



Employment and Social Affairs Platform

Diagnostic report on undeclared work in The Former Yugoslav Republic of Macedonia

DRAFT

Report prepared by Prof. Nikica Mojsoska Blazevski, with Prof. Colin C Williams¹

Skopje, 2018

¹ The structure of the present report, and inspiration for what content to include, is mainly based on a previous diagnostic report on undeclared work in Greece, prepared by Prof. Colin Williams, Dr. Stavroula Demetriades and Dr. Eleni Patra.



Contents

Executive summary	7
1 Introduction: Background context	12
2 Undeclared work: An analytical and policy framework	16
2.1 Analytical framework.....	16
2.2 Policy approaches towards undeclared work.....	19
3 Extent and nature of undeclared work in The Former Yugoslav Republic of Macedonia	25
3.1 Magnitude of the undeclared economy	25
3.2 Nature of the undeclared economy	28
3.2.1 Varieties of undeclared work.....	28
3.2.2 Demand for undeclared goods and services.....	31
3.2.3 Supply of undeclared work	33
3.2.4 Under-declared employment: envelope wages.....	36
3.2.6 The role of the personal connections.....	39
4 Drivers of the undeclared economy in The Former Yugoslav Republic Macedonia	40
5 Organization of the fight against undeclared work: institutional framework.....	55
5.1 Responsibilities of government ministries	55
5.2 The role of social partners.....	65
5.3 Bodies of Social Dialogue	68
5.4 Towards a joined-up strategic approach	69
6 Current policy approach and measures: an evaluation	71
6.1 Direct controls: deterrence measures	74
6.2 Penalties and sanctions.....	74
6.2.1 Detection measures.....	76
6.3 Direct Controls: supply-side incentives	82
6.4 Direct Controls: demand-side incentives.....	87
6.5 Indirect controls.....	90
6.5.1 Altering informal institutions: awareness raising campaigns	91
6.5.2 Reforming formal institutions	94
6.5.3 Changing the products of formal institutions	96
7 Policy recommendations and sequencing.....	97
7.1 Sequencing of the policy measures	120
7.2 Specification of a feasible sector and/or region to launch a pilot programme	120



This project is funded by the EU

8	References	121
	ANNEX A: KEY STAKEHOLDERS CONSULTED	130

List of Tables

Table 1. Unregistered employment, figures and trends (population aged 15+)	26
Table 2. Number of active enterprises according to size, 2013-2016.....	28
Table 3. Employment structure according to enterprise size, 2013-2015	29
Table 4. Main poverty indicators, 2013-2016	53
Table 5. A hierarchy of joined-up government	55
Table 6. Policy measures used in The Former Yugoslav Republic Macedonia and 31 other European countries to tackle undeclared work	71

List of Figures

Figure 1 – Reasons for working informally	35
Figure 2 – Forms of hidden economy	36
Figure 3. Share of the net income received as envelope wage, proportion of workers receiving envelope wage	39
Figure 4. Trust in state and institutions	40
Figure 5. Social embeddedness of undeclared economy.....	42
Figure 6. GDP per capita, 2002-2016	43
Figure 7. Corruption perception index	44
Figure 8. Corruption pressure experienced by those in different employment situations, 2016	46
Figure 9. Satisfaction of the citizens with the public services, 2017	46
Figure 10. Tax rates and tax administration	47
Figure 11. Estimates by the public of the rate of corruption among tax officials in SEE, 2016	49
Figure 12. Tax rates as share of GDP (in %).....	49
Figure 13. Spending on ALMPs as a share of GDP	51
Figure 14. Social expenditures as % of GDP	51
Figure 15. Effect of labour administration on the enterprises	58



List of abbreviations

ALMPs - Active Labour Market Measures
AROP - At-risk of poverty
AROPE - At-risk of poverty or social exclusion
ATM - Automated Teller Machines
BCM - Business Confederation of the Former Yugoslav Republic of Macedonia
CIT - Corporate Income Tax
CPI - Corruption Perceptions Index
EEA - European Economic Area
ESA - Employment Service Agency
FGLS - Feasible Generalized Least Square method
FTUM - Federation of Trade Unions of the Former Yugoslav Republic of Macedonia
GDP – Gross Domestic Product
ILO - International Labour Organization
KPIs – Key Performance Indicators
MIMIC - Multiple Indicators Multiple causes
MLSP – Ministry of Labour and Social Policy
MSE – Micro and Small Enterprises
NBRM - National Bank of the Former Yugoslav Republic of Macedonia
OEM - Organization of Employers of the Former Yugoslav Republic of Macedonia
PIT - Personal Income Tax
PRO – Public Revenue Office
RCC – Regional Cooperation Council
SEC - Socio-Economic Council
SEE - South Eastern European
SLI – State Labour Inspectorate
SMI – State Market Inspectorate
SSC – Social Security Contributions
SSO – State Statistical Office
SWTS - School-to-work transition survey
VAT - Value Added Tax



Foreword

Addressing undeclared work is a complex and difficult challenge, especially when a country faces a difficult socioeconomic situation marked by high unemployment, a poor business environment and limited fiscal space. In The Former Yugoslav Republic Macedonia, undeclared work remains a significant feature of the economy, despite measures taken in recent years to address the issue, including imposing stricter sanctions, reducing labour costs and taxation, and reducing bureaucratic obligations and the administrative burden for citizens and firms.

In this context, the Regional Cooperation Council has implemented a project on "Supporting the transition from undeclared to declared work in The Former Yugoslav Republic Macedonia". The project has led to two unique and important outputs. The first one is the present report which provides a Diagnosis of Undeclared Work in The Former Yugoslav Republic Macedonia. The Diagnosis supports the new Strategy for formalization of the undeclared economy in The Former Yugoslav Republic Macedonia (2018-2022) which was recently (in 2018) adopted by the Government. It also provides a detailed set of policy recommendations that reflects the ILO's vision of a balanced approach combining incentives with compliance measures, as enshrined in the ILO Recommendation No. 204 on the transition from the informal to the formal economy, adopted at the International Labour Conference in June 2015.

It also supports the 'holistic approach' of the European Commission's European Platform Tackling Undeclared Work. This is where national governments use a whole government approach to tackle undeclared work, by joining-up on the level of both strategy and operations the policy fields of labour, tax and social security law, and involve and cooperate with social partners and other stakeholders. This approach involves using the full range of *direct* and *indirect* policy measures available to enhance the power of, and trust in, authorities respectively. The objective is to transform undeclared work into declared work in an effective manner.

These approaches affirm that the transition to formality is essential to achieve inclusive development, to improve working and living conditions, to promote sustainable small and medium enterprises, and to achieve fair competition and fiscal consolidation at national level.

We would like to express our special thanks to the high level team of experts that prepared this comprehensive Diagnostic Report: Professor Colin Williams from Sheffield University and Professor Nikica Mojsoska Blazevski, who made a remarkable analysis of the situation and a key contribution to the national policy debate on undeclared work.



Executive summary

This diagnostic report evaluates the extent, nature and drivers of the undeclared economy in The Former Yugoslav Republic of Macedonia followed by recommendations regarding how this sphere can be tackled.

Extent and nature of the undeclared economy in The Former Yugoslav Republic of Macedonia

Undeclared work is an extensive phenomenon in The Former Yugoslav Republic of Macedonia. While LFS data show that around 18.5% of employed persons in The Former Yugoslav Republic of Macedonia in 2016 worked without a contract, the estimates of the size of the undeclared work range from 17% to 40%, depending on the estimation method used. Besides unregistered employment, there is also underreporting of wages (for the purpose of payment of taxes and social contributions), i.e. envelope wages. The estimates of the incidence of envelope wages range from a low of 7.7% of formal employees to a high of 50%, and studies show that these hidden wages are commonly paid based on the mutual consent of both parties. The demand (i.e. purchase) of goods produced in undeclared economy is relatively high; studies find that around 18%-32% of the citizens bought some informally produced good in the year prior to the survey. The main factors that push individuals to work undeclared are: non-availability of jobs, the economic benefits of working undeclared for the worker and the client, as well as the (perception of) widespread undeclared work.

Undeclared work is undertaken by all social groups in The Former Yugoslav Republic of Macedonia. There appears to exist a necessity-driven ‘lower tier’ populated by younger people and those with financial difficulties, and a more voluntary-oriented ‘upper tier’ occupied by professional groups. The latter type, though, seems to be more widespread, consisting of professionals who not only appear to gain greater rewards from their undeclared work but also from using undeclared labour such as for domestic cleaning and home maintenance. It would thus be a mistake to adopt a laissez-faire approach towards the undeclared economy based on the belief that it is a survival strategy for populations excluded from the declared economy. What interventions are required, therefore, to tackle the undeclared economy?

Drivers of the undeclared economy in The Former Yugoslav Republic of Macedonia

In the past few years, significant advances have been made in understanding the determinants of undeclared work by a new institutional approach. To explain undeclared work, this asserts that every society possesses institutions which prescribe, monitor and enforce the ‘rules of the game’ regarding what is socially acceptable. In all societies, these institutions are of two types: formal institutions that prescribe ‘state morality’ about what is socially acceptable (i.e., laws and



This project is funded by the EU

regulations), and informal institutions which prescribe ‘citizen morality’ (i.e., socially shared rules, usually unwritten).

Undeclared work, from this institutional perspective, is explained as arising when the failings of formal institutions lead to state morality being different to citizen morality. These formal institutional failings are of four types: (i) formal institutional voids, such as a weak welfare ‘safety net’ which forces citizens into undeclared work to survive; (ii) formal institutional inefficiencies, or resource misallocations by formal institutions; (iii) formal institutional uncertainty, and/or (iv) formal institutional weaknesses and instability. These failings result in citizens viewing as socially acceptable what is deemed illegal by the state. Undeclared work arises, therefore, due to the failings of formal institutions which leads citizen morality to not be aligned with state morality.

Analysing the evidence on which formal institutional failings are significantly associated with the growth of undeclared work, the last few years have seen multiple studies which reveal that undeclared work is more extensive in those nations when there is: lower GDP per capita; higher public sector corruption and lower quality governance; lower expenditure on labour market interventions to help the most vulnerable groups; lower social expenditure, and social transfer systems that are ineffective in reducing the level of inequality and severe material deprivation.

To tackle the undeclared economy in The Former Yugoslav Republic of Macedonia, therefore, there will be a need to address the following formal institutional failings:

- low growth rates of GDP per capita;
- low quality of governance, lack of trust in government and institutions and people, and relatively high corruption, which has been increasing in the recent years;
- inadequate support to unemployed people, especially the most vulnerable groups, in helping them to successfully transition to a stable employment;
- increasing social expenditure, although this will be effective in tackling undeclared work only if coupled with
- developing more effective social transfer systems to reduce the level of inequality and severe material deprivation. Social transfers (other than pensions) are very ineffective in reducing poverty in The Former Yugoslav Republic of Macedonia;
- Besides addressing these structural determinants, there are many additional organisational and policy initiatives that can be pursued to tackle the undeclared economy.

Unless these failings of formal institutions are addressed, then the asymmetry between state and civic morality will persist, and consequently so too will the prevalence of undeclared work. How, therefore, can these failings and imperfections in formal institutions that lead to an extensive undeclared economy be addressed?

Organisation of the fight against undeclared work: institutional framework



This project is funded by the EU

Until recently, the situation in The Former Yugoslav Republic of Macedonia in terms of the institutional framework for tackling undeclared work was a “departments silos’ approach. Although some cooperation existed at the level of operations, and to some extent for data exchange, there were no common databases and/or shared key performance targets and goals. Instead, the departments involved in the fight against undeclared work largely worked separately, with each responsible for their own segment of the undeclared economy. Cooperation increased in 2014, with the adoption of the Law for prohibition and prevention of unregistered activities, whose implementation requires joined up approaches between several inspection bodies. Another positive step in this direction has been the establishment of the Inspection Council in 2014 as a coordinating body for all inspection bodies.

The coordination and cooperation between the different state agencies has been further enhanced with the first Strategy for formalization of the undeclared economy 2018-2022 (adopted in early 2018). The Strategy presents a step in a right direction in terms of bringing together all relevant stakeholders including social partners. However, the success of this new approach will depend on the capacity of the newly established Coordinative body (and the Ministry of Labour and Social Policy) to bring together and to coordinate the involved stakeholders, but also on whether the other institutions will prioritize undeclared work over (or at the same level) as their other regular activities.

The involvement of the social partners in tackling undeclared work so far has been relatively weak. This has been taken into account in the new government Strategy, where social partners were involved from the very beginning. Still, it remains to be seen if they will be considered as partners in the implementation of the Strategy.

Current policy approach and measures: an evaluation

The policy towards undeclared work in The Former Yugoslav Republic of Macedonia has been mainly based on a repressive approach which is grounded in the rational actor approach. This asserts that people engage in undeclared work only if the costs of doing so exceed the benefits. The policy measures heavily focus upon a direct controls approach based on deterring engagement in undeclared work by increasing the penalties and risks of detection. Little emphasis is given to on the one hand, improving the benefits of and incentives for declared work, and on the other hand, more indirect tools to deal with the formal institutional failings so as to reduce the asymmetry between state morality and civic morality, such as awareness raising campaigns and dealing with the imperfections and failings of formal institutions (e.g., by facilitating procedural and redistributive justice and fairness, and pursuing wider economic and social policies). Hence, there is a lack of wider, more integrated holistic approach that targets and tackles the major drivers of the undeclared economy.

The new (and first) Strategy for formalization of the undeclared economy 2018-2022 sets a basis for a change in the paradigm for tackling undeclared work towards measures that enable compliance (preventive and curative measures), as well as indirect controls approach (i.e.



This project is funded by the EU

enhancing the norms, beliefs and attitudes). The Government is currently developing an action plan for the implementation of the Strategy. However, whether the Strategy will bring the desired shift of the policy towards undeclared work depends on several crucial factors such as the: cooperation and coordination of the involved institutions (and social partners), political will and the priority given to formalization by the government (including the budget resources), the capacity of the main institutions and their willingness to change their approach to undeclared work.

A National Action Plan: policy recommendations and sequencing

Based on a multi-stakeholder diagnostic of the causes, circumstances and forms of undeclared work in The Former Yugoslav Republic of Macedonia, and the experience of the International Labour Organization (ILO) and European Platform Tackling Undeclared Work that the transition to the declared economy can best be facilitated through an integrated strategy, a policy mix and institutional coordination, a comprehensive national action plan is proposed to tackle the undeclared economy. A coordinated and evidence-based approach is recommended based on a package of policies that involve: more effective deterrence measures; simplifying compliance to help individuals operate on a declared basis; the provision of various incentives to businesses to operate on a declared basis, suppliers of labour to make their work known, and purchasers of goods and services to hire declared work; as well as a range of indirect tools to resolve the failings of formal institutions so as to engender a culture of trust and commitment among the population to operating on a declared basis.

- If undeclared work is to be transformed into declared work, the current rift between state morality and citizen morality that results in macro-level failings and imperfections of the formal institutions must be addressed. These include:
 - Redressing the low GDP per capita and the slow progress in the living standard;
 - Improving the quality of government and reducing public sector corruption;
 - Increasing expenditure on labour market interventions to help vulnerable groups; and
 - Developing more effective and targeted social transfer systems that reduce the income inequality and the high levels of severe material deprivation.

Running alongside these broad macro-level policies, each ministry responsible for different aspects of the fight against undeclared work should seek to implement the following policy recommendations that broaden the range of approaches and measures used, and draw upon international good practice in what is considered an effective and efficient approach.

On the one hand, and reflecting the need for a cross-government approach, there are a range of measures that all ministries involved in tackling the undeclared economy should implement. These policy measures that cross-cut all ministries include:

- Implement a holistic integrated strategic approach towards tackling undeclared work;



This project is funded by the EU

- Modernise the strategic objectives and KPIs of the main inspection bodies in relation to undeclared work;
- Create a Working Group on “Combating Undeclared Work” within the Economic-Social Council;
- Improve the legal framework by introducing a definition of undeclared work;
- Set up an Undeclared Economy Information Unit;
- Make greater use of normative notification letters;
- Introduce risk-based approaches in targeting and planning inspections;
- Introducing a ‘white list’ of legitimate employers for public procurement contracts;
- Introduce a system of ID cards for all workers in the construction industry;
- Reverse VAT scheme in the construction industry;
- Remove the barriers to formality by simplifying compliance on tax, labour and social security law, especially among micro and small firms;
- Provide free record-keeping software to businesses and improve the provision of formalisation advice;
- Increase incentives to use electronic payments to reduce undeclared work;
- Introduce a tax rebate incentive scheme for small scale home repairs;
- Use service vouchers in sectors where undeclared work is rife;
- Strengthening the human resources of State Labour Inspectorate (SLI), training of labour inspectors and reorganization of the SLI;
- Launch public awareness campaigns on the benefits of declared work;
- Introduce employer-led voluntary supply chain responsibility initiative.

While some of these measures apply only to certain institutions, some of them involve many government institutions and social partners and hence there is a need for coordination.

Specification of a Pilot Programme for a sector and/or region

Since this report proposes a large shift of the policy approach towards undeclared work, which can be constrained by lack of financial resources, but also lack of capacity of the institutions to design and implement some of the measures, we propose that the approach of piloting on a smaller scale (say, a specific economic sector, specific region, etc.) is applied. Following the success of the piloting, measures can then be extended nationally or not taken forward.



This project is funded by the EU

1 Introduction: Background context

The reduction of the undeclared economy is a key step in the process of establishment of a predictable and stable business environment, equal opportunities and healthy competition. Formalization of the undeclared economy will increase the fairness of the taxation system, improve the mutual confidence among the economic actors, the state and the citizens, and will increase tax morale. In addition, it will increase tax revenue, enabling the state and its institutions to provide better quality services and greater social security for citizens. Facilitating the transition to formality is especially important for the citizens sense of belonging among the most vulnerable categories, who do not have access to social security and employment related benefits, protection of rights and possibilities for career advancement.

Undeclared work is a complex phenomenon. The problem and nature of the undeclared economy has a multidimensional background, forms and effects. It refers to a diversity of situations, motivations and needs, across the different tiers of the society. In the same vein, undeclared work in The Former Yugoslav Republic of Macedonia is multifaceted and has a very complex nature.

The Government of The Former Yugoslav Republic of Macedonia has been continuously implementing activities to reduce the undeclared economy and formalize undeclared and unregistered business activities, mainly through implementation of annual action plans for the reduction of the undeclared economy. The policy for reduction and formalization of the undeclared economy thus far has combined the use of sanctions (repressive measures), detection measures and, to a lesser extent - incentives. Preventive and curative measures are largely absent. In 2018, the Government adopted the first Strategy for formalization of the undeclared economy 2018-2022, supported by the International Labour Organization (ILO). The Strategy is a first attempt of the Government to shift the focus of its actions from reduction of undeclared work to formalization, and from deterrence (punishments and detection measures) to measures for enabling compliance. At this very moment, the Government (i.e. the working group established for preparation of the Strategy) is developing the action plan for implementation of the Strategy.

