

# Burdened Business is a Hidden Business – Business Perspective of the Hidden Economy in Macedonia, Albania and Kosovo

*Policy Brief Nr. 40, April 2017*

## 1. Introduction

If there are couple of terms that have been overused in the past political campaigns and are almost without exception a part of each heads' of state speech are job creation, private sector development (SMEs), budgets, taxes and revenues. That is why the hidden economy remains a topic of interest for policy makers, economists and academics alike as it affects each of those issues to a varying degree and carries a potential to solve some of the shortcomings instilled in them through action or inaction.

There is a growing acceptance that at different scales the hidden economies are here to stay due to their resilient nature and adaptive capacities to changing political, legislative and economic environments. The belief in the opposite, that the hidden economy can be eradicated it is not only unlikely but also counterproductive as it can carry substantial benefits to the local population and the economy by using it as a buffer in times of hardship or transition. In fact, globalization and deregulation of the world economy seem to have generated conditions in which the heterogeneous hidden economies can thrive and expand.<sup>1</sup> In fact informal businesses, especially start-

## Key points

- Whereas around half of businesses in Macedonia in 2014 stated that the tax rates for respective taxes were 'as high as they should be' - with a notable exception of the company tax and social security - in 2016 these values have dropped to 30-35%.
- 1/3 of businesses in Macedonia (31.4%) and two thirds in Albania (60%) and Kosovo (62.3%) have confirmed that manipulating with VAT is a common practice. Macedonia sees deterioration in this manner (by 50%) as only 21.6% of businesses have confirmed this practice back in 2014.
- 'Corruption' is the most important factor for the existence of the hidden economy according to 45.7% of businesses in Macedonia, 72.9% in Albania, while in Kosovo 'Corruption' is in second place (48.6%) just after 'High tax burden' (60%).
- The hidden turnover is more significant in Albania where 84.3% of companies confirmed the presence of this practice out of which a large portion (40%) confirmed the practice to be used 'in most cases.'

<sup>1</sup> Castells, M. and Portes, A. 'World underneath: The origins, dynamics, and effects of the informal economy', in: The Informal Economy: Studies in Advanced and Less

Developed Countries, ed. Portes, A. et al. Baltimore: Johns Hopkins University Press.

up enterprises which initially function informally can carry a significant potential value for the economy as their activities can be tied up with innovation and entrepreneurship which can have high value added over the long term. The heterogeneity of the phenomenon of hidden economy is visible by just looking at the different adjectives attached to it: informal, parallel, clandestine, grey, underground, shadow, unregulated, subsistence, coping, non-monetized, alternative, and so on.

In the previous policy briefs (Nr. 38 and 39) we have focused on the elements surrounding the phenomena of the hidden economy that are closely linked to individuals and the general population. This brief will look at the data coming from the business surveys conducted in the three countries in 2016 in order to shed light on this phenomena from the business perspective which is equally, if not more, important for understanding the hidden economy dynamics in Macedonia, Albania and Kosovo.

## 2. Tax Evasion – Business Survey Data

**For the majority of businesses interviewed in Macedonia, the current tax system does not represent a problem for development of their business (28.6%) or represents an insignificant problem (31.4%), regardless of the size of the company, or in total 60% of the business in 2016 (compared to 65% in 2014).** Similar as in 2014, the largest detected problems are the unfair competition, assessed as a medium and big problem by 64.3% of businesses, political situation in the country (50%), and crime, theft and unrest (50%). Businesses have increased their negative perceptions

### *A signal for the Government of Macedonia – corruption now is a bigger business concern compared to 2014.*

*In 2016 Macedonian businesses seem to be more concerned about corruption and measures to tackle it rather than with more effective simulative measures for businesses.*

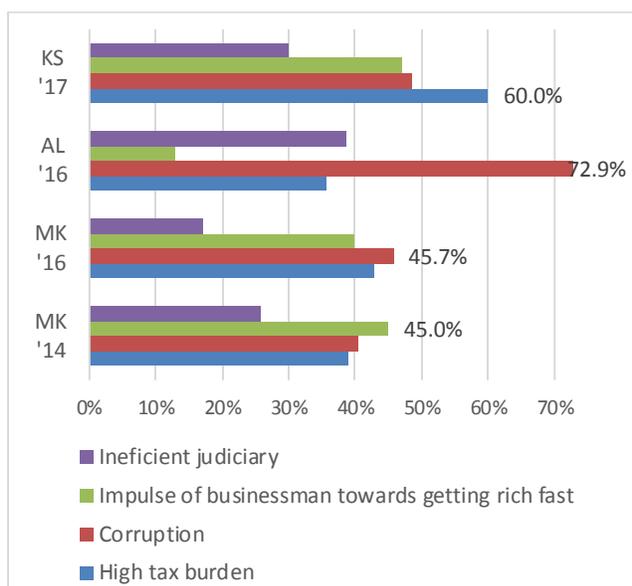
about the political situation in Macedonia by 1/3 and today 37.1% perceive it as a problem (compared to 26.5% in 2014).

