/D4D survey 2016 (population).

Having or not having a contract does not necessarily show the full spectrum of hidden employment. As presented in Figure 4 the difference between the wages written in the contract and the actual amount paid (through envelope wages or other types of temporary service contracts) also provides a good insight that inspectors and labor ministers can use to appropriately tweak their measures aimed at tackling undeclared labor. As the first figure shows, more than **1/3 (37.3%) of employees in Macedonia, ¼ (22.7%) in Albania and 1/5 (20.5%) in Kosovo have their social security contribution paid by employers on contracted wages that are lower than the actual wage they receive.** The situation in Macedonia is slightly worse than in 2014. While in Macedonia and Albania around half of employees have wages paid that equal the amount established in their contracts Kosovo employees fair better in this category with 66.1% confirming this good practice. The difference, again, might be accounted by the fact that Kosovo employers are not legally bound to pay for their employees' health insurance.

Negative perceptions over state social and healthcare insurance might fuel incentives for informality

While assessing their level of agreement with different statements related to the hidden economy, it becomes evident that the current level of satisfaction with their wage for many workers is much more important than the long-term security implied with regularly paid social and healthcare contributions. Specifically, **22.1% responded that they would rather be an undeclared worker with a higher wage, than a declared one with a lower wage in Macedonia, 22.7% in Albania and, interesting enough, just 7% in Kosovo.** Kosovars have positive perceptions over formal economy and view it as more stable in the long-term given the benefits they will ultimately gain in terms of pension contributions.

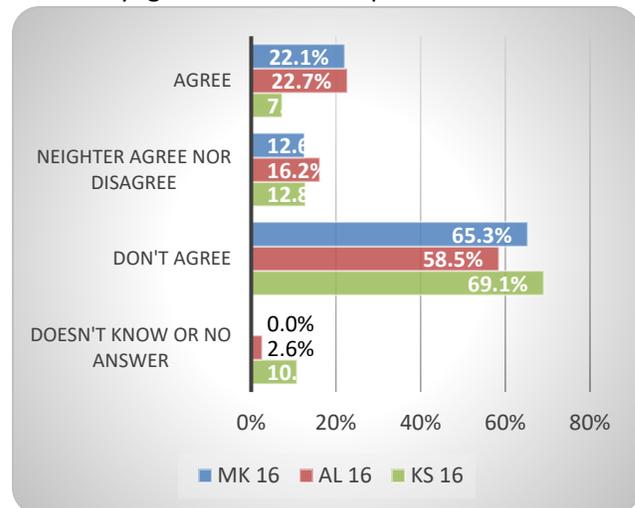


Figure 5 - Level of agreement with the statement 'I would rather be an undeclared worker with a higher wage, than a declared one with a lower wage' (Q MK11 E). Source: CRPM/IDM/D4D survey 2016 (population).

Disagreement with the statement on the other hand is solid across all three countries ranging from 65.3% of employees in Macedonia (improvement from 58.6% in 2014), 58.5% of employees in Albania, to a high of 69.1% in Kosovo.

Education, not surprisingly, plays an important role in shaping perceptions, future decisions, and available job opportunities in the context of the specific labor market and its elements of demand and supply. The data strongly indicates that education plays a significant role in the distribution of written contracts acquirement which is evident by looking at the different levels of educational attainment. This is a hint for regulatory bodies as to where to dedicate more resources in detection but also in increasing

targeted educational measures on a local and national level.

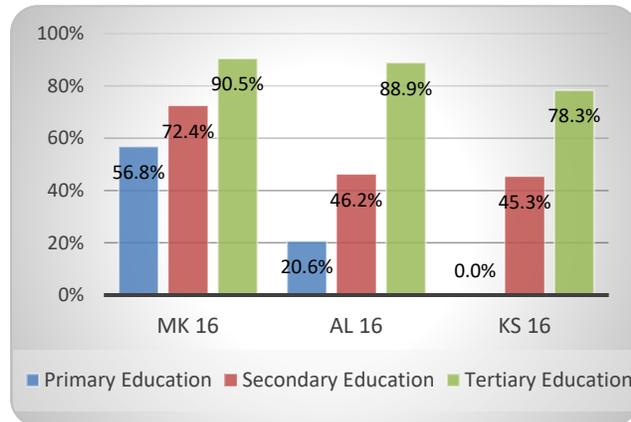


Figure 6 - Percentage of population with written contract for primary job according to educational attainment % (Q3 vs Q.D3). Source: CRPM/IDM/D4D survey 2016 (population).