This diagnostic report seeks to further develop and contribute to the preparation and delivery of the action plan by setting out an integrated and holistic approach, as advocated by ILO Recommendation 204 (ILO, 2015)² and the European Commission's European Platform

² It would have been much more beneficial for the authorities of The Former Yugoslav Republic Macedonia if this diagnostic report was prepared before the Strategy was adopted. Still, we believe that the approach and framework used in this diagnostic report will add additional value and insights into the issues of undeclared work in the country



This project is funded by the EU

Tackling Undeclared Work (Williams, 2016). Tackling the undeclared economy remains a significant challenge despite the efforts made in recent years, including imposing stricter sanctions, reducing taxation and the labour tax wedge, and simplifying bureaucratic obligations and reduction of the administrative burden. The current business climate in the Former Yugoslav Republic of Macedonia is characterized by relatively high under-reporting rates, as well as a relatively high share of undeclared work. This, along with high unemployment, has undermined the collection of tax revenue and social security contributions. As a result, the country has been trapped in a vicious cycle of low revenues, increasing debt and low quality of social services. The main policy approach so far has been to create an environment of low taxation and simplified taxation system, which was expected to bring higher tax compliance. While this aim was generally accomplished, the implicit (negative) effect was the very moderate improvement of the quality of the social services and of formal institutions along with increasing public debt (the debt reached 47.6% of GDP in 2017, from 23% in 2008).³ The low transparency and accountability of the government further heightened this negative, unintended effect. Hence, **the current policy approach may actually push firms and individuals to exit the declared economy**, worsening further the fiscal position and limiting the ability of the government to stimulate investment, economic activity and job creation.

In a context marked by a high level of undeclared work (including a widespread practice of under-declared work), tackling the undeclared economy is increasingly seen as a major economic and social challenge in The Former Yugoslav Republic of Macedonia. There is consequently an urgent need to reformulate the policy intervention in a way that can enable the country to tackle this realm. Taking fully into consideration ILO Recommendation 204 and the holistic approach of the European Commission's European Platform Tackling Undeclared Work, the aim of this report is therefore to investigate the main determinants of the undeclared economy and to provide appropriate and efficiently integrated policy frameworks and the associated policy guidelines to introduce incentives to enable the transition from undeclared to declared work. To achieve this, the objectives of this report are to:

- identify the most recurrent forms of undeclared work in the country;

and assist the Government to develop better action plan and/or to improve the action plan at the mid-term review. Unfortunately, the Government decided to develop one action plan for the whole period of the implementation of the Strategy (2018-2022), and to then undertake a mid-term review.

³ Data from Ministry of Finance, <https://www.finance.gov.mk/mk/node/57>.



This project is funded by the EU

- identify the categories of workers, enterprises or sectors warranting priority action to tackle undeclared work and the specific forms of undeclared work in which they are engaged;
- identify the main incentives and drivers of undeclared work in The Former Yugoslav Republic of Macedonia;
- review the legal, policy or strategic frameworks to inform the design and implementation of laws and regulations, policies and other measures aiming to facilitate the transition to the declared economy;
- identify priority measures and sequencing to facilitating the transition from undeclared to declared work;
- enable the identification of a possible and feasible sector and/or region to launch the pilot programme to reduce undeclared work in The Former Yugoslav Republic of Macedonia, and
- provide a set of policy recommendations and a sequencing to formulate the road map.

Therefore, on the one hand, this report provides support to the Government and social partners in tackling undeclared work by identifying the causes, circumstances and forms of undeclared work. This has been achieved through a desk review of the available studies and research related to undeclared work in The Former Yugoslav Republic of Macedonia, supplemented by a multi-stakeholders diagnostic of the situation involving the meetings listed in Annex A. On the other hand, the information generated has been used to formulate a comprehensive policy action plan, with a view to enabling the transformation of undeclared work into declared work. The program set out to facilitate the transition from undeclared to declared work in The Former Yugoslav Republic of Macedonia provides an integrated regulatory and policy framework based on a combination of deterrence, preventive and curative policies, and is based on good practice being developed elsewhere in the European Union and beyond, including ILO recommendation 204 (ILO, 2015). As part of this, some pilot activities are recommended to enable the resultant integrated policy framework to be implemented and its impact assessed in terms of declared work.

Although there is no official universal definition of ‘undeclared work’, it is widely accepted across the European Union that this covers ‘*productive activities that are lawful as regards their nature, but are not declared to the public authorities, taking into account the differences in their regulatory systems between Member States*’ (European Commission, 2007a: 2). Similarly, based on a review of several definitions used in the literature, Williams and Bezeredi (2017a) define undeclared work as “remunerated exchanges that are unregistered by or hidden from the state, for tax, social security and/or labour law purposes but are legal in all other aspects” (p. 516). It is also important to explain the term “tackling” which is used within this report. In article 1 of Decision (EU) 2016/3441 establishing the European Platform Tackling Undeclared Work, it is stated “‘tackling’, in relation to undeclared work, means preventing, deterring and combating undeclared work as well as promoting the declaration of undeclared work’.



This project is funded by the EU

Despite some 45 different adjectives and 10 nouns currently used to denote this activity (e.g., ‘informal’, ‘shadow’, ‘black’ and ‘underground’ sector/economy/work), we use the undeclared economy throughout this report. Indeed, the definition used aligns closely with the definition of the ‘shadow economy’ adopted by Schneider and Enste (2000, 79), which views it as including all legal production and provision of goods and services that are deliberately concealed from public authorities for the following four reasons: (i) to avoid payment of income, value added or other taxes; (ii) to avoid payment of social security contributions; (iii) to avoid having to meet certain legal standards, such as minimum wages, maximum hours, safety standards, etc.; and (iv) to avoid compliance with certain administrative procedures, such as completing statistical questionnaires or other administrative forms. Although such a definition intimates that undeclared work might be a voluntary decision not to comply with legal obligations, to assume this would be to ignore how economic units and individuals may not be able to abide by the law, for instance, due to inappropriate legislation or lack of awareness. This has been taken on board in this report and its action plan. The ILO Recommendation 204, moreover, provides a broader concept of informal economy of which undeclared work is part, which (a) refers to all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements; and (b) does not cover illicit activities, in particular the provision of services or the production, sale, possession or use of goods forbidden by law, including the illicit production and trafficking of drugs, the illicit manufacturing of and trafficking in firearms, trafficking in persons, and money laundering, as defined in the relevant international treaties. As such, the only difference between declared and undeclared work in this report is that it is not declared to the authorities for tax, social security and labour law purposes when it should be. If other differences exist, it is not undeclared work. For example, if the goods and services provided are illegal, it is part of the wider criminal economy, whilst if there is no monetary payment, it is part of the unpaid sphere.

Nationally, there is no definition of undeclared economy in any of the laws regulating economic activities, tax regulation and employment relations. The Labour Code (Official Gazette No. 167/2015)⁴ does not provide a definition of undeclared work as the law is narrow in its scope and states that its jurisdiction is only for the formal work contracts between workers and employers (article 1). In 2014, the authorities adopted a Law on prohibition and prevention of performance

⁴ The direct translation of the Law is “Law on employment relationship”. A consolidated version of the law in the national language can be found at: http://www.mtsp.gov.mk/content/zakoni/30.9_ZRO%20precisten%20167%2015.pdf.



of unregistered activities (Official Gazette No. 99/2014 and amendments in 147/2015). The Law (article 7) defines the following activities as unregistered (i.e. undeclared):

- any work performed by a company that is not registered in the register of a specific industry but only in the Company register;
- any work performed by a company/physical person for which the company/physical person does not possess an act or document that is required by legislation related to the formal business operations;
- work performed by physical persons that is not registered with responsible state body;
- if a company or physical person performs a work in case they are prohibited to do so by a responsible state body.

The newly adopted Strategy for formalization of the undeclared economy is the first attempt of the policymakers to appropriately and precisely define the term informal economy, based on the definition used by the ILO, as well as the methodologies used by the Eurostat and the national statistical system.

2 Undeclared work: An analytical and policy framework

2.1 Analytical framework

Undeclared work by definition is not declared to the authorities. This makes it difficult to obtain reliable estimates of its magnitude and characteristics, with various methods used to estimate its size and characteristics. Evaluating the different measurement methods available, the European Commission (2007a: 4) state:

‘Undeclared work can be measured both directly and indirectly. Indirect methods are based on the comparison of macroeconomic aggregates (such as national accounts, electricity consumption, cash transactions). Indirect (especially monetary) methods often over-estimate the level of undeclared work and say little about its socio-economic characteristics. 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.’

The resultant consensus has been to use indirect methods to measure the size of the undeclared economy and direct methods to identify its characteristics in terms of who engages in it, what they do and why, so as to inform policy development (Eurofound, 2013; Williams and Schneider, 2016). This will be the approach adopted in this report.

To identify the drivers of the undeclared economy is important because it is these that need to be tackled to reduce the undeclared economy. Recently, significant advances have been made in understanding the determinants of undeclared work by adopting an institutional perspective which transcends the previous competing debates about the varying causes of undeclared work



This project is funded by the EU

(Godfrey, 2015; Webb et al, 2009, 2013; Williams and Franic, 2016; Williams and Horodnic, 2015a,b,c). Institutions, or governance mechanisms, which prescribe, monitor and enforce the ‘rules of the game’ regarding what is socially acceptable, are seen to exist in every society (Baumol and Blinder, 2008; North, 1990). In all societies, these institutions are of two types: formal institutions that prescribe ‘state morality’ about what is socially acceptable (i.e., laws and regulations), and informal institutions which prescribe ‘citizen morality’ (i.e., socially shared rules, usually unwritten) (Helmke and Levitsky, 2004).

Undeclared work, from this institutional perspective, is explained as arising when the failings of formal institutions lead to state morality being different to citizen morality. As Webb and Ireland (2015) outline, these formal institutional failings are of four types:

1. formal institutional voids, such as no social protection or a welfare ‘safety net’ which forces citizens into undeclared work to survive;
2. formal institutional inefficiencies, or resource misallocations by formal institutions, such as when formal institutions seek to protect or maximize economic rents for elites, or when state capture occurs by such elites, resulting in the majority not receiving a fair share in return for their contributions, or suffering from overly burdensome taxes, registration and licensing regulations and costs;
3. formal institutional uncertainty, such as when there is fear regarding the future of specific formal institutions, or when technology and socio-cultural change outpaces the ability of formal institutions to accommodate new domains of activity (e.g., ‘the sharing economy’), and/or
4. formal institutional weaknesses and instability, manifested in their lack of capacity and capability to enforce legislation (Webb et al., 2009) and/or there are continuous changes in the formal ‘rules of the game’ about what is acceptable, which leads citizens to reject the continuously changing formal rules of the game in favour of their own more stable unwritten socially shared rules.

Undeclared work arises, therefore, due to these failings of formal institutions producing a situation in which the formal ‘rules of the game’ (state morality) differ to what citizens view as socially acceptable (citizen morality). Indeed, the greater is the non-alignment of state morality and citizen morality, the greater is the prevalence of the undeclared economy.

Which specific formal institutional failings, therefore, result in the non-alignment of citizen morality with state morality, and thus the prevalence of undeclared work? Until now, there have been three competing theories which each identify different formal institutional failings as the cause of more extensive undeclared economies. Firstly, *modernization theory* has argued that undeclared work is rife in societies which are under-developed economically (i.e., with lower levels of GDP per capita) and where the formal institutions of governance are not modernised, displayed by the existence for example of higher levels of public sector corruption and lower qualities of governance. Secondly, ‘*state over-interference*’ theory has argued that undeclared work is a resistance practice voluntarily pursued and a rational economic response to high tax



This project is funded by the EU

rates and too much state interference such as over-burdensome rules and regulations (e.g., Becker, 2004; De Soto, 1989, 2001; London and Hart, 2004; Nwabuzor, 2005; Sauvy, 1984; Small Business Council, 2004). Third and finally, ‘*state under-intervention*’ theory views undeclared work as a direct by-product of too little, rather than too much, state intervention in work and welfare arrangements. In this approach, undeclared work is viewed as an inherent and integral component of contemporary capitalism and a key facet of the sub-contracting, downsizing and outsourcing arrangements that are emerging in advanced capitalism and enable enterprises to achieve profit through flexible production and cost reduction (Meagher, 2010; Taiwo, 2013). Consequently, undeclared work is depicted as unregulated, insecure and low paid employment conducted out of necessity by marginalized populations excluded from the declared economy and conducted as a last resort when no other options are available to them (Ahmad, 2008; Castells and Portes, 1989). As such, undeclared work is seen to result from a lack of social protection for workers and the remedy is greater state intervention in work and welfare provision to protect workers from poverty (Davis, 2006; Gallin, 2001; Slavnic, 2010).

Reviewing the studies that evaluate these theories by examining the cross-national variations in these economic and social conditions, and cross-national variations in the size of the undeclared economy, the same findings continuously emerge. Whether one measures the size of the undeclared economy using Schneider’s MIMIC estimates or using direct surveys (Williams, 2014a,b,c, 2015a,b, 2017; Williams and Martinez-Perez, 2014) and whether one compares the 28 member states of the European Union (Williams, 2014c; 2017; Williams and Horodnic, 2016), post-socialist transition economies (Williams, 2014a, 2015b) or countries across the developing world (Williams, 2014b, 2015a,c,d), the finding is that there is no evidence to support the state over-interference thesis. Instead, the prevalence of the undeclared economy is positively associated with the tenets of the modernisation and state under-intervention theses. To tackle the undeclared economy, therefore, these multiple studies reveal a need to focus upon:

- increasing GDP per capita;
- improving the quality of governance and reducing corruption;
- increasing expenditure on labour market interventions to help the most vulnerable groups;
- increasing social expenditure, and
- developing more effective social transfer systems so as to reduce the level of inequality and severe material deprivation, which includes improving the efficiency of collection.

Indeed, unless these formal institutional failings are tackled that result in an asymmetry between state morality and citizen morality, undeclared work will persist.

For example, Williams and Horodnic (2016) examine the formal institutional failings that are associated with higher level of under-declared work (i.e., the illegal employer practice of under-reporting employees’ salaries) in the EU-28 using data from the 2013 Eurobarometer survey of 11,025 employees. Rather than an individual criminal act that increasing the risk of detection can



This project is funded by the EU

tackle, they reveal that this is a symptom of systemic problems. They show that under-declared work is concentrated in countries with:

- lower levels of economic development and less modernised state bureaucracies;
- greater income inequality;
- higher rates of severe material deprivation;
- less effective redistribution via social transfers, and
- lower levels of labour market interventions to protect vulnerable groups in the labour market.

They also importantly reveal no significant association between increasing the perceived risk of detection and the likelihood of participating in under-declared work, when other variables are held constant. Under-declared work is nevertheless significantly associated with the non-alignment of state morality and citizen morality, reflected in the tax morality. To reduce under-declared work, therefore, the conventional approach of improving detection seems ineffective. Instead, if under-declared work is to be resolved, policy measures are required that tackle the formal institutional failings that lead to an asymmetry between the formal ‘rules of the game’ and citizen morality.

2.2 Policy approaches towards undeclared work

It is now widely accepted across the developed, transition and developing world, that the aim of governments is not to eradicate the undeclared economy, but to move undeclared work into the declared economy (Dekker et al., 2010; Eurofound, 2013; European Commission, 2007a; ILO, 2015; Small Business Council, 2004; Williams and Nadin, 2012, 2013, 2014a,b).

Figure 1 displays the full range of tools available for transforming undeclared work into declared work. On the one hand, there are direct tools. These transform undeclared into declared work by ensuring that benefits of operating in the declared economy outweigh the costs of working in the undeclared economy. This is accomplished either by using deterrence measures to increase the costs of non-compliance (‘sticks’) and/or by making the conduct of declared work more beneficial and easier (‘carrots’). On the other hand, there are indirect tools. These shift away from using ‘sticks’ and ‘carrots’, and instead focus on dealing with the formal institutional failings so as to repair the social contract between the state and its citizens in order to foster a high trust high commitment culture.

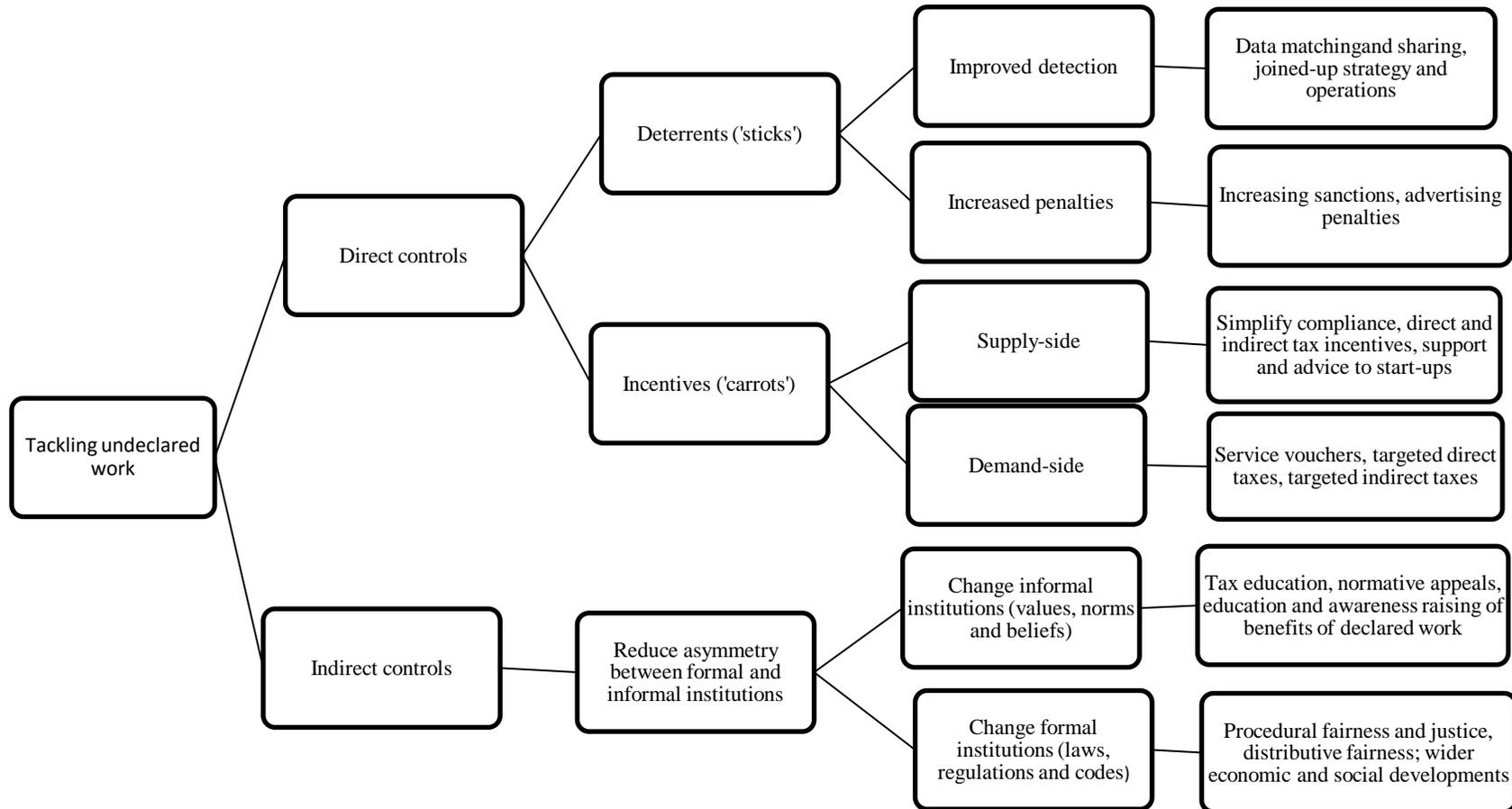


This project is funded by the EU

Figure 1. Policy approaches and measures for tackling undeclared work



This project is funded by the EU



Direct controls, therefore, seek to reduce the costs and increase the benefits of operating on a declared basis (OECD, 2008). Viewing the non-compliant as rational economic actors who engage in undeclared work when the pay-off is greater than the expected cost of detection and punishment, the objective is to change the cost/benefit ratio facing those participating or considering participation in undeclared work (e.g., Allingham and Sandmo, 1972; Hasseldine and Li, 1999; Richardson and Sawyer, 2001). This can be achieved in two ways:

- *Deterrence measures* seek to detect and punish non-compliant ('bad') behaviour (i.e., undeclared work). This is achieved by firstly, raising the perceived or actual likelihood of detection and/or secondly, increasing the penalties and sanctions for those caught. This 'negative reinforcement' approach thus seeks behaviour change by using 'sticks' to punish non-compliant ('bad') behaviour.
- *Incentive measures* seek to make it easier to undertake, and reward, compliant ('good') behaviour (i.e., declared work). To achieve this, one can use either:
 - Preventative measures to stop people moving into the undeclared economy in the first place (e.g., by simplifying compliance, using direct and indirect tax incentives to make it beneficial to operate on a declared basis, and providing support and advice about how to start-up legitimately); or
 - Curative measures to incentivise workers and businesses to make the transition to the declared realm. These can be either (a) supply-side incentives targeting businesses and workers in the undeclared economy or (b) demand-side incentives targeting their customers with rewards for using declared goods and services.