These negative perceptions are also evident when businesses are asked to point out the most important factors responsible for the occurrence of the hidden economy.

**Namely, factor number one chosen by 45.7% of businesses in Macedonia is ‘corruption’.** Nevertheless, apart from the general satisfaction with the tax system in the country, taxes are considered to play an important role in the occurrence of hidden economic activity. Specifically, the ‘high tax burden’ is considered to be the second most important factor for the existence of hidden economy, selected by 42.9% of business representatives, after the ‘impulse of businessmen towards getting rich fast’ (40%) (Figure 1).

	MK '14	MK '16	AL '16	KS '16
<b>Factor Nr.1</b>	Impulse of businessman towards getting rich fast (45%)	Corruption (46%)	Corruption (73%)	High tax burdening (60%)
<b>Factor Nr.2</b>	Corruption (40%)	High tax burden (43%)	Inefficient judiciary (39%)	Corruption (48.6%)
<b>Factor Nr.3</b>	High tax burden (39%)	Impulse of businessman towards getting rich fast (40%)	High tax burden (36%)	Impulse of businessman towards getting rich fast (47.1%)

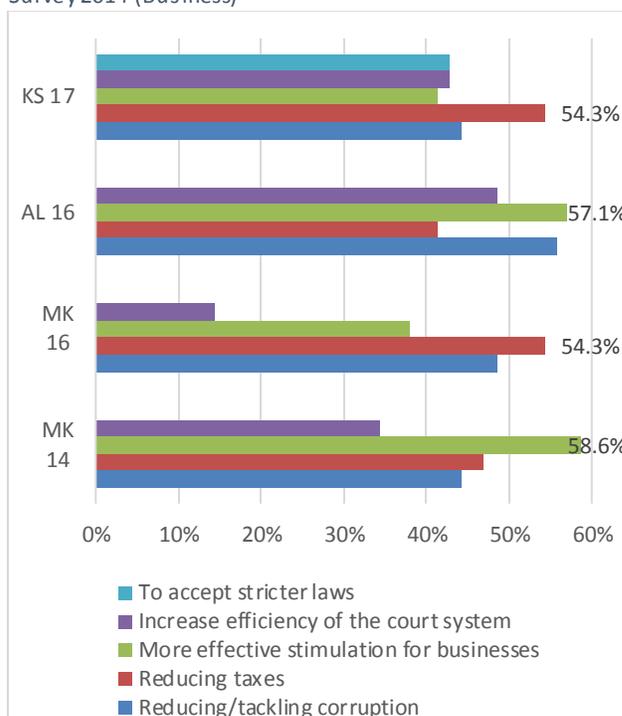
Figure 1 - Most important factors for the existence of hidden economy (Q.C14). Source: CRPM/IDM/D4D 2016-2017 survey and CRPM/CSD Survey 2014 (Business)



Consequently, and in line with the findings from the 2014 CRPM/CSD business survey, the top three measures proposed by **Macedonian businesses** for reducing hidden economy include – **‘reducing taxes’** selected by **54.3%** of businesses; **‘reducing/tackling corruption’** (**48.6%**); and **‘introducing more effective stimulation for businesses’** (**38%**), (See Figure 4Figure 2). The difference is that in 2016, as showcased by both Figure 1 and Figure 2, **Macedonian businesses view corruption as a bigger problem for the economy** and put more importance of the need of implementing **measures that reduce or tackle corruption**.

Similarly, in **Albania tackling/reducing corruption is second most chosen measure by businesses (55.7%) for reducing the hidden economy and more effective stimulation for businesses, selected by 57.1% of business representatives as the most favored measure**.