The data shows noticeable differences with regards to educational attainment levels where only 56.8% of employees in Macedonia, 20.6% in Albania and none in Kosovo¹⁹ with primary education have acquired a written contract for their primary job. The situation for employees with tertiary education further enhances the importance of education as 90.5% of employees in Macedonia with tertiary education, 88.9% in Albania and 78.3% in Kosovo have acquired a written contract for their primary job (See Figure 6). The data clearly show, unsurprisingly, that the probability of working under a written job contract increases with the level of educational attainment, and this is especially drastic when employees move from attaining primary to secondary education.

Mashing up the data from the previous question with the total household income present an additional view into the incentives for engaging in hidden labor and/or tax evasion (See 7). Between 67% and 72% of Macedonian employees disagree with the statement while between 22% and 17% of them agree with the statement similarly across all household income levels. This is a big improvement from 2014 (flattening of the agreement/disagreement curves) especially in the household income levels ranging from 0 to 325 EUR. Kosovo employees appears to follow similar

perceptions as the ones in Macedonia in 2014 which 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 safety net.

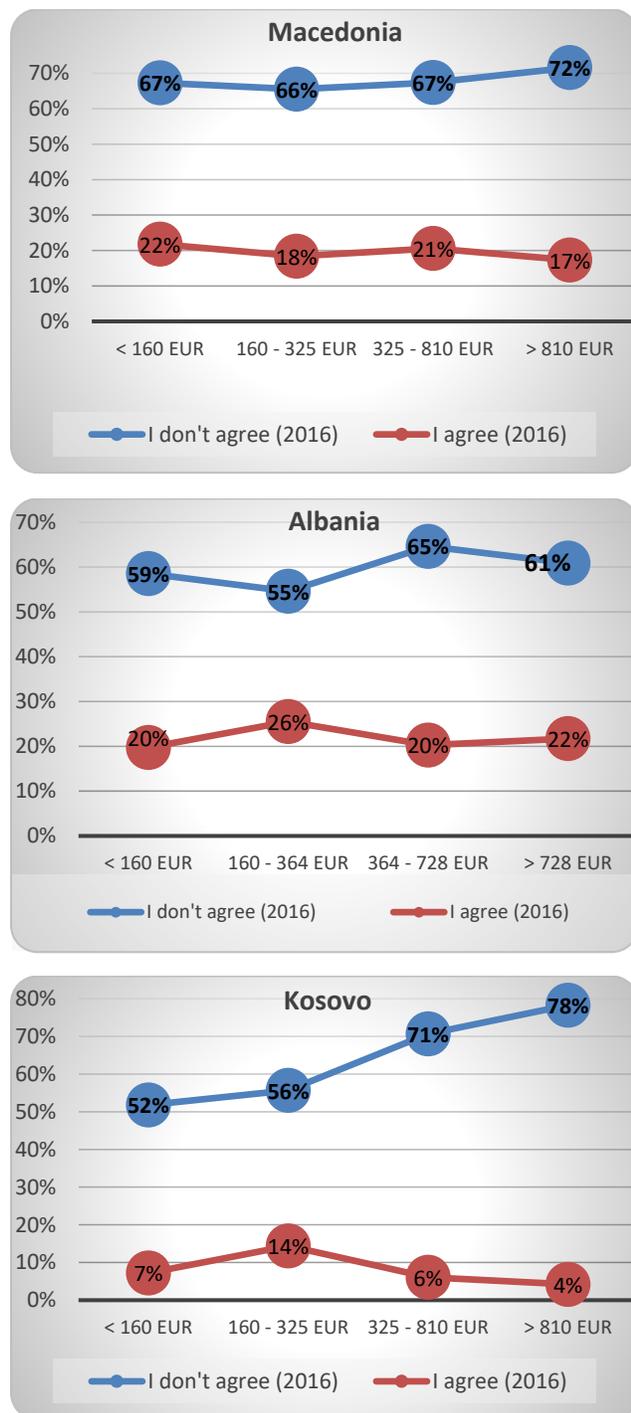
Progressive tax system implemented without positive measures to incentivize high earners to declare labor and pay their taxes is deemed to enhance incentives for hidden economic activities i.e. tax evasion.

The data on Albania however tells a different story. Generally what we want to see is upward curving disagreement slopes and downward curving agreement slopes. This is in line with the fact that Albanian employees living in households earning up to 728 EUR agree and disagree with the statement in percentages relatively similar to what can be seen in Macedonia and Kosovo. **However level of agreement decreases from 65% to 61% for wealthier employees– living in household earning incomes larger than 728 EUR.**

¹⁹ The reason for this is that the in survey sample from Kosovo just 9% of respondents have primary education or

less. And of those almost all are unemployed or just have a secondary activity with no employment contract.