The problem with using these direct tools is that those operating on an undeclared basis are not always rational economic actors purely calculating the costs and benefits. They can be also social actors who engage in undeclared work because there is lack of alignment between their own morality and the laws and regulations, such as due to a lack of trust in the state and what it is seeking to achieve.

Indirect controls, therefore, seek to deal with the formal institutional failings and repair the social contract between the state and its citizens so as to create a high trust high commitment culture (Alm et al., 1993; Torgler, 2003; Wenzel, 2002). The intention is to seek a voluntary commitment to compliant behaviour rather than force citizens to comply using threats, harassment and/or incentives (Kirchler, 2007; Torgler, 2007, 2011). Undeclared work occurs where formal institutional failings lead to citizens' norms, values and beliefs differing to the laws and regulations, meaning that what formal institutions deem illegal activities are seen as socially legitimate in the eyes of citizens. To tackle undeclared work therefore, there is a need to address the formal institutional failings and repair the social contract. To align citizen morality with state morality, one can either:

- *Change the informal institutions* - to change the norms, values and beliefs of citizens regarding the acceptability of undeclared work, so that these are in symmetry with the laws and regulations, one can use awareness raising campaigns and educational initiatives about the costs of undeclared work and benefits of declared work.
- *Change the formal institutions* – this is particularly important in societies in which there is a lack of trust in government, such as due to public sector corruption or in societies where citizens do not believe that they receive back from government what they expect. This can involve either:

- Changes in the internal *processes* of the formal institutions to improve the perception amongst citizens that there is procedural and distributive fairness and justice, and/or
- Change in the *products* of formal institutions by pursuing wider economic and social developments (e.g., increased social expenditure levels, more effective social transfers).

The emerging evidence-base is that the ‘best practice’ when tackling undeclared work is to **combine direct and indirect tools** (Williams, 2014a; Williams and Renooy, 2013). For example, governments may pursue greater social expenditure to provide a welfare ‘safety net’ and culture changes in government departments towards a more customer-oriented approach, and introduce publicity campaigns to elicit greater commitment to compliance, but may also simplify regulatory compliance and introduce incentives (e.g., amnesties, tax deductions) to enable undeclared labour to move into the declared realm. At the same time, and in relation to those failing to comply, they may also pursue improvements in the probability of detection and tougher sanctions for those subsequently caught. The debate therefore is not over whether it is best to use either indirect tools or direct tools. The emergent evidence-base is that both are required to effectively tackle undeclared work. Rather than debate is over how to combine and sequence the various direct and indirect measures. Two contrasting approaches exist for doing this:

- *Responsive regulation* - this envisages a regulatory pyramid, sequenced from the least intrusive indirect controls at the bottom and used first, to the most intrusive direct controls at the top. The idea is that an authority does not need in most cases to pursue the coercion option at the top of the pyramid to win compliance. Instead, it can start with the commitment measures at the bottom of the pyramid and if these fail to elicit behaviour change with some groups, then the level of intrusiveness escalates up the pyramid until it reaches the intervention that elicits the desired response. The outcome is recognition of a continuum of attitudes towards compliance and different policy responses that can be temporally sequenced starting with commitment measures, then incentives and only after these fail are sanctions used (Braithwaite, 2002, 2009). The Australian government for example has adopted this ‘responsive regulation’ approach. In the first instance, indirect controls facilitate voluntary self-regulated compliance, followed by persuasion and only then punitive measures to tackle non-compliance (Braithwaite, 2009; Job et al., 2007).
- *Slippery slope framework* - this argues that citizens abide by the law either because they fear detection and fines due to the power of authorities (**enforced compliance**) or because they feel a commitment to be honest because they have trust in the authorities (**voluntary cooperation**). When there is effective enforced compliance as well as high voluntary cooperation (i.e., both power and trust), undeclared work is absent. When there is ineffective enforced compliance and little voluntary cooperation, undeclared work is extensive (Alm and Torgler, 2011; Alm et al., 2012; Kastlunger et al., 2013; Khurana and Diwan, 2014; Kirchler et al., 2008; Kogler et al., 2015; Muehlbacher et al., 2011a,b; Prinz et al., 2013).

This recognition that both effective enforced compliance and high voluntary cooperation are essential for tackling undeclared work is now being seriously considered by authorities in various countries (OECD, 2013).



Indeed, the European Commission's European Platform Tackling Undeclared Work has referred to this slippery slope framework as a '**full policy operationalisation model**'. This is seen as a model for implementing the holistic approach that combines the range of policy approaches and measures available (and uses all measures concurrently). This approach asserts that the most effective approach is to concurrently implement direct measures (e.g., workplace inspections) to enhance the power of authorities as well as indirect measures (e.g., awareness raising) to enhance trust in authorities (Williams, 2016). This approach is based on evidence that a high trust high power approach is the most effective in tackling undeclared work.

It is this analytical framework and policy approach that is the basis for this report. With this analytical framework and policy approach in hand, attention now turns to an analysis of The Former Yugoslav Republic of Macedonia and what needs to be done.

3 Extent and nature of undeclared work in The Former Yugoslav Republic of Macedonia

3.1 Magnitude of the undeclared economy

There is a large discrepancy between the different measures of the prevalence of undeclared work in The Former Yugoslav Republic of Macedonia. The results from the direct and indirect measures show that the undeclared economy is in a range of 17-40% of GDP. Research uses different models and methods in an attempt to estimate the undeclared economy. Schneider et al. (2010), who provide calculations for 169 economies, estimated the size of the shadow economy in The Former Yugoslav Republic of Macedonia at 35% in 2007. According to this data, the shadow economy in The Former Yugoslav Republic of Macedonia is lower than the average in the countries of Europe and Central Asia.⁵ Novkovska (2012) estimates the size of the undeclared economy in the period 2009-2011 to approximately 35% of the GDP, measured using the Electricity Consumption Method and the Latent Variable Method. Dybka et al. (2017) use a number of methods to estimate the size of the undeclared economy in a group of countries (including The Former Yugoslav Republic of Macedonia), over time. Their estimates of the size of the undeclared economy in The Former Yugoslav Republic of Macedonia in 2015 range between 8.2% and 17.2% of GDP⁶, using the Multiple Indicators Multiple Causes (MIMIC) method and the Feasible Generalized Least Squares method (FGLS). Moreover, they show that the undeclared economy has decreased in the country since 2007-2008 and conclude that The Former Yugoslav Republic of Macedonia is one of the few countries where the official GDP adjustments for the unrecorded economy are greater than the (estimated) actual undeclared economy. These and other available studies show that the size of the undeclared economy in The Former Yugoslav Republic of Macedonia has been decreasing in the recent years.

The State Statistical Office (SSO) implements an adjustment to the official GDP to cover for the non-observed economy. The adjustments for the non-observed economy have been decreasing, from 20.1% in 2008 to 17.2% in 2014 (the latest available data). This GDP adjustment for the non-observed economy in the country is considered as small and not comprehensive though the opposite was found in the study of Dybka et al. (2017).

⁵ Unfortunately, in the paper of Medina and Schneider (2018) which provides estimation of shadow economy in 151 countries around the world using the Multiple Indicators Multiple Causes (MIMIC) approach, The Former Yugoslav Republic Macedonia along with some other countries were dropped during the calibration phase, because of lack of long enough time series.

⁶ The estimates presented in their study show shadow economy as % of GDP, where GDP is a sum of the official GDP plus the estimated shadow GDP. On the other hand, most other calculations show undeclared economy as a % of official GDP (or employment).

Data from the Labour Force Survey (LFS) of the SSO for the period 2008-2016 indicate that the share of unregistered employment in total employment in the country has decreased from 28.6% (2008) to 18.5% (2016) (see Table 1).

Table 1. Unregistered employment, figures and trends (population aged 15+)

	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total number of employed	609,000	629,900	637,800	645,100	650,500	678,800	690,188	705,991	723,550
Total number of informally employed	174,025	169,916	166,814	160,957	146,295	152,805	155,993	140,642	133,777
Informal employment rate*	28.0%	27.0%	26.0%	25.0%	22.0%	22.0%	22.0%	19.9%	18.5%

Source: SSO, Labour Force Survey, different years.

* The share of unregistered employment in the total employment, defined as workers without formal employment contracts (in registered and non-registered businesses).

Males are more likely to work unregistered compared with females: 20.5% of men in employment compared with 15.4% of women. Undeclared work is highest for the population aged 65+ (who are mainly retired people) and for young persons aged 15-24 (35%). According to the LFS data for 2014, unregistered employment was mainly prevalent in manufacturing (19.3% of total unregistered employment), agriculture (18.5%), trade 13.5% and construction (7%). However, in some of these sectors the prevalence of undeclared work is very high whereas in others it is low (i.e. we need to take into account their respective shares in overall employment). For instance, although manufacturing has a large share in unregistered employment, a small fraction of manufacturing workers is undeclared (4.7%). On the other hand, as much as 64% of the agricultural workers are undeclared.⁷ Workers employed in elementary occupations, plant and machine operators and crafts and related workers were most represented among unregistered workers in 2014. In addition, 62% of the workers with elementary occupation were non-registered.

Data from the School-to-work transition survey (SWTS) of the ILO show that there is widespread undeclared work among young workers in The Former Yugoslav Republic of Macedonia.⁸ In particular, 48.1% of youth aged 15-29 in the country worked informally in 2014, the latest year that the SWTS was implemented in the country (Mojsoska-Blazevski, 2017). The incidence of undeclared work is slightly higher for young men than women and in rural relative to urban settlements (which is likely a result of larger involvement in farming). Largest part of the informally employed young workers are engaged in formal enterprises (77.6%).

⁷ These data are from LFS but are not regularly published by the SSO. They are though reported in the study of Spitznagel et al. (2016), Annex A5, for year 2014.

⁸ Data were collected through an ad-hoc survey to the LFS.



In addition to the data from the LFS, there are also other surveys that estimate the size of the undeclared economy in The Former Yugoslav Republic of Macedonia. The survey on undeclared work carried out by Spitznagel et al. (2016)⁹ indicates that around 10.5% of the respondents stated that they engaged in some sort of unregistered activity in the past 12 months, which is significantly less than the official statistical data. These persons were most commonly engaged in agriculture (18.1%), general manual labour (8.4%), restaurants (8.2%), construction (7.9%), etc. The most common reason given for engaging in the undeclared economy is the inability to find a regular job (54.3% of the respondents stated this reason). Additional common reasons are: the seasonal nature of the work (43.4% of the respondents), the economic benefit of undeclared work for the worker and the client (36.6%), because undeclared work is widespread in the sector/region where they are engaged (29.4%), as well as the lack of confidence in the state (26%). Although a relatively small number of the respondents stated that they worked undeclared, according to the perception of the respondents, 31.9% of the population aged 15 and older is engaged in undeclared work.¹⁰

There are no official studies in The Former Yugoslav Republic Macedonia that estimate the size of the undeclared economy based on the results of tax, social security and/or labour inspections. Some data can be used from the government reports on implementation of the action plans for tackling undeclared work.¹¹ For instance, in 2015, the State Labour Inspectorate (SLI) found 237 non-registered workers during their inspections (which is about 0.03% of total LFS employment in the country). The special focus of the inspections in that year was the textile industry due to many complaints by the trade unions for high undeclared work and non-compliance of the employers, especially related to workers' rights to rest during a work week, overtime work, basic work conditions, etc. In 2015, there were inspections in 906 textile production capacities employing 86,789 workers. The inspectors produced 185 findings for legal violation for different elements of the labour law (leaving chance to employers to correct the compliance), and 8 decisions related to non-registered employees (one decision can involve more than one employee). Inspections were also targeted towards part-time employees, i.e. whether they are truly employed on a part-time basis, or employers register them on fewer hours per week just to reduce the payments to the social security funds (and pay part of the wage in cash). 654 inspections were carried out involving 1,669 employees. In 599 cases some irregularities were found such as there was no system or there was incomplete system of daily attendance registration of workers (start and end hours of the work day). The Public Revenue Office (PRO) also carried out inspections related to the implementation of the tax legislation. For instance, in 2015 they implemented

⁹ The research has been implemented under an IPA project "Support to the fight against undeclared work" financed by the EU, whose main beneficiary was the State Labour Inspectorate.

¹⁰ Similarly to the business surveys, the informal workers and citizens express their perceptions about the existence of a high level of undeclared work, but report a low level of undeclared work relating to their personal experiences.

¹¹ Until 2015, the Government was preparing annual Action plans for tackling informal economy.

control of the personal income tax of 92 persons and found irregularities for 55 of the cases. The total amount of the foregone tax was EUR790 thousand, as well as an interest payment of EUR 165 thousands.

The findings of the targeted SLI audits presented above may show two different stories: it is either that the size of the undeclared economy is very small or the effectiveness of the audits. Although this data give some indication of the size of the undeclared work, the problem is that data on inspections cannot be used to estimate the size of the undeclared economy because they are not based on a random or representative sample, but are mainly based on targeted sectors/companies with (perceived) risk of high undeclared work. Therefore, from a methodological point of view, it is wrong to extrapolate from the sample to the population. A more accurate picture of the incidence would be obtained if a random sample was selected for regular inspections. However, this is not to be recommended as the mandate of SLI and other inspection services is to target sectors and activities likely to be violating labour, tax and social insurance legislation.

3.2 Nature of the undeclared economy

3.2.1 Varieties of undeclared work

The relatively large share of micro- and small enterprises (MSEs) in The Former Yugoslav Republic Macedonia coupled with high unemployment is frequently seen as the catalyst for the prevalence of the undeclared economy. Official statistical data on active enterprises in The Former Yugoslav Republic Macedonia show that micro-enterprises represent 83.6%, whilst 97.7% of enterprises in The Former Yugoslav Republic Macedonia fall under the MSEs category (Table 2). The growth potential of MSEs is relatively small hence the government needs to create favourable conditions for these enterprises to grow and provide formal jobs.

Table 2. Number of active enterprises according to size, 2013-2016

	Number				Share (%)			
	2013	2014	2015	2016	2013	2014	2015	2016
0 employees ¹⁾	4415	3972	7329	8057	6.2	5.6	10.4	11.3
Micro (1-9)	60599	60215	56261	56725	85.0	85.2	80.2	79.3
Micro (10-19)	2989	3092	3032	3111	4.2	4.4	4.3	4.3
Small	1787	1869	1947	2030	2.5	2.6	2.8	2.8
Medium-sized	1291	1305	1339	1363	1.8	1.8	1.9	1.9
Large	209	206	231	233	0.3	0.3	0.3	0.3
Total	71290	70659	70139	71519	100.0	100.0	100.0	100.0

Source: State Statistical Office, active enterprises. Available at: <http://www.stat.gov.mk/PrethodniSoopstenijaOblast.aspx?id=79&rbrObl=22>.

1) Including business entities with an undetermined number of employees.

Micro-enterprises with 0-19 employees have largest share in the total employment in the economy; 42.5% in 2015 (Table 3). Still, the share of large enterprises in the total employment rose from 22% in 2013 to 25.6% in 2015. This phenomenon is related to the increasing presence of foreign direct investment in the country. Small enterprises create the major part of vacancies according to the data on vacancies published by the State Statistical Office.

Table 3. Employment structure according to enterprise size, 2013-2015

	2013		2014		2015	
Total		in %		in %		in %
0-9	115515	34.0	116231	32.9	120039	32.5
10-19	35209	10.4	35523	10.1	36901	10.0
20-49	41491	12.2	43217	12.2	45243	12.3
50-249	72613	21.4	69868	19.8	72706	19.7
250+	74518	22.0	88473	25.0	94348	25.6

Source: State Statistical Office.
http://makstat.stat.gov.mk/PXWeb/pxweb/mk/MakStat/MakStat__StrukturniStat/275_StrDel_Mk_09_13posize_klas_mk.px/?rxid=46ee0f64-2992-4b45-a2d9-cb4e5f7ec5ef

The undeclared practices of micro companies create unfair competition for the formal ones and push them into undeclared work. The study of CRPM (2015) shows that the second most important problem that supports undeclared work among the companies in The Former Yugoslav Republic Macedonia is unfair competition. Most of the respondents to the survey reported that micro enterprises who mainly work informally create this unfair competition.

The undeclared economy includes both wholly undeclared work and under-declared work. *Undeclared work* refers to work entirely undeclared to the state for taxation, social insurance and/or labour law purposes. This includes unregistered employees without a contract who work for a business, for a household, as family members, private tutors, or as farm workers. These workers might be secondary or multiple job holders who have social security coverage in their main job but do not contribute in their second job, or they may be pensioners, students, or others not in additional forms of declared employment. Besides undeclared wage work, there is also undeclared own-account work conducted on a self-employed basis where all or some of their transactions are not declared. The undeclared self-employment in the country is a very small part of the undeclared economy, with only 4% of the undeclared workers being self-employed (the remaining part are wage employees) (SELDI, 2016). Still, some of these self-employed in The Former Yugoslav Republic Macedonia may well be

‘bogus self-employed’, but the national labour legislation does not cover these cases of self-employment.¹²

Under-declared work, meanwhile, here refers to the illegal employer practice of salary under-reporting, including the practice of declared employers paying declared employees two salaries: (a) an official salary declared for tax, social security and labour law purposes, and (b) an additional undeclared remuneration received ‘under the table’ or by ‘envelope’. Another variant of under-declared work can be when businesses such as textile companies and supermarkets, employ a person on say a part-time basis whereas they work as a full-time employee. Detection of this form of under-declared employment by the authorities is difficult. For instance, some of the employers in the country reacted to the recent increase of the minimum wage by shifting some of their full-time workers to a part-time basis. Indeed, the SLI takes into account such cases and targets its inspections based on data from the Employment Service Agency-ESA (where all work contracts are registered) for companies where most workers are registered on part-time basis, or companies that increase significantly the share of workers registered on part-time contract, etc.