Figure 2 - Measures for reducing the Hidden Economy. (Q. C15). Source: CRPM/IDM/D4D 2016-2017 survey and CRPM/CSD Survey 2014 (Business)



However almost half of Albanian businesses (48.6%) stated a need for increased efficiency of the court system which might be an indicator for some functional deficiencies of the court or legal system in the country.<sup>2</sup> This can be attributed, to the very high risk the businesses and citizens experience in the judicial system of Albania such as bribing court officials in exchange for favorable judicial decisions and the lack of accountability of judges and prosecutors alike. Global competitiveness reports 2015-2016<sup>3</sup> and EU progress report 2015<sup>4</sup> give additional weight to this claim. Bribing is one of the 11 hidden economy practices explored by the conducted **business surveys which in deed confirm the large extent of bribing with 1/3 of businesses in Albania (35.7%) and 1/4 in Kosovo (22.9%) and only 1/10 in Macedonia (8.6%) claiming these practice being used ‘constantly’ or ‘in most cases.’**

<sup>2</sup> GAN Business Anti-Corruption Platform report on Albania <http://www.business-anti-corruption.com/country-profiles/albania>

<sup>3</sup> World Economic Forum: Global Competitiveness Report 2015-2016 <http://reports.weforum.org/global-competitiveness-report-2015-2016/>

<sup>4</sup> EU Progress Report 2015 [https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/key\\_documents/2015/20151110\\_report\\_albania.pdf](https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/key_documents/2015/20151110_report_albania.pdf)

A 2016 judicial system reform should address some of the detected deficiencies which also have an impact on the extent of hidden economy practices used. More time is necessary to evaluate whether the aims of this reform, as well as the new Constitution, will redefine the judiciary and the prosecution system, counteract the extensive corruption in the justice system, reveal and break the bonds of judges and prosecutors with politics and crime etc., and generally bring more accountability and transparency in the Albanians justice system. **In fact corruption is such a big issue in Albania that ¾ of interviewed businesses (72.9%) claim corruption to be the most important factor for the existence of the hidden economy, followed by 'inefficient judiciary' (38.6%) and 'high tax burden' (35.7%).**

Kosovo shares many of the business concerns present in Macedonia and Albania about factors of and measures for tackling the hidden economy in the country. **The most important factor for the existence of hidden economy is 'High tax burden' (60%), followed by 'Corruption' (48.6%) and 'impulse of businessmen towards getting rich fast' (47.1%).** Not surprisingly, **top three suggested measures to reduce the hidden economy are decreasing taxes (54.3%), reducing/tackling corruption (44.3%) and sharing the third spot at 42.9% business approval are 'implementing stricter laws' and 'more efficient judiciary.'** The last 2 suggested measures are related

to their views evident from some of the answers in the survey that many of the legal offences and breaches go unpunished. In relation to business satisfaction with the tax rates of different taxes there seems to be a change in perceptions in Macedonia. Whereas **around half of businesses in 2014 stated that the tax rates for**

Figure 4 - How would you assess the size of different tax rates in Macedonia? Q. C17. Source: CRPM/IDM/D4D 2016-2017 survey and CRPM/CSD Survey 2014 (Business)

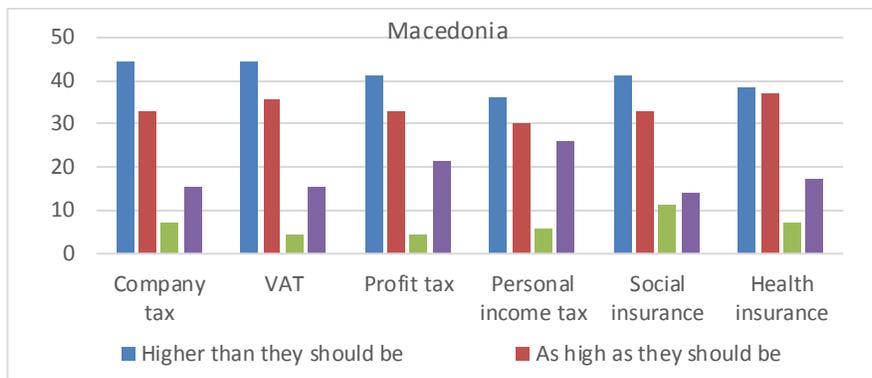


Figure 5 - How would you assess the size of different tax rates in Albania? Q. C17. Source: CRPM/IDM/D4D 2016-2017 survey and CRPM/CSD Survey 2014 (Business)