Figure 7 – Macedonia, Albania and Kosovo, (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 household income (Q. D27B vs. MK11E). Source: CRPM/IDM/D4D survey 2016 (population).



There can be many intertwined factors responsible for this discrepancy but one of them might be related to the fact that since 2014 Albania canceled its 10% flat income tax rate and introduced progressive income tax of 13% for incomes between 220 and 950 EUR as well as a 23% income tax of employees with income larger than 950 EUR.²⁰ The progressive income tax is an additional tax burden which might incentivize higher earning employees to have a negative attitude towards formalizing businesses which in turn can lead them to seek ways in avoiding to declare their activity or other measures to evade paying taxes despite having the means to do so. The findings that will be presented in the following brief on hidden economy and tax evasion will provide more context and data on the possible relation among these factors.

4. Conclusion

Undeclared work is one of the main manifestations of **hidden economy affecting people within a variety of socio-economic environments** which at the same time is characterized with possible **negative outcomes ranging from social tensions, rising inequalities and income gaps to corruption and criminal activities**. Two countries have EU candidate status, and Kosovo has signed the stabilization and association agreement with the EU but all three are characterized by higher unemployment rates than the EU average of 9.6% (Apr. 2015), consequently high levels of undeclared work estimated by some studies to be more than 30% of the GDP of the three countries and rising inequality.

The large **unemployment rate (24% in MK, 15.9% in Albania and 32.9% in Kosovo as of Q2 2016)**, is one of the most important indicators that give rise to hidden economic activities and practices. However despite recent findings of greater efficiency of soft measures the main focus in tackling undeclared work, just as most Eastern European Countries, is still largely on Labor Law violations. Even though recently there are measures aimed at **improving detection/better targeting still employing repressive measures** is the

²⁰ Invest in Albania website, Short overview of the Albanian tax system. Accessed 05.10.2016 <<http://invest-in-albania.org/taxation-system/>>

dominant policy approach in these countries. Hidden salaries remain the most acute concern, with the **employment income being partially or completely undeclared for almost half (44%) of employees in Macedonia (a rise from 40% in 2014), 36% in Albania and 37% of employees in Kosovo.**

Substantial 9% of all Macedonian employees with primary employment work without a contract (a rise from 7% in 2014), and are not being paid any social security contributions whatsoever. The percentage of these employees **in Albania and Kosovo is double and represents 17% and 21%** respectively of all employees. Secondary employment is plagued by even starker figures. 40% of secondary job employees in Albania and above 80% in Macedonia and Kosovo work without contracts and no social and healthcare contributions are being paid.

Education matters in undeclared labor. **Only 56.8% of employees with primary education in Macedonia, 20.6% in Albania and none in Kosovo have acquired a written contract for their primary job compared to over 80% for employees with university degrees.**

More than **1/3 (37.3%) of employees in Macedonia, ¼ (22.7%) in Albania and 1/5 (20.5%) in Kosovo** have their social security contribution paid by employers on contracted wages that are lower than the actual wage they receive. Secondary/additional employment is plagued by absence of written contracts and **around 90% of these employees** in Macedonia and Kosovo (Albania being the exception here) **have no written contract** and only very few are dedicated in paying their social security, healthcare contributions and personal income tax.

This policy brief is just the tip of the iceberg of the data describing the hidden economy dynamics in Macedonia, Albania and Kosovo and in particular undeclared labor. All the aspects of the undeclared labor in Macedonia, Albania and Kosovo presented here are to serve as a roadmap, for researchers and policymakers working in the field, to better position present policies and targeting mechanisms in order to decrease hidden economic tendencies while at the

same time making sure that the needs of the most vulnerable in these societies are adequately met. The next policy brief will analyze the dynamics of tax evasion in the three countries and how it matches and reacts to changes in the policy landscape and the incentives/disincentives framework that have been created on the road of the policy making process. In conclusion, even though there is a tendency to label undeclared workers and their economic activities as “bad” one has to be aware that also “... in reality it is a natural and unprovoked reaction of the incapability of the formal economy to satisfy the needs of a part of its society members.”²¹

²¹ Mema, Fatmir and Zef Preci (2003), “Comments on: Hidden Economy a Barrier for a Sustainable Development”, Fourth Conference of Bank of Albania “The

Albanian Economy: Progress and C 2003, Saranda, Series of books on scientific conferences, 63-69. P. 63.