One of the major problems when analysing the nature of the undeclared economy in The Former Yugoslav Republic Macedonia is that there are very few sources of data, especially from the national institutions (with some exception of the SSO data). Hence, the analysis presented here is based on a several, larger scale research studies that were carried out in recent years.

There are different types of undeclared work based on the violation of the labour legislation and related acts. According to the collected answers based on the questionnaire, the most widespread practices for violation of the labour legislation are: non-registered workers, envelope wages, non-payment of overtime work and work during national holidays, inaccurate working hours reporting, etc. In the study of CRPM (2015), the surveyed firms confirmed that there are various practices violating the Labour Law. For instance, they identify the inclusion of hidden clauses in the employment contracts, i.e. under-reporting of the wages in the formal employment contracts. The survey carried out by ILO in 2015 has yielded similar results.

There are several factors that support the undeclared economy in the country, such as:

- A great portion of the undeclared economy in the country arises from the illicit and undeclared cross-border trade in goods. These goods are imported in the country informally or at a lower cost than legitimate ones, and then undermine the economy and reduce tax income in various ways. The hidden imports lead to a wide array of

¹² As previously stated, the Labour Law covers only formal employment relationships, where there is a written contract between employees and employers. Currently, the Government started to work on new labour law which, according to the ILO suggestions should be law that covers all forms of employment, and should seek to implement the ILO Recommendation 198 which *inter alia* covers the disguised employment.

forms of evasion of the payment of duties to the state, circulation of cash, hidden wages, bribery and corruption, etc. Such products are also sold at lower prices and disrupt the formal fair competition. CRPM (2015) estimated that approximately 20-33% of imports are hidden, by comparing the customs administration data on the registered imports of the major trade partners in The Former Yugoslav Republic Macedonia and, consequently, the registered imports.

- The large use of cash in payment transactions in The Former Yugoslav Republic Macedonia is at the same time a cause and an effect of the undeclared economy. This form of undeclared economy is related to undeclared cross-border trade, cash withdrawals from companies through loans as to evade taxation, hidden wages, private transfers from abroad, etc. Despite the legislative changes that were undertaken in the country to reduce the extraction of cash from companies and the circulation of the cash, the fiscalisation (amendments to the Law for registering cash payments) and similar initiatives, cash is still widely used.
- High level of remittances in the country which encourage undeclared work. Indeed, Ivlevs (2016) provides evidence that remittances in transition economies (including The Former Yugoslav Republic Macedonia) are associated with a higher probability of undeclared work among non-migrant households.

To further understand the sectors in which the undeclared economy is concentrated and who participates in such work, firstly, the demand for undeclared goods and services is analysed, secondly, the supply of undeclared work and third and finally, the nature of under-declared work in the form of 'envelope' wages in terms of who receives such additional undeclared wages and the determinants of its prevalence.

3.2.2 Demand for undeclared goods and services

This section is mainly developed based on the survey that was carried out within the framework of the project "Support to the Fight against Undeclared Work", funded by EU (Spitznagel et al., 2016). The survey provides a detailed analysis of the purchase of undeclared goods/services, profiling the individuals that demand such goods, reasons for the demand, types of goods/services, etc. The analysis is complemented by the additional available data sources/studies.

Results of the study of Spitznagel et al. (2016) show that a third of the respondents (natural persons), i.e. 32.2%, confirm that they have purchased goods or services which they believe to have been manufactured fully or partially using undeclared work (such goods and services are referred to throughout the study as undeclared goods and services) in the previous 12 months. The share of citizens in The Former Yugoslav Republic Macedonia who acquire undeclared goods is much higher than the EU average (11%), but close to the proportions found in the Eurobarometer survey (2013) in Greece (30%), Netherlands (29%) and Latvia (28%). There are studies that find much lower demand for undeclared goods in The Former Yugoslav Republic Macedonia. For instance, the study of Williams and Bezeredi (2017a) based on 2,000 structured face-to-face interviews, revealed that only 17.7% of the respondents in The Former Yugoslav Republic Macedonia purchased goods or services in the undeclared economy.

The acquisition of undeclared goods and services occurs quite frequently, with over half of



the respondents stating that they acquire undeclared goods a few times in the previous month of the survey. According to the survey, the greatest portion of the undeclared work is carried out in production and sales of fruits and vegetables (28.9% believe that these goods have been produced using undeclared work), cigarettes, food and beverages (27%), garments, textile and footwear (17%), firewood (16.4%), hairdresser's and cosmetic services (14.4%), etc. The greatest motives behind purchasing undeclared goods and services are: low price (according to 80% of the respondents), faster service (40% of the respondents), but in many instances the purchase of undeclared goods is because of their better quality (37.8%). Some of the respondents (19%) reported that they acquired undeclared goods/services because such goods/services do not exist in the formal market, or that they do that as a favour to a friend/relative/colleague (13.5%). Williams and Berezedi (2017) examine the reasons why individuals buy goods/services in the undeclared economy in three economies (Croatia, Bulgaria and The Former Yugoslav Republic Macedonia). They find that in most cases it is due to the lower price (57.1%), but for 48.1% of the respondents it was because of the failures in the formal economy (for instance, the non-availability of the products in the formal economy), and in 24% of the cases it was related to a social or redistributive reasons (where purchasers act as social actors rather than rationally comparing costs and benefits).¹³

The survey results presented in Spitznagel et al. (2016) also show the demographic characteristics of the population that demand undeclared goods. The study does not find large differences between men and women in the demand of undeclared goods and services. Opposite to this, the study of Williams and Bezeredi (2017a) finds that women on average are less likely to purchase undeclared goods by 26.6%. Younger respondents (aged 15-19) and older ones (aged 60+) are least likely to demand undeclared goods. In contrast, about 40% of the respondents from the age group 50-54 had acquired undeclared goods and 28.3% undeclared services (Spitznagel et al., 2016). Employed and unemployed individuals are more likely to acquire undeclared goods relative to inactive persons. Ethnic Macedonians, and persons living in urban settlements are more likely to purchase undeclared goods. The financial position of a person also affects their acquisition of undeclared goods. In particular, of the respondents with monthly income of EUR500 and more, 48.4% reported that they had acquired undeclared goods and 46.7% reported to have acquired undeclared services. On the other hand, of the respondents with income below EUR160, 28.9% acquired some undeclared goods and 15.3% undeclared services. As the authors conclude, the socio-demographic characteristics of the individuals purchasing undeclared work in The Former Yugoslav Republic Macedonia is similar to the characteristics in the EU economies. The average yearly expenditure on undeclared goods in the country is around EUR200, which is about twice the median expenditure in the EU.

¹³ The authors, Williams and Bezeredi (2017a) provide a detailed explanation of three potential motivations for purchasers in the informal economy, that are lower costs explanation, social motives explanation and formal economy failure. They test these three potential explanations on the case of Bulgaria, Croatia and The Former Yugoslav Republic Macedonia.

The main providers of undeclared goods and services are more distant, individual persons or households (in 57.5% of purchases), whereas 26% of the respondents bought the undeclared goods/services from persons in their immediate social environment.

The authors conducted a multivariate regression analysis in order to unveil the main factors associated with the probability of demanding undeclared work (the dependent variable was “Have you in the last twelve months acquired any services or goods of which you had a good reason to assume that they embodied undeclared work?”). The results show that:

- Citizens of Vardar and Polog region have highest probability to demand undeclared goods;
- Urban population is 1.46 times more likely to report that they purchased undeclared goods relative to the rural population;
- Higher household income leads to higher demand for undeclared goods;
- There is a link between employment status and demand for undeclared goods. Registered unemployed persons have a higher probability to demand undeclared goods relative to retired persons, and the effect is statistically significant. The coefficients for the employed persons are not statistically significant;
- Citizens who have a more positive attitude towards anti-social behaviour (based on 7 survey questions) are more likely to acquire undeclared goods/services.

The study of Williams and Bezeredi (2017a) adds several other variables (i.e. potential factors) that may explain why people purchase in the undeclared economy. Their results show that these factors are all significant in explaining such behaviour. In particular, they show that the “undeclared” behaviour is lower for: i) people that perceive that there are high penalties and risk of detection; ii) those who believe that there is lower undeclared work in the economy and iii) those with higher tax morale. These findings bring very important lessons to the policymakers for their approaches to formalizing undeclared economy. In particular, they show that the trust in institutions, the perception about the fairness of the society, tax morale, and perception of high penalties and risk of detection are more important determinants of undeclared work than the socio-demographic characteristics of individuals.

3.2.3 Supply of undeclared work

Government policies for formalization of the undeclared economy should combine approaches both on the demand and supply side of the market. In the previous section, we explained the customers of the undeclared economy, whereas this section focuses on those who supply their labour to the undeclared economy and produce goods and services in the undeclared economy.

The survey of Spitznagel et al. (2016) collected information on the respondents who had carried out some undeclared activity in the past 12 months, but also in the 7 days prior to the survey. The findings show that 10.5% of the respondents (the extrapolated number of



individuals for the overall population is 176,000) worked undeclared in the previous 12 months to the survey (i.e. in 2014).¹⁴ This is a sensitive question, for a respondent to personally admit that s/he is performing some undeclared work (whereas it is more acceptable that a person purchases some undeclared good). Hence, we can expect some under-reporting of participation in undeclared work. On the other side, workers may be more open to report their undeclared work, as in the national legislation, when a worker is found at a work place without a work contract, the obligation and penalty rests solely with the employer. Such legislation has an implicit assumption that workers are pushed by employers into working undeclared and that their rights are violated, although as we see in the next section, there are workers who voluntarily work informally as to receive a higher take-home wage, increased due to the reduced social contributions paid. The potential under-reporting of undeclared work can be seen in the finding that a relatively small number of the respondents stated that they worked undeclared, while in their view, 31.9% of the population aged 15 and older is engaged in undeclared work.¹⁵

Spitznagel et al. (2016) find that the undeclared work is highest among unemployed persons: 21% of unemployed persons reported that they have worked undeclared in the previous 12 months. 9% of the inactive worked undeclared and 8% of employed workers. Similar to the LFS data, the survey data of these authors show that men are more likely to work undeclared (15.3% of men), whereas undeclared work is lower for women (5.3%) (the gender ratio of undeclared workers is 3:1). Workers in the age groups 20-24 and 30-39 years are more likely to work undeclared relative to all other age groups, whereas participation in undeclared work is lowest among the age group 60+ (these results are not in line with the LFS data). Secondary educated workers have highest propensity to work undeclared, in 14.1% of cases (they represent over half of the overall number of undeclared workers). Persons with tertiary education have the same level of participation in undeclared work as the national average, whereas 7.5% of those with low levels of education worked undeclared in the previous 12 months. Education is also likely to be connected with the type of undeclared work conducted, i.e. whether workers work without a work contract, whether they have higher salary than in the formal contract, whether their social contributions are paid on the minimum age, etc. The latter is related to the vulnerability of the undeclared workers but also requires different actions by the state.

This study finds no difference in the occurrence of undeclared work by income level. Regarding household size, individuals from households with three adults are more likely to work undeclared (in 15% of cases), and those from two-adult households least likely (in 7.4%). Whereas there is no difference in undeclared work among the two major ethnic minorities (ethnic Macedonians and ethnic Albanians), individuals from other ethnicities are

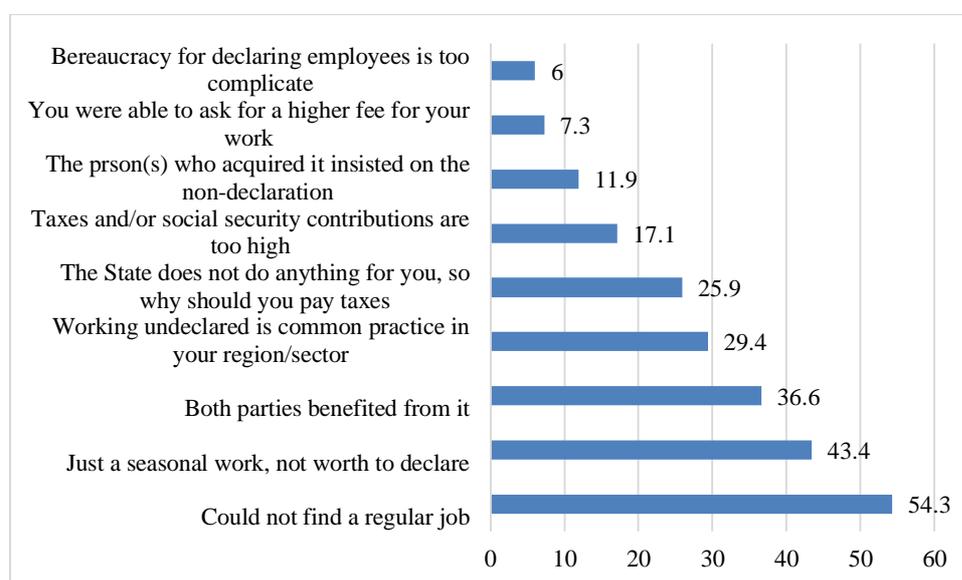
¹⁴ The informal employment as reported by the LFS in 2014 was 156,000.

¹⁵ Similarly to the business surveys, the informal workers and citizens express their perceptions about the existence of a high level of undeclared work, but report a low level of undeclared work relating to their personal experiences.

much more involved in undeclared work (18.8%). Among the regions, the highest proportion of individuals from the Polog region (with a majority of ethnic Albanian population) reported working undeclared (14.2%). The multivariate analysis performed by the authors finds that the individuals who are more inclined to anti-social behaviour are most likely to engage in undeclared work.

The most common reason given for engaging in the undeclared economy is the inability to find a regular job (see Figure 1). Additional common reasons are: the seasonal nature of the work (43.4% of the respondents), the economic benefits of undeclared work for the worker and the client (36.6%), the general prevalence of undeclared work in the sector/region where a worker is engaged (29.4%), as well as the lack of trust in the state (26%).

Figure 1. Reasons for working undeclared



Source: Survey results reported in Spitznagel et al., 2016.

The survey of Spitznagel et al. (2016), finds the following characteristics of undeclared work:

Sectors of occurrence: According to the Spitznagel et al. (2016), undeclared work is most prevalent in agriculture where 18.2% of workers operate on an undeclared basis, manual work (8.4%), restaurants (8.2%), construction (7.9%), etc.

Frequency of undeclared work: The study by Spitznagel et al. (2016) reveals that about a third of undeclared workers are engaged in undeclared work frequently; 27.4% work undeclared several times a week, and 18.3% of people were engaged in undeclared work as a one-off event. The average time of engagement in the undeclared work reported by the respondents was 14 weeks during the last 12 months, and 24 hours per week (which is about half of the regular, 40-hours week defined in the national legislation). The study does not find large differences in the frequency of engagement by socio-demographic groups, with few exceptions, that are having completed secondary education, being an ethnic Albanian, and workers with very low income (below MKD 5,000).



Remuneration: Most undeclared workers were paid in cash (86.2%), and a few (5.8%) were compensated in-kind, with the remainder receiving a combination of the two. The average annual earnings were MKD 35,360 (EUR 575) compared to the average annual wage of EUR 4,625.¹⁶ The average earnings from undeclared work mask large differences between the ethnicities: the average hourly wage for the sample was MKD 177, whereas the average for the ethnic Albanians was double the national average.

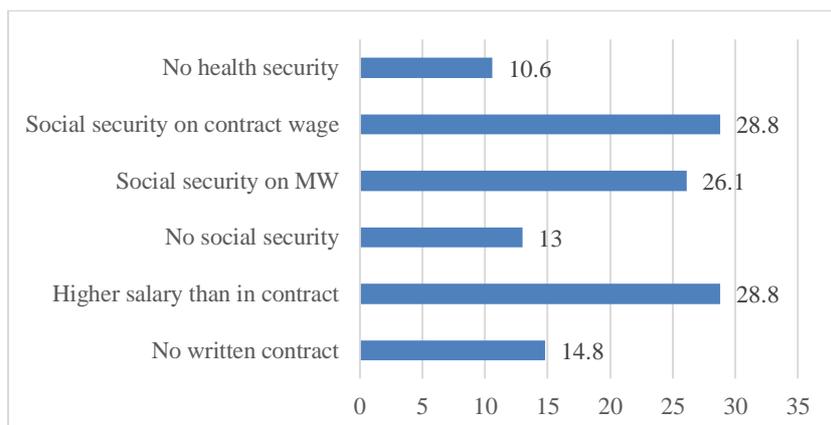
Customers: About third of undeclared work is performed for friends and colleagues (30.3%) and for individual households. Contrary to expectations, relatives (who are 12.3% of the customers) and neighbours (3.9%) are least likely to be customers of undeclared workers.

3.2.4 Under-declared employment: envelope wages

There are different forms of work in the undeclared economy, from engaging workers without a formal contract, declaring only a part of the wage of a formal employee, etc. As Figure 2 shows, about 15% of the undeclared workers in the Former Yugoslav Republic of Macedonia have no written contract. However, a more widespread form of undeclared work is not paying at all or paying lower social contributions, based on a lower contractual wage than the real wage and/or the minimum wage. In this case, workers receive all or part of their wage in cash, as an “envelope wage” (also called hidden wages and cash-in-hand). The envelope wages are used as a way of reducing labour costs (by employers), but are also sometimes used in agreement between the worker and employer, so that the worker receives a higher take-home wage than what the salary would be in case of a fully formal contract. The envelope wage is set through a verbal contract (different from the formal work contract) and is by definition illegal. If this illegal labour practice is widespread in an economy, it means that the state cannot protect workers in terms of the quality of working conditions, workers’ rights, but also it can lead to weakening collective bargaining and unfair competition (Andrews et al., 2011; Williams and Franic, 2017).

Figure 2. Forms of undeclared economy

¹⁶ This comparison is very basic, does not take into account the difference in hours worked, etc.



Source: SELDI, 2016.

Although it is known that envelope wages are present and widespread in The Former Yugoslav Republic Macedonia, the estimates of its size vary from as low as 7.7% of all formal employees to as high as 50% of all formal employees. According to the survey of the Center for Research and Policy Making (CRPM), envelope wages are the most widespread form of undeclared economy in The Former Yugoslav Republic Macedonia. As many as 50% of the respondents in the 2016 survey of CPRM stated to have received wages that are fully or partially undeclared (CRPM, 2016), despite the fact that a majority of them are in formal employment. In particular, for 37.3% of the formally employed workers, employers pay contributions on a lower wage than the actual one (i.e. the contractual wage is lower than the actual one). Only half of the formal workers receive their social security contributions on the actual amount of their wages. The surveys show that the envelope wages are most commonly paid upon a mutual consent of both parties. In particular, 22% of the workers in The Former Yugoslav Republic Macedonia stated that they prefer not to be formally employed but receive higher wages rather than have the status of formal employees and receive lower wages (CRPM, 2016).