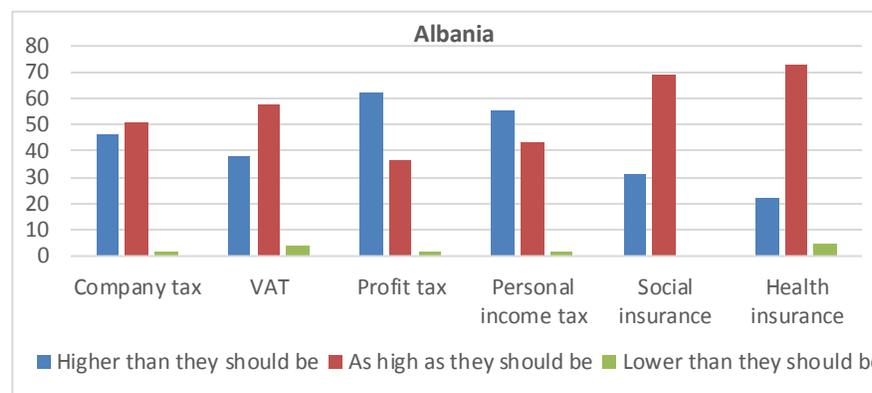
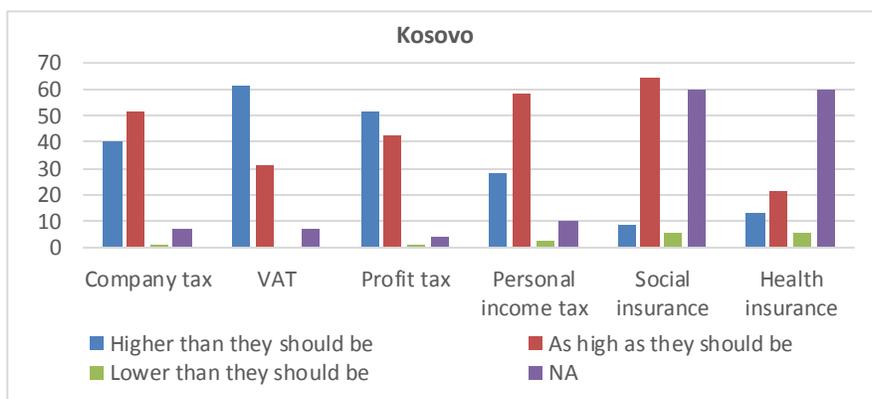


Figure 3 - How would you assess the size of different tax rates in Kosovo? Q. C17. Source: CRPM/IDM/D4D 2016-2017 survey and CRPM/CSD Survey 2014 (Business)



respective taxes were 'as high as they should be' and with a notable exception of the company tax and social security, in 2016 these values have dropped to around 30-35% (see Figure 4).

In 2016 more businesses voice opinions that the 'taxes are higher than they should be' than 'as high as they should be.'<sup>5</sup> Given that there hasn't been significant changes in the established tax rates since 2014 the reason for the perception skewness might be the growth of negative business perceptions related to the ongoing political crisis that affects GDP growth (despite projected GDP growth of 3.5% and 3.7% for 2017 and 2018 by the National Bank of R. Macedonia), general business prospects, future domestic and foreign direct investments as well as construction and its related branches which were the leading engines of the Macedonian economy up to 2016.

**Business perspectives over the height of taxes in Albania differ significantly in relation to Macedonia. Albanian businesses overwhelmingly claim that taxes are 'as high as they should be' with 69% and 73% of businesses claiming social and healthcare contributions rates respectively are set at proper levels.**

In relation to company tax and VAT more than half of businesses again claim that the taxes are as they should be. However business disagree to a larger extent when it comes to the **established rates for profit tax and personal income tax and 62% and 55%, respectively, of the Albanian businesses surveyed claim that these taxes are higher than they should be.**

Kosovo shares many of the business sentiments present in Macedonia and Albania but at the same time presents its own challenges to its business landscape. **Business satisfaction with the taxes is quite mixed but points to general dissatisfaction with more than half of the businesses claiming that the VAT (61.4%) and profit tax (51.4%) are higher than they should be.** However from the 3 countries Kosovan businesses show an overwhelming

satisfaction of the **personal income tax with 58.6% of businesses claiming that it is 'as high as it should be'**. This goes in line with the fact that 60% of the Kosovar businesses (the most compared to Macedonia and Albania) chose 'high tax burden' as the most important factor for the existence of the hidden economy.

### 3. Businesses and utilization of established hidden economy practices

Governments very often produce detailed strategies for combating the negative effects of the hidden economy and assigning activities to multiple state and not so frequently to non-state actors which involve dozens or hundreds of measures across several laws and ministries. This approach works only if the country has a well-functioning and coordinated government. However in most of the cases these strategies are used for reporting in front of international institutions. Especially in developing countries with substantial parts of the population living on or below the poverty line the Governments are less likely to take a tougher stance on enforcing measures, such as the ones dealing with the hidden economy in order to avoid causing large scale social unrest.