On the lower end of the estimates, the survey results of Spitznagel et al. (2016) show that only 7.7% of the workers receive envelope wages (according to the findings of the field survey). The scope of the payment of envelope wages was found to be greatest in the services sector where 11% of the formal employees reported that they receive envelope wages. Of those workers who receive an envelope wage, on average 46.7% of their monthly net salary is provided as an undeclared envelope wage. The survey also showed that 38.5% of these workers are content with receiving envelope wages, 30.6% would prefer to receive a fully formal wage and about a quarter are undecided. In terms of the potential negative effects of envelope wages (such as lower social security, potential of detection, etc.), about half of the workers (48%) have not experienced any negative or positive consequence, more than a quarter (22.6%) perceived a higher risk of losing the job, 13.8% believe that they are at risk

of more accidents, and 15% report as a negative consequence the non-payment of social contributions.

Yet another indicator of the incidence of envelope wages is the fact that a great number of the formal employees receive wages at a level between the minimum wage and the minimum floor for payment of contributions.¹⁷ In particular, in 2014, 32% of all workers received wages in the amount of MKD 8.000-12.000, i.e., in the range between the minimum wage and the minimum base for payment of contributions (SSO, 2015).¹⁸ Thus, the suggestion is that the employers are paying lower contributions and personal income tax, and then pay additional undeclared envelope wages to the workers.

The Survey of quality of life of Finance Think (2017) showed that 17.8% of the formally employed workers receive part of their wage in cash (under-declared employment). This phenomenon is more widespread across youth (19-29 years of age) and the older workers (50+), being close at 20%. 16% of the workers within the age group 30-49 receive part of their wage in cash. Across the economic sectors, the highest share of envelope wages is found in transport (33.3% of all workers), construction (27.7%), IT sector (22%), industry (19%), accommodation and service food (18.1%), etc. According to the education structure of the workers, envelope wages are most widespread among workers with primary or no education (close to 100%), those with 3-year tertiary education (46.2%), 4-year vocational education (19.9%), and then it significantly declines for the tertiary educated workers. Envelope wages are most common for workers at low formal wage levels: 62% of workers who receive a salary up to the level of the minimum wage, also receive an additional cash wage. This share declines with the increase of the wages and completely vanishes at wage levels which are two times of the minimum wage. This survey data shows that, on average, the formal part of the wage is larger than the undeclared part, so that the cash payment is about 34% of the overall wage. However, envelope wages are again most widespread among low-educated and low-paid workers. In particular, for workers who receive wages up to the level of the minimum wages, the declared and undeclared parts of the wage are almost equal, and they earn double the wage which is officially reported.

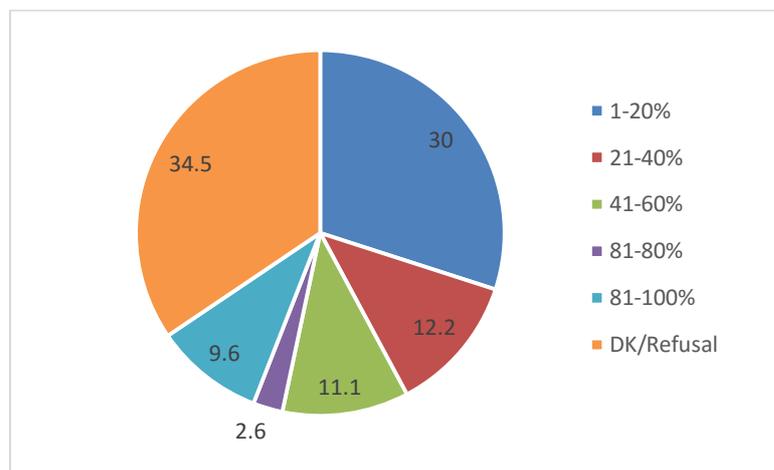
The study of Williams and Franic (2017) based on face-to-face interviews with 2,000 individuals in The Former Yugoslav Republic Macedonia conducted in 2015 showed that 13% of the employees in the country were receiving envelope wages. As Figure 3 shows, about one-third of workers receiving envelope wages receive only 1-20% of their wage in cash, but at the other end almost 10% of these workers receive over 80% of their net income as cash-in-hand. This study is a first one that examines the issue of envelope wages in a more detailed way and from a perspective of the vulnerability of the workers that receive envelope wages. It looks at the whether the verbal contract between employer and worker which involves an envelope wage incorporates additional conditions, such as that workers will work

¹⁷ Set at 50% of the average gross wage.

¹⁸ SSO, Employees and net wages for 2014 (last available data).

more than the statutory work hours (or those in the contract), that the worker will not fully use their annual leave entitlement, etc.

Figure 3. Share of the net income received as envelope wage: as proportion of workers receiving envelope wage



Source: Based on GREY survey reported in Williams and Franic (2017).

The survey of Williams and Franic finds that 59.2% of the workers receiving envelope wages had some additional conditions accompanying their undeclared wages. In most of these cases, workers were asked to work longer hours, followed by performing tasks which were not part of their work agreement, and not to use fully the holiday entitlements. The regression analysis based on logit model for the three countries which were involved in the study (Bulgaria, Croatia and The Former Yugoslav Republic Macedonia) showed that there were no gender differences in the propensity to receive envelope wages, although that was because of underrepresentation of women in the sector in which envelope wages are most widespread (construction). The incidence of envelope wages reduces with a workers' age. Workers in agriculture and those conducting household and repair services are as likely as workers in construction to receive envelope wages. The regression analysis also reveals that the tax morale significantly affects the probability that a worker receives envelope wage. On the other hand, there is no statistically significant relationship between the probability of receiving an envelope wage and the expected sanctions (fine and/or prison). The latter brings similar evidence and guidance for the policymakers as the study of Williams and Bezeredi (2017a). It reveals the importance of the norms, values and beliefs of the workers for their engagement in undeclared work. On the other hand, taking into account these findings, the deterrence approach which increases the risk of detection and the penalties would not bring any positive development in tackling this form of under-declared employment.

3.2.6 The role of the personal connections

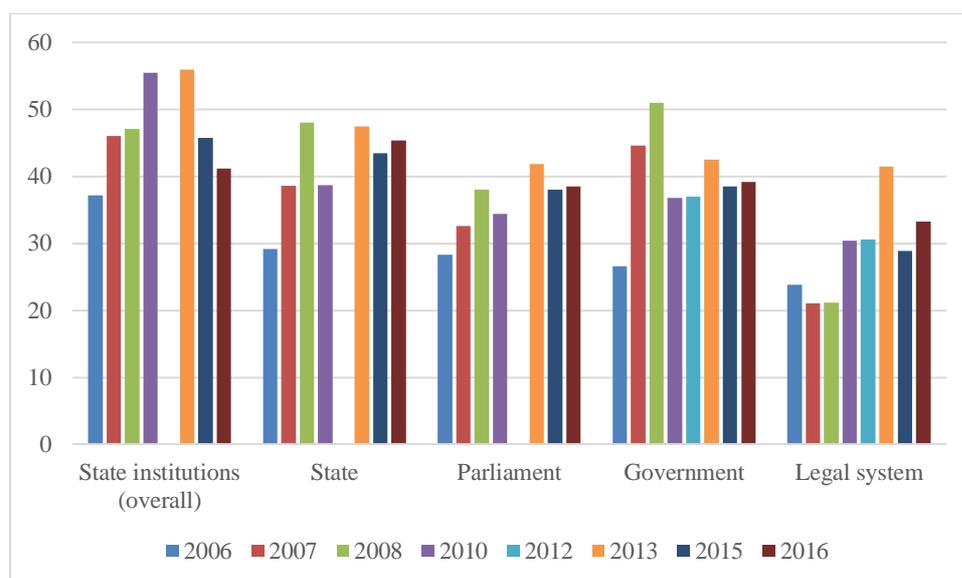
One additional form of informality is the use of personal connections (social networks or ties) to circumvent formal procedures, known as “pulling strings” or, nationally, “vrski”. Whereas there are some beneficial effects of *vrski*, some authors point out their darker side (Ayios et al., 2014), which manifests in nepotism, corruption, etc. High tolerance and acceptance of informality is usually connected with widespread practice of receiving and providing

personal favours. The study of Williams and Bezeredi (2017b), for instance, shows that 88% of interviewed 2,014 persons in The Former Yugoslav Republic Macedonia stated that they think that the use of *vrski* is very important in the country to get things done. Although the respondents generally held a negative view on using personal connections, 35% of respondents had used *vrski* in the 12 months prior to the survey to get things done. Medical services, finding a job, getting repairs (for home of car), solving problems with law-enforcement agencies and speeding up bureaucratic procedures were the main areas where respondents had to use their social ties. The regression analysis presented in the paper reveals that younger, richer individuals, those engaged in undeclared economy and those from villages are more likely to use personal connections to get things done. Fewer respondents reported that they provide favours for someone else. In this case, again, most frequent area where respondents had made an arrangement for somebody they knew to gain access to medical services (8.2%) and 7.7% helped somebody to find a job. The profile of the respondents who provided favours is similar to that of those receiving a favour. This data brings some important policy conclusions. While government can apply stricter penalty policy towards undeclared work and misuse of the social networks, there is a large scope for reducing the asymmetry between formal and informal institutions, either or both through changing norms and values of the citizens and modernization of the formal institutions (Williams and Bezeredi, 2017b).

4 Drivers of the undeclared economy in The Former Yugoslav Republic Macedonia

As the analytical framework in section 2.1 highlighted, undeclared work arises when the failings and imperfections of formal institutions result in an asymmetry between state morality (the laws and regulations) and citizen morality (citizens' norms, values and beliefs regarding the acceptability of these laws and regulations). In Figure 4, an indication is provided of the degree to which state morality and citizen morality does not appear to be aligned in The Former Yugoslav Republic Macedonia by examining the proportion of people who have trust in the government and the state institutions. As a general pattern, the level of trust was increasing in the country until 2012 but then started to decline (with some improvement in some areas in 2016). In 2016, 41% of the citizens trusted the state institutions (although, highest trust was recorded for the army and police). The trust in the state is relatively high. Government enjoyed a high level of trust in 2008, when economic growth picked up and the government had made a significant progress in the economic reforms. However, the level of trust declined the next year, following the decline by NATO for membership. There is an improvement in the trust in the legal system, but the starting point is too low: in 2006 only 21% of the citizens had trust in the legal system. The trust in the Parliament in 2016 was also relatively low although it has improved since 2006.

Figure 4. Trust in state and institutions



Source: MCIC, 2016.

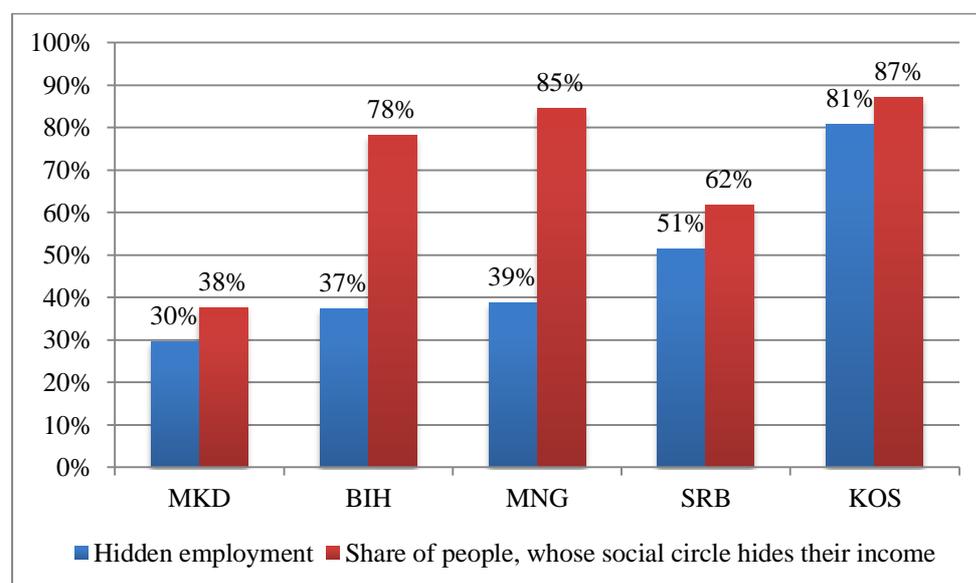
To the extent that these attitudes are reflected in the compliance behaviour of citizens, the low level of trust in the authorities is accompanied by low voluntary compliance. Distrust between citizens and state can be one of the major reasons behind undeclared work. In The Former Yugoslav Republic Macedonia, there is a relatively large distrust in terms of horizontal relations (i.e., in citizens trust in other taxpayers), as well as vertical relations (i.e., lack of citizen trust in the state). In such an environment, non-compliance will be high, government will not be able to collect its tax revenues, labour law will be violated by firms, and the acceptability of undeclared work will be widespread. Indeed, Williams and Bezeredi (2018) find that horizontal trust in The Former Yugoslav Republic Macedonia plays a very important role in explaining the likelihood of an individual participating in undeclared work.

SELDI (2016) provides an estimate of the social embeddedness of the undeclared economy in the Western Balkan region calculated as the gap between self-reported participation in the undeclared economy and the involvement of one's social circle in the undeclared economy.¹⁹ The report finds that in general, within the region, individuals who hide their income have narrow social networks which disproportionately involves other people who hide their work/incomes. In The Former Yugoslav Republic Macedonia, about 38% of respondents know people who hide their income fully or to some extent. The problem is that the social embeddedness of the undeclared economy has a "multiplying" effect on undeclared work. In particular, the SELDI study found that majority of the unemployed workers (62% as an average of the 5 economies) know someone who hides hers/his income which increases the

¹⁹ The latter is approximated as a share of respondents who answered that none of people they know declare their full income or only some of them declare their full income.

chances that the transition of the unemployed towards employment will be through undeclared work. In addition, hiding the employment and income and knowing many people who do so, leads to high tolerance and acceptability of undeclared work and undermines the efforts for its reduction. In the business area, however, there is no perception of widespread undeclared work. For instance, the Balkan Business Barometer shows that most firms in The Former Yugoslav Republic Macedonia (76%) think that a typical company in the country reports 76-100% of its sales for tax purposes.²⁰ 3% believe that typical company reports only 26-50%, and another 3% that firms report 51-75% of their annual sales (18% of companies refused to answer the question).

Figure 5. Social embeddedness of undeclared economy



Source: SELDI Hidden Economy Survey, 2016.

Indeed, the high **tolerance and acceptance of the undeclared economy** is one of the reasons for its existence and persistence in The Former Yugoslav Republic Macedonia. In other words, despite the fact that the companies are victims of companies working wholly or partially in the undeclared economy, they often use enterprises operating in the undeclared economy as their suppliers. In particular, the results of the ILO survey indicate that 44.1% of the surveyed enterprises are customers of enterprises operating in the undeclared economy and only 10% state that they have never used informal companies as suppliers (ILO, 2015). In 78.8% of the cases, the undeclared suppliers are used to lower costs, while often the undeclared suppliers offer products of higher quality (6.1%).

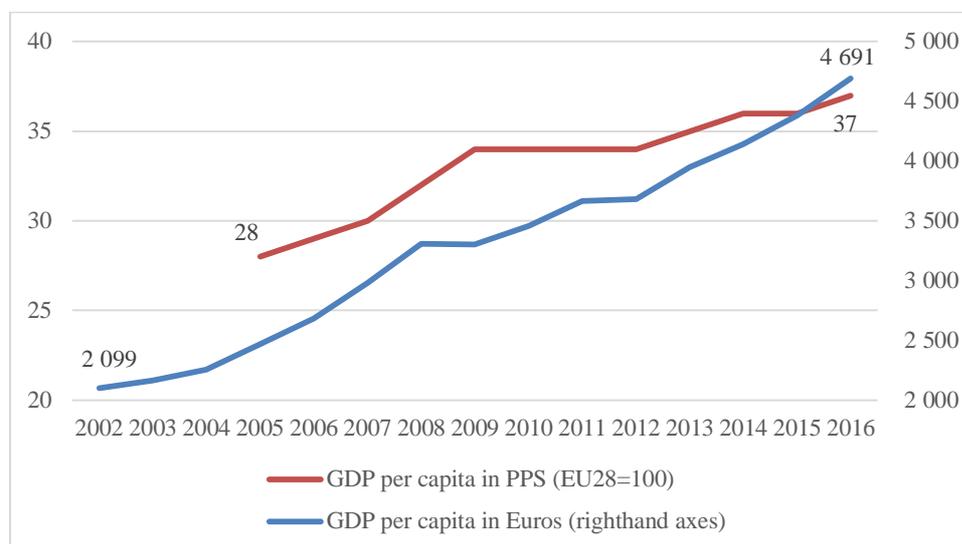
²⁰ Data available at: <https://www.rcc.int/seeds/results/3/balkan-business-barometer>.

As section 2.1 revealed, a wealth of cross-national studies reveal that the failings and imperfections in the formal institutions that result in an asymmetry between state morality and citizen morality, and thus the prevalence of undeclared work, are:

- lower GDP per capita;
- higher corruption and lower quality of governance;
- lower expenditure on labour market interventions to help the most vulnerable groups;
- lower levels of social expenditure, and
- social transfer systems that are less effective at reducing the level of inequality and severe material deprivation, which includes improving the efficiency of collection.

Here, therefore, we evaluate the direction of change in each of these in The Former Yugoslav Republic Macedonia in order to evaluate where macro-level intervention is required in order to stem the growth of the undeclared economy in the country.

Figure 6. GDP per capita in The Former Yugoslav Republic Macedonia, 2002-2016



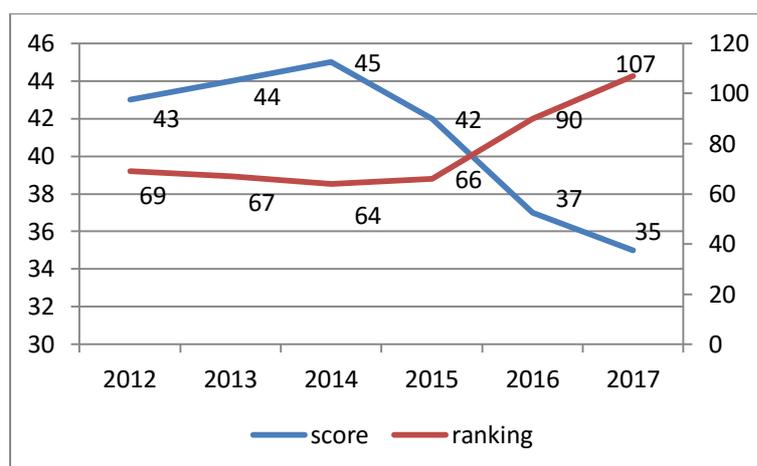
Source: State statistical office for the GDP per capita in EUR, at: <http://www.stat.gov.mk/PrikaziSoopstenie.aspx?rbtxt=32>. Eurostat database for the GDP per capita in PPS, at: <http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tec00114>.

The living standard of a country has been widely identified as strongly correlated with the size of the undeclared economy: the lower the GDP per capita, the larger the undeclared economy (Williams 2014a,b,c, 2015a,b, 2016; Williams and Horodnic, 2016). Figure 6 examines the trends in GDP per capita (in current euros), as well as the relative living standard of the citizens (measured as GDP per capita in PPS in The Former Yugoslav Republic Macedonia relative to the respective GDP in EU-28). Data show that there has been a large increase in the living standard of the citizens in the period from 2002 to 2016, i.e. more than doubling (from EUR 2,099 to EUR 4,691). The relative living standard (compared to the EU-28) also improved but only moderately. While in 2005, the living standard of the citizens of The Former Yugoslav Republic Macedonia was 28% of the average for the EU-28, this ratio increased to 37% in 2016. Further improvement in the living standard can

support some reduction of the undeclared work, but that will require much higher growth rates of the economy (amidst the significant decline in the growth rates in 2017 and first quarter in 2018).²¹

It is also the case that cross-national studies reveal that the greater the level of public sector corruption and the lower the quality of governance, the more extensive is the undeclared economy (see section 2.1). In The Former Yugoslav Republic Macedonia, according to Transparency International's Corruption Perceptions Index (CPI), there is a high level of perceived public sector corruption. In particular, according to the CPI, The Former Yugoslav Republic Macedonia in 2017 was ranked 107th out of 180 countries (see Figure 7). In the analysed period, the index was initially increasing (i.e. improving) but the political crises in the country in the last several years (which started with a large corruption tape scandal) contributed to a significant deterioration of the CPI. The index declined to 35 points (on a scale where 0 equals highly corrupt to 100 equals very clean), whereas the ranking from 69th place to 107th place. Although governments are generally prepared to enact suitable legislation on tackling corruption, the application thereof is still a major issue. Therefore, the fight against corruption still presents the most serious challenge to the region.

Figure 7. Corruption perception index, The Former Yugoslav Republic Macedonia



Source https://www.transparency.org/news/feature/corruption_perceptions_index_2017.

The reduction of the corruption can be an important tool for decreasing the undeclared economy. Thus, policies aiming at the reduction of the undeclared economy should primarily focus on the fight against corruption, as well as on improving the trust in government and the quality of governance. This inevitably requires combating the clientilistic relationships of politicians and addressing the society weaknesses that create a room for rent-seeking behaviour of politicians and the civil servants.

²¹ The real GDP stagnated in 2017 and increased only by 0.1% in the first quarter of 2018.



This project is funded by the EU

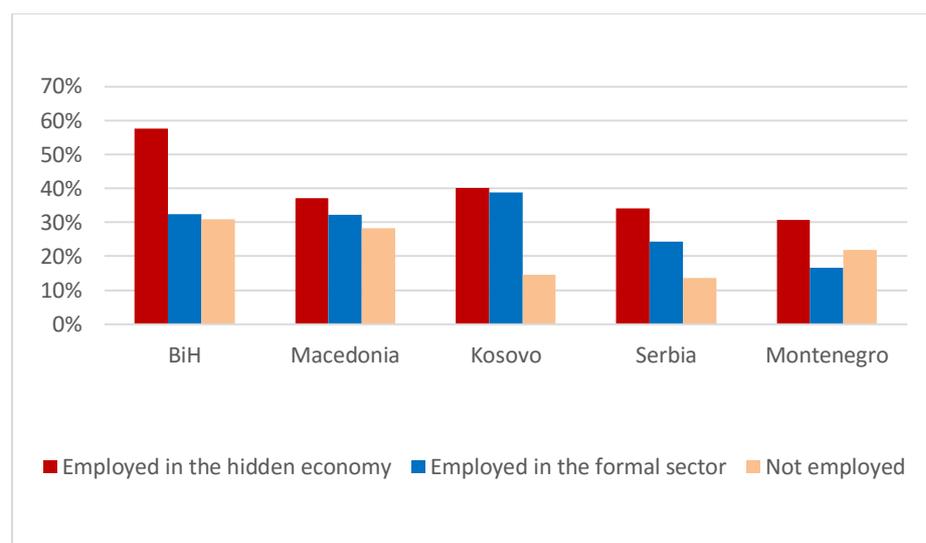
There are several research studies in The Former Yugoslav Republic Macedonia in which citizens and firms report that the corruption is an important trigger of the undeclared economy (SSO, 2013; CRPM, 2015; Nuredinoska et al., 2016). These studies show that the corruption exists in all segments of the society and life, but at the same time there is a large tolerance towards this phenomenon.

One of the few studies implemented in The Former Yugoslav Republic Macedonia that does not measure the perception of corruption, but real cases of corruption shows that the corruption is widespread phenomenon (SSO, 2013). 6.5% of the companies that had a contact with public officials in 2012 reported that they paid some bribe (one in ten companies included in the research had a contact with the officials). On average, these companies paid 4.8 bribes to the public officials (one bribe on every 11 weeks). The bribery is most widespread in the construction sector (11.7%), retail and wholesale trade (7.5%), electricity production, distribution of gas and water (5.1%) and in services. About half of the bribe (52%) was paid in-kind, i.e. in a form of food and drinks. When paid in cash, the average payment is 17,349 MKD, which is a rather small amount but if transferred into euros by purchasing power parity (PPP) reaches EUR 689 in PPP. The most important reason for the bribery is to speed up some procedure (50%) and to finalize it (9.6%), but often the bribery is not directly related to a specific, current cause/need. As we previously argued, in case of well-functioning institutions and clear and established regulation and procedures, there would be little room for bribery. The bribery is most widespread among custom officers (6.3%), and in the cadastre (3.4%). However, very few companies (only 3.3% of those that participated in a bribery transaction) reported the corruption. Small companies (10-49 employees) are much more likely to be involved in bribery, which puts a large (financial) burden on them.

The research of Nuredinoska et al. (2016) shows that corruption is the 5th major problem in The Former Yugoslav Republic Macedonia in 2015 (after unemployment, political instability, poverty and low income). Most of the respondents held a view that the main trigger behind corruption is the desire of the political leaders for becoming rich in a short period of time. In 2015, every third citizen faced a pressure for (were required) to pay a bribe, whereas 29% have actually given a bribe (if this is extrapolated to the whole population, it implies that over 480 000 citizens have given a bribe at least once in 2015). The study shows that less educated citizens are more likely to bribe. Only 7.4% of the citizens who were bribed reported the bribery to some government institution. However, this study confirms the large tolerance towards corruption: 47% of citizens stated that they accept/tolerate some forms of corruption (and as much as 68.8% of ethnic Albanians). In most cases, the bribe has a practical meaning and serves the purpose of addressing some problem of the involved citizens. 62.7% of the citizens believe that public officials are involved in corruption in the following order: judges, ministers, political party leaders, members of the Parliament, customs' officers (the last category has seen a largest reduction in the perception of corruption since 2001).

Figure 8 shows a relative perspective of the corruption pressure towards citizens in the Western Balkan region. The pressure for corruption²² of citizens in The Former Yugoslav Republic Macedonia is comparatively on a higher level, but more importantly this data reveal that workers who are employed in the undeclared economy are more likely to experience corruption pressure (and those not employed, the least).

Figure 8. Corruption pressure experienced by those in different employment situations, 2016

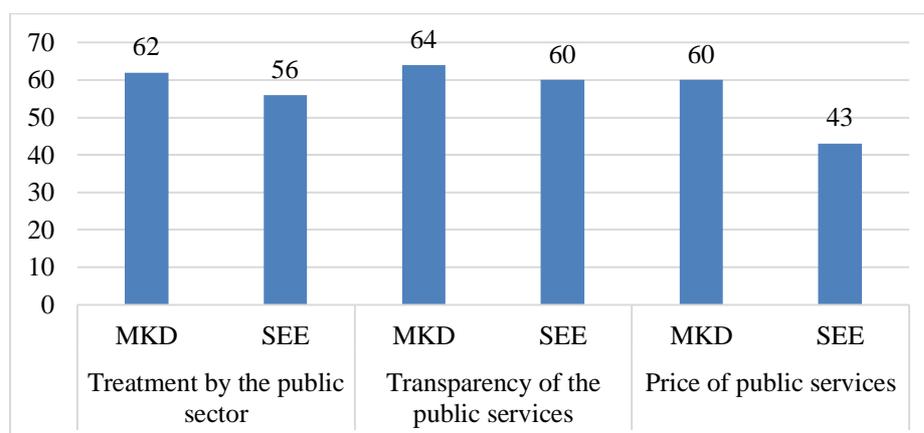


Source: SELDI Corruption Monitoring System, 2016 and SELDI Hidden Economy Survey, 2016

Despite the recent deterioration in the CPI, The Former Yugoslav Republic Macedonia has made substantial progress since the early 2000s in terms of adopting and enhancing the legal framework for the fight against corruption (Corruption Prevention Act, Conflict of Interest Act, Elections Act, Financing of Political Parties Act, etc.), as well as by strengthening institutional and administrative capacities (mainly by setting up the State Commission for Prevention of Corruption). The first Corruption Prevention and Repression Programme was established in 2002, whereas currently, the 4th Programme covering the period of 2016-2019 is being implemented. However, good regulation itself is not enough to improve the situation. Implementation matters more (as well as the perception of the public on the matter).

Figure 9. Satisfaction of the citizens with the public services, 2017

²² Defined as an adult citizen who was being demanded directly or indirectly to bribe public officials.



Source: RCC, Balkan Opinion Barometer, at: <https://www.rcc.int/seeds/results/2/balkan-opinion-barometer>.

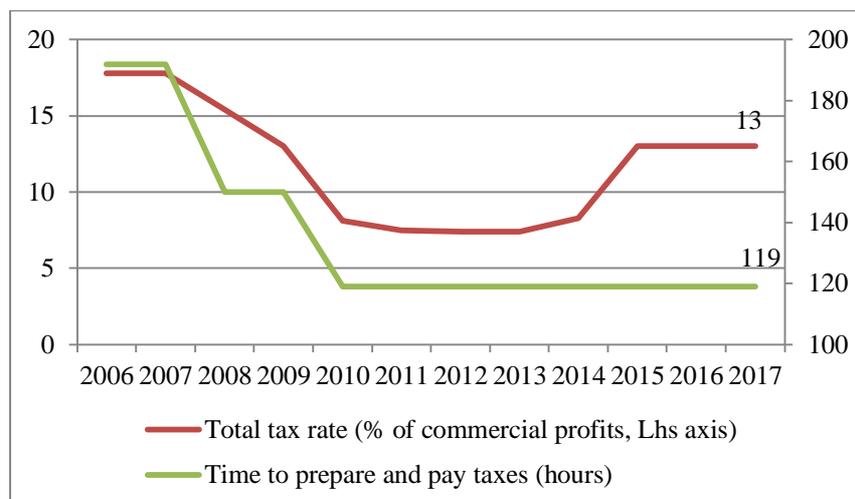
Note: Reported shares are for citizens who think that the item under consideration is: good, very good or excellent.

Quality and price of the public services delivered to citizens and firms can also have a large influence over the willingness of citizens to operate on a declared basis. Figure 9 shows the share of citizens in The Former Yugoslav Republic Macedonia and citizens of South Eastern European (SEE) economies who have a positive view for certain elements of the public services. For instance, in 2017, 62% of citizens of The Former Yugoslav Republic Macedonia reported that the treatment of citizens by the public institutions (police, health system, judiciary, etc.) is good. 64% believe that public services are transparent towards citizens and 60% are relatively satisfied with the price of the public services. While these figures show that the majority of citizens are satisfied with public services, one has to note that majority of the answers are under the category “good”, rather than “very good” or “excellent”.

The Balkan Business Barometer also collects information from firms related to their satisfaction with public services. This data show that 43% of businesses in The Former Yugoslav Republic Macedonia are satisfied or strongly satisfied with the public services for businesses (the average for the SEE is 26%). Moreover, 42% are neither satisfied nor dissatisfied which shows that there is a large room for improvement of the public services as to better align the citizens’ and state’ morality.

Many elements of the tax system - tax rates, fairness in taxation, the administrative burden on firms from taxation and perception about the corruption in the tax administration - have an important effect on the citizens’ tax morality. The Former Yugoslav Republic Macedonia is a country with relatively low tax rates and a low administrative burden of taxes, suggesting that taxes should not be a major reason behind the undeclared work. As Figure 10 shows, in 2017 the total tax rate was 13% of the commercial profits which is a comparatively low level. The country has made significant progress in terms of the administrative burden to firms measured as hours required for firms to prepare and pay taxes (from 192 hours in 2006 to 119 hours in 2017). In addition, while in 2006, firms had to undergo 43 procedures to pay taxes, the number declined to 5 in 2017.

Figure 10. Tax rates and tax administration



Source: World Bank, at: www.doingbusiness.org.

The Balkan Business Barometer reports firms' opinions about the tax administration and tax rates. Despite the progress in tax administration shown above, tax regulation was reported by firms in The Former Yugoslav Republic Macedonia as most important single regulation that is an obstacle to business by 16% of the companies in 2017 (although an equal share of companies stated that no specific regulation is a barrier, but all regulations).

Similarly, the ILO report (2015) showed that for 39% of the companies, a high tax burden was the most important reason for the existence of the undeclared economy. Although the companies believe that the tax burden is not high, other aspects of the tax system and policy may lead to participation in the undeclared economy, such as the ambiguity of the legislation, the selective treatment by the tax administration, the heavy administrative burden in terms of the assessment and payment of taxes.

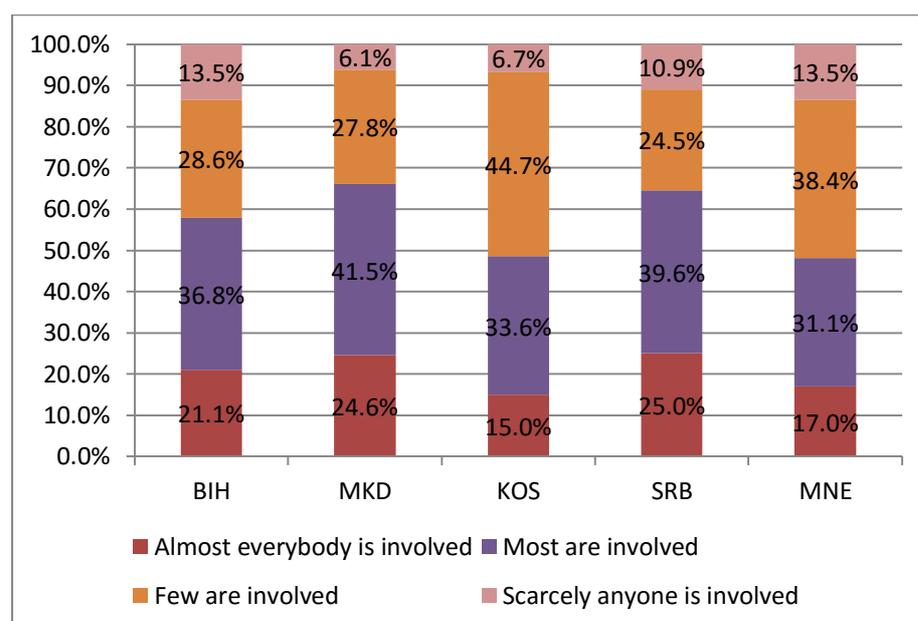
However, a multitude of studies reveal that there is little, if any, evidence that higher tax rates are significantly correlated with higher levels of undeclared work (Friedmann et al., 2000; Ihrig and Moe, 2000; Kuehn, 2007; Williams, 2014a,b,c, 2015a,b, 2016; Williams and Martinez-Perez, 2014; Williams and Horodnic, 2016). For example, Vanderseypen et al. (2013) in the European Commission's annual *Economic and Social Developments in Europe 2013*, examined the relationship between undeclared work and various tax rate variables, namely the implicit tax rate on labour, the share of labour wages in total taxes, and the tax wedge on labour. They find no statistically significant correlation between the prevalence of undeclared work and tax rates. Further tax reductions, therefore, are not the way forward. Instead, the situation is more complex. On the one hand, in societies where citizen morality and state morality are aligned, tax rates can be high since citizens realise that taxes are the price they pay for a civilised society. Tax rates, therefore, are not the (main) problem. It is the lack of trust in the state and belief that they receive appropriate public goods and services for the taxes they pay. The lack of trust in the state apparatus and the low quality of public services results in low acceptance of any tax (and not just high tax rates) by citizens.

The plans of the current Government of The Former Yugoslav Republic Macedonia is to increase taxation. However, given the low trust and tax morality in the country, higher tax rates may not result in higher tax revenues (at least not one to one). Indeed, in 2009, when the Government decreased the personal income tax (PIT) rate and the rates of the social security

contributions (SSC), the revenues (both from the PIT and the SSCs) actually increased. Improvement of the trust in government, reduction of corruption, higher quality public services, etc., (i.e. better alignment of the state morality and citizen morality), should precede any increase in taxation. Higher penalties for non-compliance are not always a good solution as high penalties may backfire if businesses and citizens consider them as perverse. On the contrary, the effect may be an increase in non-compliance and corruption (SELDI, 2016), including undeclared work.

A potential explanation for the co-existence of low taxation and a large undeclared economy can be the perception of the taxpayers about the fairness of the tax administration (and the presence of corruption within the tax authorities). Figure 11 shows that many citizens in The Former Yugoslav Republic Macedonia hold a perception that there is a high level of corruption among the tax officials. In particular, 66% of the citizens think that either almost everybody in the tax authorities is corrupt or that most are corrupt, which is highest share among the countries involved in the SELDI study.

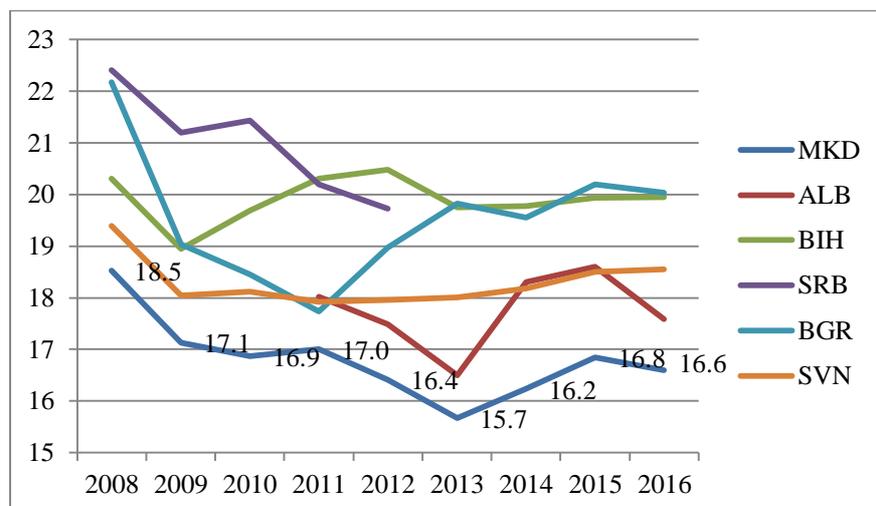
Figure 11. Estimates by the public of the rate of corruption among tax officials in SEE, 2016



Source: SELDI Corruption Monitoring System, 2016 and SELDI Hidden Economy Survey, 2016

However, even taking into account the low tax rates in the country (and the widespread undeclared work), the government still manages to collect relatively high revenues (see Figure 12). In addition, the OECD average of tax revenues to GDP in 2016 was lower than in The Former Yugoslav Republic Macedonia, at 15.4%.