When Governments do not comply completely with their own strategies, and their agencies do not coordinate well, they are not penalized by voters during elections, and agencies which do not coordinate well are not penalized administratively. These incentives for governments not to comply with their own strategies are even more pronounced when the policies at hand are emotionally charged and mostly concern measures directly affecting vulnerable groups (unemployed, undeclared workers, low income households) which carry the potential for high media coverage and very high potential to hurt the voting base of the party in power. Thus, smart policies that take into account particular vulnerabilities and take a more

<sup>5</sup> Note: Compared to 2014 in 2016 there are significantly more respondents that responded with NA to this

question which might be the reason for the skewness towards negative business perceptions of taxes.

consultative approach before putting measures in place will have a better chance to be accepted by the general population and thus followed through by governments.

There are various methods that businesses utilize in order to avoid or manipulate with tax reporting and tax compliance. Some of the most common ones are:

1. **Hiring a worker without contract or with contract with hidden clauses;**
2. **Reporting lower revenue and/or turnover;**
3. **Non-payment of duties, taxes and excise;**
4. **Giving and taking bribes;**
5. **Not issuing bills and invoices;**
6. **Insisting on performing cash payments;**
7. **Performing procurement without tender;**
8. **Executing deals in kind;**
9. **Executing illegal inflow or outflow of assets;**
10. **Manipulating the VAT tax payment;**
11. **Using accounting tricks in order to pay lower taxes.**

These hidden economy practices vary across countries in accordance with the specific policy and tax leakages shaped by the measures that have been undertaken and others that have not yet been implemented. For example measures such as forcing businesses, from retail, trade and hospitality sectors, to install GPS enabled fiscal cash registers tries to combat VAT fraud and evasion while giving access to the country's Public Revenue Service to substantial amount of real time data which they can use to monitor and better target audits and inspections to higher risk groups and at the same time avoid unnecessarily burdening tax payers who comply with the tax regulations.

The hidden economy survey for businesses performed in 2014 in Macedonia and in 2016-2017 in Macedonia, Albania and Kosovo gives a rare look into the frequency of use of the 11 hidden economy business practices by some entities in the private sectors in these countries. As described previously, one of the ways to avoid taxes is to report lower turnover than the actual one and in Macedonia 54.4% of the surveyed companies confirmed that this hidden economy practice is used within their sector

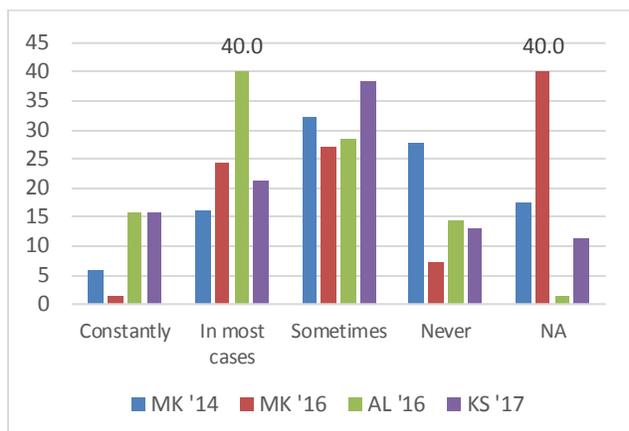
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*“VAT-related losses occur either through conventional, non-organized tax evasion (not issuing taxable receipts, underreporting sales of actual products and services, or overvaluing spending on inputs) or through more organized abuse of the system involving fictitious transactions with absent or insolvent traders (i.e. carousel fraud). The former involves one (i.e. retail without tax receipts) or a maximum of two parties (business to business, when manipulating the amount on invoices) during transactions. The latter involves complex networks including real businesses (i.e. real producers, logistical companies, accountants' offices) and zero assets companies owned by poor, uneducated or even convicted people, among whom multistage paper transactions are made.”*  
*SELDI.net – Hidden Economy and Good Governance in Southeast Europe: Regional Assessment Report 2016.*