Figure 12. Tax rates as share of GDP (in %)



Source: World Bank, World Development Indicators.

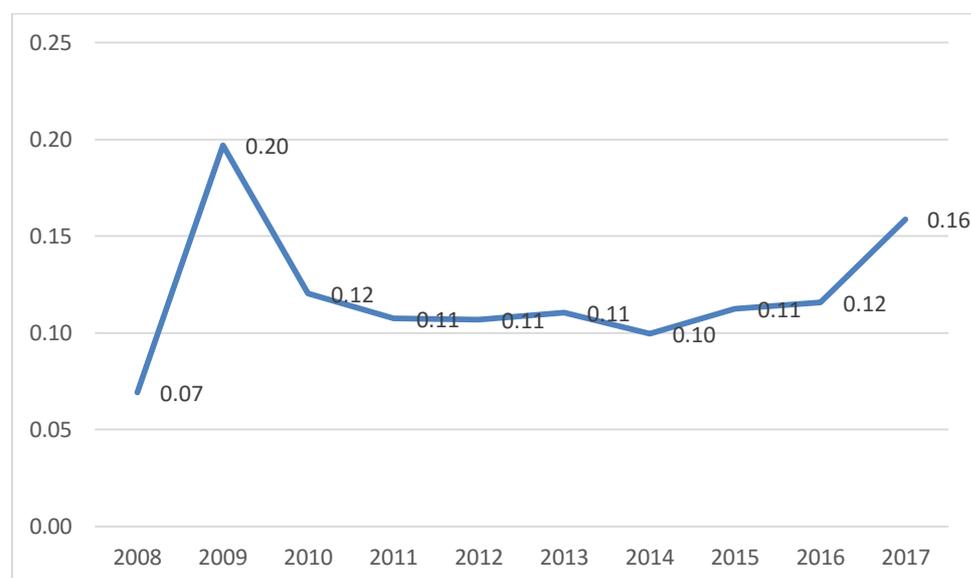
There is also no evidence that reducing state intervention in the labour market reduces the size of the undeclared economy. Instead, quite the opposite is the case. Undeclared work is lower in countries where a larger proportion of GDP is spent by governments on interventions in the labour market targeted at groups with difficulties, such as the unemployed, people in jobs but at risk of involuntary job loss, and inactive persons currently not part of the labour force but who would like a job and are disadvantaged in some manner (Eurofound, 2013; Vanderseyen et al., 2013; Williams, 2014a,b,c, 2015a,b, 2016; Williams and Horodnic, 2016).

The Former Yugoslav Republic Macedonia spends very little on active labour market measures (ALMPs). Figure 13 shows that in 2017 the country spent about 0.16% of GDP on active measures (including services) which is quite low compared with the spending in EU countries. The spending increased in 2017 (and remained at this level in 2018, according to the planned expenditures), but is still lower than in 2009 when the government increased the spending as part of the anti-crises policy package. The planned expenditures in 2018 are approximately EUR 16.3 million targeting around 26,000 unemployed (of which 9,549 should be included in active measures and the remaining ones will benefit from ESA services).²³ The coverage of the unemployed is about 13.4% of the registered unemployed persons. However, close to 68% of the overall number of participants in ALMPs will receive employment services and only 32% will be involved in an active measure. Some progress in terms of the effectiveness of the ALMPs was achieved in recent years (Mojsoska-Blazhevski and Petreski, 2015). However, the effectiveness of the programs is still limited by the low demand for workers in the economy and the low capacity of the ESA (both financial and human capital).

²³ 99% of the overall costs are for active measures, and only 1% for the services. The Operational Plan is published at: <http://www.avrm.gov.mk/content/ОП/Оперативен%20план%20за%202018%20година.pdf>.

In 2018 the Government started a pilot for introducing Youth Guarantees (based on the EU experience). The Guarantee envisages that each young person under the age of 29 will be given an adequate job offer, an opportunity to continue education or be included in some of the internship or training measures for preparation for employment, within 4 months after completion of education or registration as an unemployed person in ESA. The pilot will involve three employment centres (out of 34) with an estimated number of participants of 1,200, for which EUR 1.6 million are planned in the 2018 Budget. Based on the results, the program can be made universal, involving about 9,500 persons annually, at a cost of approximately EUR 12.6 million per year.

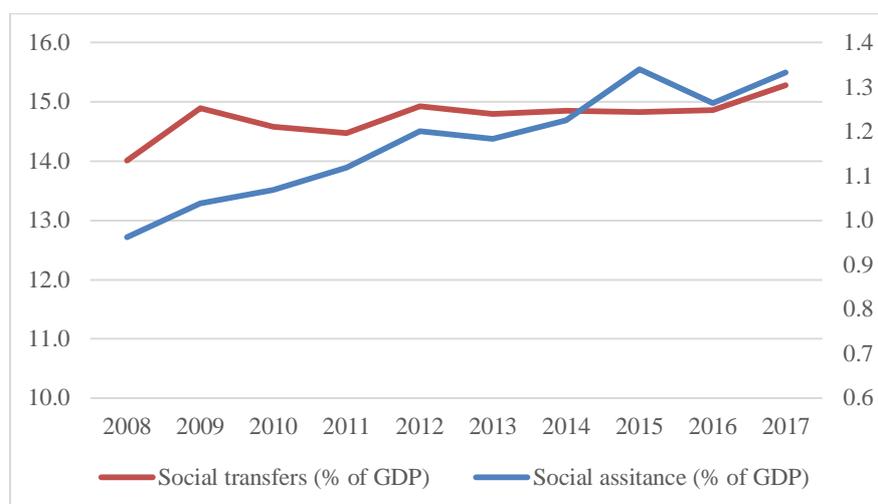
Figure 13. Spending on ALMPs as a share of GDP



Source: Author own calculations based on data from the Employment Service Agency, www.avrm.gov.mk.

It has also been widely shown that the greater the level of expenditure on social protection as a proportion of GDP, the less prevalent is undeclared work (Eurofound, 2013; Vanderseypen et al., 2013; Williams, 2014a,b,c, 2015a,b, 2016). The total spending on social assistance in The Former Yugoslav Republic Macedonia in 2017 was 1.3% GDP, showing a slight upward trend in recent years (Figure 14). In a broader sense, the social transfers from the state budget account for 15.3% of GDP. The social assistance in the country provides a relatively low safeguard of citizens against poverty due to the low spending on social programs along with the targeting issues (Petreski and Mojsoska-Blazhevski, 2017).

Figure 14. Social expenditures as % of GDP



Source: Own calculations based on data from Ministry of Finance.

Poverty in the country has been declining since 2013, but slightly increased in 2016 (latest available data). In 2016, the proportion of the population at-risk of poverty (AROP) was 21.9% (see Table 4). Previous studies show that the more the state is successful in using direct taxes to reduce the proportion of the population at risk of poverty, the less prevalent is undeclared work in economies. Examining the effectiveness of state redistribution via direct taxes, measured by the decrease in percentage points of poverty (defined as the proportion of the population with an income below 60% of the national median income) after social transfers, a statistically significant positive correlation is found (Eurofound, 2013; Vanderseyen et al., 2013; Williams, 2014a,b,c, 2015a,b, 2016). In The Former Yugoslav Republic Macedonia, however, the effectiveness of social transfers in reducing poverty is considerably lower than in the EU as a whole. On the one hand, pensions play a very important role in reducing poverty: poverty before social transfers in 2016 was 41.6%, however pensions reduce the proportion AROP to 25.7% (Table 4). However, the effect of the social transfers on poverty is quite low, as they manage to further reduce the AROP (after pensions are taken into account) to 21.9% (only by 3.8 percentage points). The major safeguard against poverty is the labour market status of a person. Employed persons are much less likely to be poor relative to the unemployed and inactive individuals. Unemployment benefits also play a marginal role in safeguarding the incomes of citizens in The Former Yugoslav Republic Macedonia. The duration of the benefits is quite low, and is linked to previous work experience. According to data from ESA, in April 2018, only 5,875 unemployed people were receiving unemployment cash benefits, which is 5.8% of the registered active jobseekers (3% of all registered unemployed).²⁴

²⁴ All registered unemployed are split into active jobseekers and passive unemployed persons, based on their self-reporting.

Table 4. Main poverty indicators, 2013-2016

	2013	2014	2015	2016
At-risk-of-poverty rate, % of population	24.2	22.1	21.5	21.9
Number of persons below at-risk-of-poverty threshold, in thousand persons	500.4	457.2	445.2	453.2
At-risk-of-poverty rate before social transfers and before pensions, % of population	41.0	41.7	40.5	41.6
At-risk-of-poverty rate before social transfers (except pensions)	26.8	24.8	24.8	25.7
Inequality of income distribution, S80/S20, %	8.4	7.2	6.6	6.6
Inequality of income distribution, Gini coefficient, %	37.0	35.2	33.7	33.6

Source: State Statistical Office, data based on SILC, various years (available at: <http://www.stat.gov.mk/PrethodniSoopstenijaOblast.aspx?id=115&rbrObl=13>).

If undeclared work is to be tackled, there needs to be a marked increase in the efficiency of the social transfer system in reducing poverty. According to data from the State Statistical Office, 30% of the population in The Former Yugoslav Republic Macedonia in 2016 was severely materially deprived, i.e. could not afford themselves 4 out of 9 economic necessities (SSO, 2017). This share is decreasing in recent years, but is still relatively high. Moreover, 17.3% of the population live in households with low work intensity. With these indicators, the combined AROPE in 2016 was 41.1%, which is a small reduction relative to 2014 when 43.3% of the population was at-risk-of-poverty and social exclusion.

The anti-poverty measures implemented by the Government in previous years were mainly focused in two arenas: a gradual increase in the amount of financial benefits and the introduction of additional types of social assistance (for instance, for deafness, blindness, for orphans). However, as the data show, the increased financial assistance was not sufficient (even along with the employment and wages increase) to reduce poverty.

Petreski and Mojsoska-Blazhevski (2017) argue that there are generally four main arguments for a more profound reform of the social benefits' system in the country: i) the small effectiveness of the social transfers in reducing poverty; ii) the low spending on social assistance programs, and iii) the labour market disincentives arising from the social assistance given the low general level of wages and large grey economy; and iv) the system is very fragmented, instead of being a universal, with 16 types of social benefits (13 types related to social protection legislation and 3 from the child protection).

The new government that come into power in May 2017 is committed to a profound reform of the social protection system in terms of: i) better targeting of the social benefits to those at social risk of poverty and social exclusion, ii) an adequate level of benefits which, combined with income from other sources, will lift the households above the poverty threshold, and iii) improved support to those people to escape poverty. In addition, the Government plans to introduce a guaranteed minimum income as of 2019.

Studies also reveal a strong positive relationship between the level of equality in societies and the prevalence of undeclared work; the greater the income inequality, the more prevalent is the undeclared economy (Williams, 2014a,b,c, 2015a,b, 2016; Williams and Martinez-Perez,

2014; Williams and Horodnic, 2016). In the period 2013-2016, the inequality of income distribution in The Former Yugoslav Republic Macedonia was declining, both measured through the S80/S20 ratio (6.6 in 2016), and the Gini coefficient (33.6%), although these data show comparatively unequal distribution of income.²⁵ Data from the World Bank (based on household budget survey) show that the inequality declined in recent years, from a Gini index of 42.8 in 2010 to 35.6 in 2015.

Studies also show that the trust in the institutions, legal system, and the tax administration, as well as trust in people, in general, has a strong effect on tax morale, tax evasion and undeclared work (Frey, 2003; Cullis et al., 2011).²⁶ Williams and Franic (2017) find that envelope wages is more prevalent among individuals in The Former Yugoslav Republic Macedonia who have lower tax morale. In other words, actions and policies towards increasing tax morale can be an important instrument for reducing the undeclared economy. Taking into account that the share of taxpayers subject to inspection annually is relatively low (and the sanctions imposed are very rarely higher than the amount of the unpaid tax/contributions), the measures/activities aimed at boosting tax morale are important for reducing the undeclared economy. The study of Ristovska et al. (2013) shows that the most important predictors of tax morality in The Former Yugoslav Republic Macedonia are: trust in government institutions, trust in judicial system and in the civil service, national pride and general satisfaction with life. On the other hand, demographic factors did not play a very important role in explaining tax morality, with the exception of age (but only for the age category 50-59, which has higher tax morality than younger people), ethnicity and income (higher income is related to higher tax morality).

In sum, to tackle the undeclared economy in The Former Yugoslav Republic Macedonia, it is not simply a case of pursuing enforced compliance/direct controls (using deterrents and incentives) and voluntary cooperation/indirect controls (using awareness raising campaigns about the unacceptability of undeclared work and reforms to the processes of formal institutions). Although these are necessary, they are insufficient. There is also a need to change the macro-level economic and social conditions which result in the prevalence of the undeclared economy. These include:

- Redressing the falls in GDP per capita;
- Improving governance and reducing public sector corruption;
- Maintaining and improving the levels of and the effectiveness of expenditure on labour market interventions to help the most vulnerable groups;
- Reforming the social assistance system and developing far more effective social transfer systems that reduce the widening levels of income inequality and ever

²⁵ State Statistical Office, data based on SILC, various years (available at: <http://www.stat.gov.mk/PrethodniSoopstenijaOblast.aspx?id=115&rbrObl=13>).

²⁶ Tax morale refers to the individual attitude toward the payment of taxes, as opposed to tax evasion, which refers to the individual behavior.



increasing levels of severe material deprivation in The Former Yugoslav Republic Macedonia.

It is important to highlight that many stakeholders identified some or all these drivers during interviews with them. There was widespread recognition for the need to align the state morality with citizen morality, mainly through indirect measures and changes in the culture, beliefs and norms. However, the focus is put on reducing the costs of formality (including taxation), deregulation and greater flexibility of employment legislation, rather than on the need to re-build the trust in the state apparatus and to reduce corruption and clientelism (this is expected as it takes much more effort and time to accomplish the latter).

The attention now turns to the organisation of the fight against undeclared work in The Former Yugoslav Republic Macedonia and an evaluation of the policy approach and measures being pursued.

5 Organization of the fight against undeclared work: institutional framework

5.1 Responsibilities of government ministries

How is the fight against undeclared work organised? And are there ways in which the institutional framework can be improved? Table 5 provides a conceptual framework for evaluating the current organisational approach of the government of The Former Yugoslav Republic Macedonia. At the top of this spectrum are fully joined-up forms of government where one agency/department is responsible for the whole undeclared economy. Moving down the spectrum, there are then a range of cross-government departmental co-operations ranging from initiatives where the co-operating government departments have common shared targets to achieve at the level of strategy, operations or data matching (and which relate to the whole undeclared economy or specific sectors, occupations and so forth). Following this, there are then cross-government departmental co-operations where the departments involved have separate targets to achieve and which again can be applied at the level of strategy, operations or data matching. Finally, and at the bottom of the spectrum, are completely fragmented forms of government in the form of a departmental ‘silos’ approach.²⁷

Table 5. A hierarchy of joined-up government

Approach	Scope	Targets	Level
Single compliance unit	Whole undeclared economy	Common	Strategy, operations and data matching

²⁷ This table only considers joined-up government, not joined-up ‘governance’, which includes tripartite social dialogue.



This project is funded by the EU

	Segment	Common	Strategy, operations &/or data matching
Cross-Departmental Cooperation	Whole/segment	Shared	Strategy
	Whole/segment	Shared	Operations
	Whole/segment	Shared	Data matching & sharing
	Whole/segment	Separate	Strategy
	Whole/segment	Separate	Operations
	Whole/segment	Separate	Data matching & sharing
Departmental 'silos'	Segments	Separate	Strategy Operations Data matching

Source: Derived from Dekker et al (2010).

Based on the classification presented above, the situation in The Former Yugoslav Republic Macedonia until recently can be characterized as a departmental 'silos' approach. Although some cooperation existed at the level of operations, and to some extent on data matching and sharing, there were no common or shared key performance targets. Instead, the departments involved in tackling undeclared work largely worked separately, with each responsible for their own segment of the undeclared economy, namely:

- the Ministry of Labour and Social Policy (MLSP) along with the State Labour Inspectorate, for labour law violations;
- the Ministry of Finance along with the Public Revenue Office for tax non-compliance (including social security fraud), and
- the Ministry of Economy, with the State Market Inspectorate and State Inspectorate for Civil Engineering and Urban Planning, for the undeclared work in company' legislation and construction and urbanism;

These institutions and bodies cooperated and coordinated through the annual Action Plans for reducing the undeclared economy which started to be prepared from 2007 onwards. These actions plans were prepared by working groups consisting of representatives from all institutions which have some responsibility for tackling undeclared work. Initially, the Ministry of Economy was the responsible institution for the preparation of the action plans, but in 2013 this obligation was transferred to the MLSP. A reporting system for the implementation of the action plans was established, through annual reports on the implementation success which were used to inform the government. However, in this initiative, as in most others, there was no transparent information available to the public on the implementation results (actually, the action plans were also not made available to the public). The main lesson from this approach towards undeclared work was that: 1) there is a need for greater involvement of the social partners in setting the goals and designing the actions, 2) despite the joint plan for reducing the undeclared economy, every institution worked separately on its priorities and actions, with little coordination and data sharing, 3) the approach based on deterrence and penalties has to be accompanied by formalization and



support to formalization, clear regulation and educational role of the inspections (prevention of undeclared work) and changing the attitudes of the citizens towards operating undeclared.

The most recent action plan was prepared for the year of 2015. In 2016, a decision was reached to prepare a Strategy for Formalization of the Informal Economy. The first Strategy for formalization of the undeclared economy was recently adopted by the Government and covers the period 2018-2022. The Strategy presents a step in a right direction in that it enhances the cooperation and coordination among the institutions, joins up the goals and the responsibilities of the different government institutions, and advocates greater data sharing and matching. Given the horizontal approach of this Strategy, one of the key factors for its successful implementation is high coordination between all stakeholders, such as: Ministry of Economy, Ministry of Finance, Cabinet of the Vice Prime-minister for economic affairs, state inspectorates (mainly the SLI and the PRO). In addition, the Economic-Social Council, and the representative social partners will also be involved in the implementation of the Strategy.

So, with the Strategy, and based on Table 5, the new approach towards undeclared work can be classified as a “Cross-Departmental Cooperation” to tackle the whole undeclared economy and involving strategy, operations and data matching and sharing.