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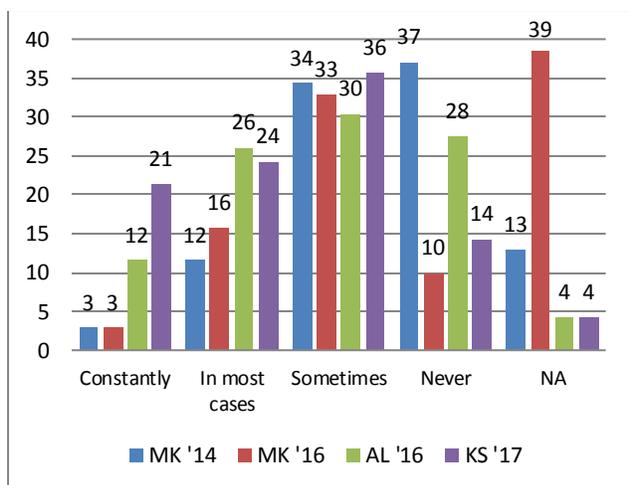
‘constantly’, ‘in most cases’, or ‘sometimes’ (Figure 6). It must be noted however that the ‘NA’ answers for Macedonia for 2016, particularly for the hidden economy practices of businesses, have more than doubled compared to the survey results from 2014 which increase the likeliness of the results presented for Macedonia to be underestimated. **The hidden turnover is more significant in Albania and Kosovo where 84.3% of companies confirmed the presence of this practice in their respective sectors out of which large portions have confirmed the practice to be used ‘constantly’ and ‘in most cases’ by 55.7% of businesses in Albania and 37.1% in Kosovo.**

Figure 6 - How frequently companies tend to report lower turnover than the actual, Q 12G. Source: CRPM/IDM/D4D 2016-2017 survey and CRPM/CSD Survey 2014 (Business)



Reporting lower revenue is yet another hidden economy practice of avoiding the tax authorities reach (Figure 8). Similar as in 2014 more than half of businesses in Macedonia (54.4%), ¼ of businesses in Kosovo (74.3%) and almost all businesses in Albania (84.3%) have confirmed this practice to be performed constantly, in most cases or sometimes. In fact one quarter of Albanian (22.9%) and Kosovar (24.3%) businesses have stated that this is performed 'constantly.'

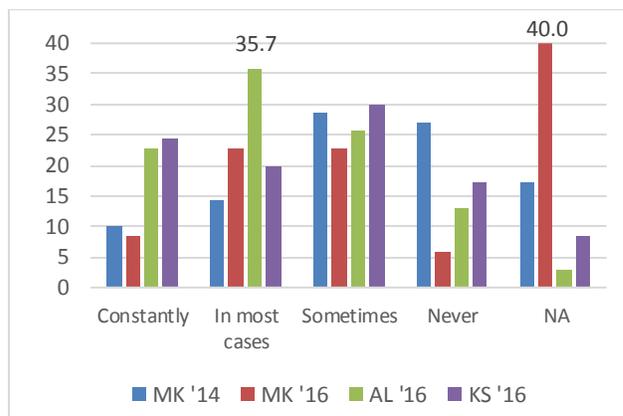
Figure 7 - Not issuing fiscal bills and invoices, Q 12F. Source: CRPM/IDM/D4D 2016-2017 survey and CRPM/CSD Survey 2014 (Business)



By using the results from the 2016 hidden economy population surveys we can confirm some of these findings especially by using the data on provision of fiscal receipts. For example 17% in Macedonia, 52% in Albania and 29.6% of respondents from Kosovo

have confirmed that they have never or rarely received fiscal receipts for clothes and shoes. For tobacco and alcohol 20% in Macedonia, 52% in Albania and 40% from respondents in Kosovo have also confirmed that they have never or rarely received fiscal bills. Although cases of never receiving fiscal receipts are relatively rare across all three countries and are kept below 18%, there are notable exceptions such as for Albania for the categories alcohol/tobacco (26.5%), books (28.3%), and for Kosovo also for books (26%). The business survey confirms, and goes beyond, these findings from population surveys in part with the fact that **52% in Macedonia, 68% in Albania and an extensive 81% of surveyed businesses in Kosovo have confirmed that non issuance of fiscal receipts/invoices is performed constantly, in most cases and sometimes in their respective sectors** with predominance of the 'sometimes' answer (Figure 7).

Figure 8 - How frequently companies tend to report lower revenue than actual, Q 12C. Source: CRPM/IDM/D4D 2016-2017 survey and CRPM/CSD Survey 2014 (Business)

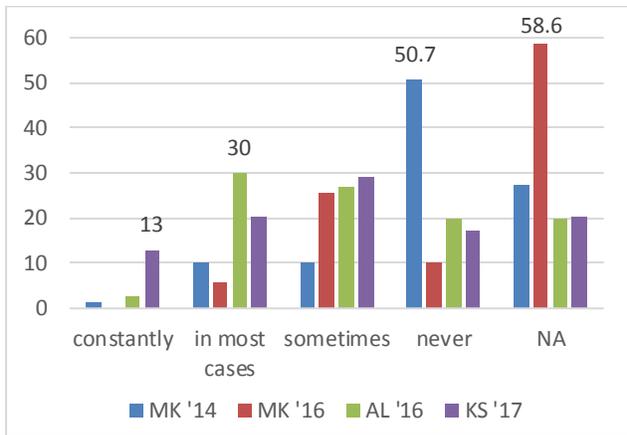


As previously described, the population and business surveys in Macedonia, Albania and Kosovo portray business environments with noticeable tendencies of businesses to hide part of their revenue streams/turnover which in turn negatively affects fair competition and government oversight, and with that public revenues.

Another method employed by some businesses in order to pay lower taxes is manipulating with the VAT and employing accounting tricks (Figure 9 and Figure 10). 1/3 of businesses in Macedonia (31.4%), and 2/3 in Albania (60%) and Kosovo (62.3%) have confirmed

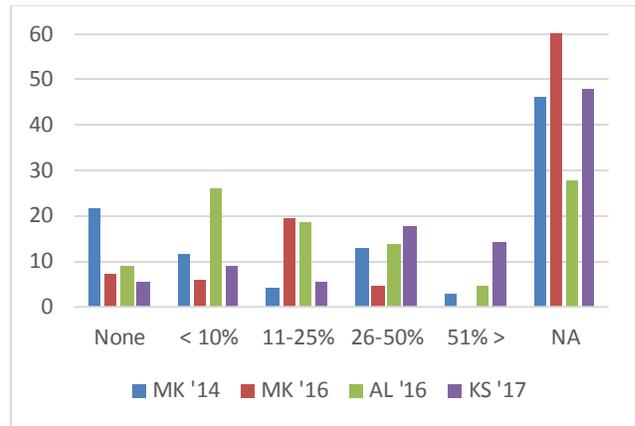
that this practice is used ‘constantly’, ‘in most cases’ or ‘sometimes’ with predominance of the latter two categories. Macedonia in 2016 sees deterioration in this manner as only 21.6% of businesses have confirmed this practice in 2014, or a deterioration of stunning additional 50% from its 2014 values (Figure 9).

Figure 9 - How frequently companies tend to manipulate with the VAT? (Q.C12\_L). Source: CRPM/IDM/D4D 2016-2017 survey and CRPM/CSD Survey 2014 (Business)



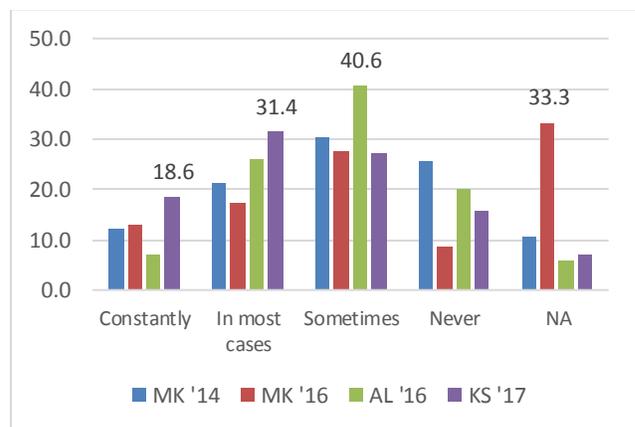
Similarly, as we can see from Figure 10 that **1/4 of companies in Macedonia (24.2%), 1/3 of companies in Albania (32.3%) and 1/4 of companies from Kosovo (23.3%) believe that between 11% and 50% of companies in their sector pay lower taxes than they should by employing these hidden accounting tricks.** However it needs to be noted that in general companies in Macedonia are less forthcoming with acknowledgments of this practice happening in their respective sector as large part of them didn't not provide an answer or did not know.

Figure 10 - What percentage of companies in your sector pay lower taxes than they should by using accounting tricks, Q. C25B. Source: CRPM/IDM/D4D 2016-2017 survey and CRPM/CSD Survey 2014 (Business)



Another important aspect which was the focus of the population survey is the extent of hiring workers without work contracts or contracts with hidden clauses. The business survey confirms the widespread use of this practice in line with the values provided with the population survey and **1/3 of businesses in Macedonia (30.4%) and Albania (33.3%), and 1/2 of interviewed businesses in Kosovo (50%) claimed that these type of workers are hired ‘constantly’ or ‘in most cases.’** As for providing workers with contracts with hidden clauses 25.7% of businesses in Macedonia, 52.8% in Albania and 31.5% on Kosovo claimed that this happens ‘constantly’ or ‘in most cases’ in their sectors.

Figure 11 – How frequently companies in your sector hire workers without work contracts? Q. C12A. Source: CRPM/IDM/D4D 2016-2017 survey and CRPM/CSD Survey 2014 (Business)



## 4. Conclusion

The governments of Macedonia, Albania and Kosovo have to remain devoted to and continue with reforming and investing in the operational capacities of their respective Public Revenue Office, Financial Police, and the State Market and Labor Inspectorate especially in the fields of performance assessment, electronic interconnectedness, data sharing, and electronic services for individuals and businesses. At the same time it has to **make sure that: the tax burden remains low enough to maintain steady but increasing rates of revenue, develop and maintain stimulating business environment, simplify procedures for opening new businesses and formalizing established businesses, and use past policy experiences to avoid creating incentives that push businesses and individuals towards tax evasion and fraud.**

Business perceptions over what they consider to be the biggest factors contributing to the existence of the hidden economy can provide road maps to governments on what important policies to focus on in order to achieve biggest impact. According to businesses governments should make more focused and concerted efforts to tackle corruption, minimize tax burden and improve the efficiency of the judiciary if they want to decrease the level of hidden economic activity. This is especially true for **corruption which was singled out by 46% in Macedonia, 73% in Albania and 49% on Kosovo as the most important factor for the existence of the hidden economy and followed by inefficient judiciary, high tax burden (Factor nr.1 in Kosovo) and impulse of businessmen for quick profit.**

Even though according to businesses high tax burden is among the top three factors for the existence of the hidden economy they still are generally satisfied with the level of taxes but Macedonia shows a worrying trend. Whereas **around half of businesses in Macedonia in 2014 stated that the tax rates for respective taxes were 'as high as they should be' and with a notable exception of the company tax and social security, in 2016 these values have dropped to**

**30-35%.** Growing political instability and perceived corruption, as noted throughout the text, could be to blame for this disparity. This is a signal for the GoM that immediate steps need to be taken to restore stability and return business trust to the 2014 levels before it starts affecting economic growth, and with that public revenues. With decreased economic growth, or in worst case recession, the present dynamics of the hidden economy as well as the available policy landscape and measures, the vicious circle of hidden economic activities will without doubt be intensified.

**Albania on the other hand differs significantly in relation to Macedonia and the surveyed Albanian businesses overwhelmingly claim that taxes are 'as high as they should be' with 69% and 73% of them claiming social and healthcare contributions rates respectively are set at proper levels.**

Accordingly, among the **top 3 measures proposed by businesses in the three countries for reducing the hidden economy suggest that certain good governance deficiencies are contributing to creating fertile ground for development of hidden economy:**

- 1. Reducing taxes;**
- 2. Reducing/tackling corruption;**
- 3. More effective business stimulations;**
- 4. Increase efficiency of the court system;**
- 5. Implementing stricter laws.**

Working in the hidden economy often is not a matter of rational and profit maximizing behavior by individuals and business entities but is often determined by educational attainment, culture or it can even be socially embedded. Thus an effective hidden economy countering policy also needs to be a comprehensive social policy. Designed policies need to target formalization of the whole economic value chain and clusters of economic actors and relationships instead of just focusing on case by case legislation or increasing penalties and control of non-compliance.<sup>6</sup> As the results from the population and business surveys show in Macedonia, Albania and Kosovo, designing a comprehensive policy against

<sup>6</sup> Hidden Economy Assessment Report 2016

hidden economic activities unavoidably needs to be linked with the country's present policies for countering corruption and improving law enforcement and embedded in their respective economic growth strategies.

Informal, parallel, clandestine, grey, underground, shadow, unregulated, subsistence, coping, non-monetized, alternative, and so on. Whatever of these names one chooses to attach to hidden economic activities, there is a growing acceptance that at different scales the hidden economies are here to stay due to their resilient nature and adaptive capacities to changing political, legislative and economic environments. Hidden economic activities can also be the carriers of great value added for the economy in the form of innovation and entrepreneurship as start-ups test their business models in the shadows to avoid some or all of the initial capital costs/business costs and redirect them into developing the business. The findings of the business survey should provide governments of the three countries with a clearer view of its good governance deficiencies and develop measure to curb them.

Obviously, there are pros and cons of hidden economic activities however it is researcher's aim, as is of this policy brief, to provide policymakers, decision makers, and academia with the data and suggest measures to counter the negative aspects of the hidden economy such as **unfair competition, tax evasion, lack of social security and legal protection for workers, decreasing government revenues, and stagnating quality/quantity of social services**. In parallel the other aim is to provide data and potential measures that work alongside with the hidden economy in order to facilitate its positive effects such as providing a framework of measures to **harness the potential of start-up entrepreneurship, labor flexibility during transitions, remittances**, etc. It is up to governments to make the decisions but it is up to researchers to provide the policy tools in the form of research and data which then governments can use for evidence based policymaking for the benefit of their societies.