Ministry of Labour and Social Policy (MLSP). The MLSP takes overarching responsibility for labour law violations, and given that tackling undeclared work in The Former Yugoslav Republic Macedonia is primarily perceived as concerned with the social protection of workers, this Ministry has taken the role of a lead Ministry in tackling undeclared work. The Ministry is responsible for the design and implementation of policies on employment, working conditions and social security, coordinating the system of labour administration, including the SLI. The MLSP has a main responsibility for monitoring of the Strategy for formalization of the undeclared economy 2018-2022.

State Labour Inspectorate (SLI). The SLI, which is an executive agency of the MLSP, is the primary body enforcing the labour law and, therefore, is responsible for the control of the undeclared work. The SLI has a responsibility to oversee the implementation of the labour legislation, collective agreements and work contracts. The SLI is responsible for ensuring proper implementation of the legislation related to the labour relations and safety at work (stemming from the Labour Law), and the legislation and measures related to the prevention and prohibition of unregistered work (of the Law for prohibition and prevention of unregistered activities). It should also ensure continuous improvements in its main work (i.e. audits), as well as the professional development of the inspectors. The main legislation that governs the work of the SLI consists of: Law on labour inspectorate (Official Gazette No. 35/1997 with most recent changes in 21/2018), Labour Law (Official Gazette No. 167/2015)²⁸ and Law on prohibition and prevention of unregistered activities. The director of the SLI is obliged to prepare annual work plan and quarterly work plans for every inspector,

^{28 28} The Law was enacted in 2005 but many changes were made in meantime. The referenced Law is a full, clean version of the Law. The authorities are though currently preparing new Labour Law.

which are then submitted for a consultation to the Inspections Council (see below). The quarterly plans are then used for preparation of a monthly individual plans which lay down in detail the dates of the planned inspections, the subjects of the inspections, as well as the complexity of the planned inspections.

The legislation was improved in recent years to increase the “educational” role of the inspectors and to allow employers to correct the wrongdoings, instead of an immediate sanctioning. In particular, in case an inspector detects a fraud, s/he has to prepare an audit report which describes the offense but also gives the employer room to correct the irregularity in 8 days. Moreover, the inspector is also obliged to issue an invitation for short education/training related to the specific legislation that the employer did not implement correctly (article 258-a, Labour Law). This education/training is organized by the SLI. In case the employer corrects the offense in 8 days, the procedure stops, otherwise the employer is sanctioned. The interviews showed that the introduction of this “educational” role of the SLI has been a very positive change. In case inspectors find non-registered workers in a workplace in some business, they also issue a notice to the employer to register those workers within 8 days. In addition, the employer is obliged not to reduce the total number of employees in the following 3 months. In case an employer repeats this wrongdoing in a period of one year, then the inspector will close the business (i.e. prohibit business operations) for 30 days and open a misdemeanour procedure.

The Labour Law also sets a basis for cooperation between SLI and the tax administration (i.e. the PRO). According to the Law, the PRO should inform the SLI about the employers who did not pay wages in a particular month so that the SLI can organize an inspection.

The Law on labour inspectorate explicitly mentions economic sectors in which each inspector has to undertake inspection each year. These include: industry, trade, construction, agriculture, forestry, transport, communal services, crafts, hospitality, as well as the laboratories for practical work in secondary vocational school and faculties. The other sectors have to be subject to a control at least once every three years. The Law also sets a basis for data sharing and exchange between the SLI and other state institutions (though there is no specific mention of which institutions).

The current inspection process is ineffective as a low number of undeclared workers are discovered despite a high number of inspections.

The reputation of the SLI among employers in terms of their fairness is relatively good, though still there is a widespread perception that the operations of the SLI are politically motivated. For instance, the Employers’ Survey of ILO (2015) showed that more than a third of the enterprises have never experienced a situation where the interference of the inspection services had a negative impact on their operations. However, 10.6% of the enterprises complain that they often experience such problems (Figure 15). Half of the respondents find the labour inspection (i.e. the inspection supervisions carried out by SLI) to be politically motivated (for 26.5% of the respondents this occurs sometimes, while for 17.1% it occurs frequently).

Figure 15. Effect of labour administration on the enterprises





Source: ILO, 2015.

Ministry of Finance. The Ministry of Finance takes responsibility for that aspect of the undeclared economy related to tax non-compliance. This Ministry is responsible for the collection of tax revenue and more particularly, in relation to the undeclared economy, tax non-compliance. The PRO is one of the main bodies of the Ministry of Finance, which is the tax inspectorate and takes responsibility for investigating tax non-compliance. The *Finance Police* is also a body within the Ministry of Finance with specific authorizations pursuant to the Law on criminal procedure, in charge of consistent application of the regulations, in particular in the field of financial, tax and customs operations.²⁹

Public Revenue Office. The PRO is a state administration body, within the Ministry of Finance and it is a separate legal entity. As of December 31 2017 the PRO had 1,230 employees.³⁰ Two main laws regulate the obligations and responsibilities of the PRO, that are the Law on Public Revenue Office and Law on tax procedure. According to the Law on Public Revenue Office (Official Gazette No. 43/14, 61/15, 27/2016, 35/2018), the PRO is an institution with legal status, which organizationally is part of the Ministry of Finance. The main responsibilities of the PRO (article 4) are the following:

- implementation of the laws and additional regulation related to the taxes;
- registration of the taxpayers and maintaining a register of the taxpayers;
- tax collection (as well as collection of the social security contributions which are then transferred to the social security funds);
- monitoring and analysis of the tax revenues;
- surveillance of the implementation of the measures and activities implemented under the tax regulation.

²⁹ <https://www.finance.gov.mk/en/node/813>.

³⁰ <http://www.ujp.gov.mk/en/uprava/category/1259>.

The PRO has a large span of responsibilities in terms of the legislation and areas which it supervises and monitors. Besides the tax legislation (such as the Law on personal income tax, Law on value added tax, Law on profit tax, etc.) it also has duties related to the Law on mineral resources, Law on combating money laundering, etc. The PRO is organized in the following units: General Directorate in Skopje, Directorate for large taxpayers, 6 regional directorates, 17 branch offices, 7 service points in local communities and several mobile counters (in those municipalities where there are no local offices).

The PRO also undertakes detection activities for undeclared work i.e. of taxpayers which perform undeclared economic activities. According to the Law on tax procedure (article 178-d), in case inspectors detect a person who performs economic activity without being registered for that (if the person makes this offense for a first time), they hand in to the person an invitation for education/training delivered by the PRO. Persons undertaking the training have a possibility to afterwards register themselves as taxpayers voluntarily (within 5 days), but if they do not, the PRO registers them as taxpayers.

The PRO is constantly working on improving its capacities for proper implementation of the tax legislation, reducing the administrative burden to companies and physical persons and improving its services (including e-services). It has a reputation as one of the most professional inspection bodies in the country. One of the important reforms towards improving its services has been the establishment of the Large Taxpayers Office of the PRO, which specifically focuses its work on large taxpayers.

As of 2019, the PRO will start using new electronic tax services called “e-Personal Income Tax” for reporting and payment of PIT by the citizens and the companies. This will simplify the procedures and lessen the administrative burden and costs for reporting and payment of PIT for taxpayer – individuals. The system e-pdd.ujp.gov.mk will enable the first pre-filled of Annual Tax Return to be issued by PRO in 2019 for individuals’ incomes generated in 2018.

At end 2017, a new Contact Center of the PRO was established aimed at providing a fast, easy and quality tax service. The goal of the Contact Center is to ease the conditions and access to the PRO services, through development of user-oriented services for companies and citizens, enabling electronic communication, easier access to tax information, reduction of administrative costs and simplifying the procedures. This activity was implemented with partners and with EU support of EUR 1.5 mill. provided by IPA funds. The PRO Contact Center has a modern and friendly environment. It incorporates good tax practices through cooperation with a Twinning partner - the Spanish Tax Administration. In addition, it provides easier access to tax services in smaller places with an additional two Mobile Tax Points.

Taxpayers are provided with access to the new specialized website kontaktcentar.ujp.gov.mk and the two new services of the PRO "SCHEDULE A MEETING" and "INFORMA". Each taxpayer has the opportunity to schedule a meeting with a tax agent at a time that is most suitable for her/him, available online via the new website of the Contact Center or by telephone. The use of the new service “SCHEDULE A MEETING” was first on a voluntary basis, and from May 2018 it became obligatory for the Regional Directorate Skopje. From 2019, this service will be available for scheduling a meeting in the other tax offices of the PRO.

'INFORMA' is also a new service i.e. an electronic system through which the PRO allows the

taxpayers to perform an on-line search and have quick and easy access to general tax information, to the most frequently asked questions and answers related to the procedures for taxation, registration and payment of tax and their tax rights and obligations.

The Strategic Plan of the PRO 2018-2020³¹ sets the following strategic objectives:

- Strengthening the administrative capacities (such as quality management, human resources management, better administration of management of arrears, etc.);
- Fight against tax evasion and reduction of the undeclared economy;
- Better management of public revenues and increased tax collection.

Within the Strategic Plan there are some specific activities which may lead to changing the approach of the PRO towards undeclared work and tax evasion, such as:

- improved detection of tax evasion, based on risk management and greater efficiency of the work rather than using many resources. In particular, the PRO plans to develop a Risk Evaluation System;
- improved cooperation and data exchange with the other institutions (although no mention of data matching is made);
- preparation of Action plan for deterrence and dealing with the undeclared economy (which is under the coordination of the MLSP);
- greater focus towards a preventive approach to tax evasion;
- preparation of a Strategy for dealing with cash payments (to be prepared by the Ministry of Finance);
- easing of the tax procedures, reduction of the administrative burden and the costs of paying taxes, and better quality of tax services (see below).

The Strategic Plan sets some targets to be achieved. For instance, there is a target for the digitalization of the tax services. In 2017, the digitalization rate was 40%, which is planned to increase to 60% in 2020 and 80% in 2024. Other targets relate to the safety of the IT system, number of employed IT specialists, etc. According to the Strategic Plan, the PRO foresees recruitment of 35 persons annually, during a period of three years, which will be involved in the foreseen development and implementation of the national programs and Strategy of the PRO for the period 2018-2020. These people should also replace the retiring staff. In summary, the PRO is improving in terms of the professionalism of its staff and services, making services accessible for the citizens and firms, improving its educational role, etc. However, a major critique towards the PRO is the lack of transparency and accountability, which can be improved by making their annual work plans and reports on the plans available.

Inspection Council. The Inspection Council was established in January 2014 by nominating a President and six members of the Inspection Council. The legal framework for

³¹ <http://www.ujp.gov.mk/en/uprava/category/471>.

establishment of the Inspection Council was developed in 2013, with amendments to the Law on inspection surveillance (Official Gazette No. 147/2013). The Council also has 25 positions for the administrative and day-to-day work, out of which only 8 positions (32%) were filled in 2018. The mission of the Inspection Council is to safeguard the rule of law, to protect the rights of the citizens, improvement of the health and the citizens' life, enhancement of the economic environment, etc. The establishing of the Inspection Council was mainly motivated by the existence of large number of inspection bodies operating in the country and the need for their coordination and synchronization. According to the Strategic plan of the Inspection Council 2018-2020³², in 2017, there were 28 inspection bodies, half of which had a legal status and half operated as organizational units of some institutions.

The main responsibilities of the Council (as laid down in the article 16-a of the Law are):

- Coordination of the inspection bodies;
- Preparation and monitoring of methodologies and work procedures of the inspection bodies;
- Review and giving feedback on the annual work programs of the inspection bodies;
- Issuing licences for inspectors and preparation and organization of exams for licencing of inspectors;
- Continuous professional development of the inspectors;
- Establishment of a software solution for automatic (i.e. electronic) delegation of the planned inspections to inspectors;
- Material and technical advancement of the inspection bodies, etc.

One of the priorities of the Inspection Council is to switch towards a risk-based system of inspections rather than the present system whose primary goal is maximization of the sanctions and inefficient use of the scarce resources. The main precondition for the risk-based management is effective collection of data and data analysis, that can lead to better prioritization and improvement of the efficiency of the inspection surveillance. Moreover, the Inspection Council acknowledges the importance of voluntary compliance with the legislation.

The Strategic objectives of the Inspection Council for the period 2018-2020 are the following (Inspection Council, 2018):³³

- Monitoring of the implementation of legislation related to the inspection supervision;

³² <http://is.gov.mk/programa-za-rabota-na-is.nspх>

³³

<http://is.gov.mk/content/docs/Програма%20за%20работа%20на%20ИС/Стратешки%20план%20на%20Инспекциски%20совет%20за%202018-2020%20година%20со%20Акционен%20план%20за%20реализација.PDF>.

- Enhancement of the professionalism of the inspection bodies and professional development of the inspectors, as well as improving the public appeal of the Inspection Council;
- Improvement of the work of the Council as a mechanism for horizontal coordination of the inspection bodies.

The action plan for the implementation of the strategic objectives includes specific activities to be undertaken. A large emphasis is put on training of the potential inspectors, development of materials for their preparation for the inspector licencing' exams, maintaining the electronic register for the activities and workload of every inspector; better coordination of the inspections; harmonization and streamlining of the regulation in each area of surveillance; etc.

Social Insurance Institutions

The third element of the undeclared economy, namely social security fraud, is the responsibility of the social security institutions. Social security (insurance) consists of: pension and disability insurance, health insurance and insurance in case of unemployment (i.e. unemployment insurance), all financed through respective contribution-based revenues. Respectively, there are three social security funds in The Former Yugoslav Republic Macedonia: the Pension and Disability Insurance Fund, Health Fund and Unemployment Fund.

The major challenge with the social insurance contributions is that employees do not see the benefit of paying the contributions immediately (except in the case of health insurance). Young people, seasonal workers and farmers need a long time to collect pension rights, while the state provides free health insurance to every citizen. In the past, this has contributed to less evasion of payment of health insurance relative to pension and disability insurance. Still, the Funds did accumulate some arrears. In the 2000s, there were also some episodes in which the government disregarded the health insurance arrears of companies. The unemployment insurance rate is low, but on the other hand citizens also do not see a large or any benefit from unemployment insurance (as we previously explained, a small share of unemployed are eligible for the benefit, and the duration of the benefit is relatively low).

In 2009, the Government undertook a large reform of the wage system which involved social contributions. This reform followed the 2008 reform in which a flat tax system was introduced to replace the previous system of progressive taxation, with a tax rate of 12% for the PIT and the Corporate Income Tax (CIT). The implementation of the reform was executed by a new Law on mandatory social insurance contributions (Official Gazette, No. 142/2008, with most recent changes in No. 35/2018) regulating the system of payment of contributions. Many related laws also had to be changed and collective agreements renegotiated. The 2009 reform, which was termed gross-wage reform, aimed at changing the system of wage negotiation and contracting, from a net to gross basis, as well as reducing labour taxation (both the PIT and the rates of the mandatory social contributions). The reform, *inter alia*, included a gradual reduction of social security contributions (SSC) rates over three years. The PIT rate was reduced from 12% to 10%, whereas the rates of the SSCs were scheduled to gradually decline from 32% in 2008 (combined rates) to 22% in 2011. Another very important component of the reform was the introduction of an integrated collection of PIT and social insurance contributions by the PRO, where afterwards PRO



transfers the collected contributions to each fund. Given the higher capacity of the PRO to collect revenues relative to the social security funds, this was an important step. Indeed, the collection of social security contributions after the reform led to increased revenues of the funds, despite the reduced rates. In addition, the liability for payment of contributions was transferred from the employer to the employee, although the employer is obliged to calculate and pay the contributions on behalf of the employee. The system of wage calculation and payments was designed to prevent payment of wages without payment of contributions (the payment has to be made by same payment order, at same time).

Given the global economic and financial recession that impacted on The Former Yugoslav Republic Macedonia in 2009, the planned reduction of the SSCs was implemented only in 2009 (the combined rate declined to 27.9%) and was afterwards postponed (and is still not implemented). The present government does not see it as a good measure, and plans to re-introduce a progressive tax system. As of June 2018, a draft proposal on amendments to the Law on PIT has been prepared which introduces an additional higher tax rate of 18%, to be applied for income above EUR 1,000 per month. However, the difficult political situation in the country postponed the discussion on this legislation.

With the reform, fringe benefits (i.e. food and travel allowances) were incorporated into wages and no longer exist in the legislation (as previously they were used to top up the formal wage of the workers, similar to envelope wages, since only PIT was paid of those benefits and not the social security contributions).

The labour costs of low-educated workers in The Former Yugoslav Republic Macedonia are comparatively high given the existence of a minimum floor for payment of social security contributions, which is set at 50% of the national average gross wage (called the minimum reference wage).³⁴ The gross wage reform did not abolish this minimum, based on the premise that it ensures at least some basic social safety net for workers, but in essence it actually safeguards government revenues. Still, with the reform, the minimum reference wage was at least synchronized, as prior to the reform it was higher for health insurance than for the other two types of insurance (at 65% of the average wage). With regard to part-time workers, all social security funds accept a partial contribution based on part-time work, i.e. contributions are calculated per hour basis. Previously, until mid-2008, part-time workers had to contribute for health insurance as working a regular 40-hours working week, which was making part-time workers relatively expensive. The introduction and the recent increase of the statutory minimum wage (to about 50% of the average wage) have enabled dissolution of the minimum reference wage as it still creates administrative burden and some confusion.

Another important reform that was implemented in 2011 was the change in the system of provision of health insurance with application from September 2011 (Law on health Insurance, Official Gazette 53/11). According to the amendments to the Law, free health

³⁴ This effect is though mitigated by the personal tax exemption which is set in absolute terms and hence is higher as a share of the wage, for low-wage workers.

insurance is provided to all citizens with no income or income under certain threshold. This threshold level refers to the income in the previous calendar year and is set at the annual level of the minimum wage in the previous year. Exceptionally, a person that in the previous year earned higher income than the annual minimum wage, but in the last two months prior to the application had lower income than the minimum monthly wage, is also eligible for state-funded health insurance. This change was made as to reduce the pressure towards registration as unemployed in the ESA. In particular, in the previous version of the Law, every person who is not insured from other basis (like employment, etc.) could get free health insurance if s/he has a status of registered unemployed person. This was creating an incentive to inactive persons to register as unemployed. With the change of the system, the number of registered unemployed persons declined, but by about 10% (not as much as expected). However, some other legislative requirements push people to register as unemployed (for instance, the eligibility criteria for social assistance).

5.2 The role of social partners

The involvement and pro-active participation of social partners is a vital element of a successful strategy for transforming undeclared work into declared work. There are several main players (i.e. representative employers' and workers' organizations) in the tripartite social dialogue in The Former Yugoslav Republic Macedonia. The social dialogue is institutionalized through the Socio-Economic Council established in 1996.

Employers' organisations

There are two main employers' organizations in The Former Yugoslav Republic Macedonia, the Organization of Employers of Macedonia (OEM) and the Business Confederation of Macedonia (BCM). The OEM was established in 2004, and represents about 15 economic sectors that employ around 70,000 persons in 1,012 private enterprises in the country.³⁵ The mission of the OEM is to represent and promote the rights and the interests of the employers through coordination and cooperation with the social partners.

The basic goals and tasks of the organization are to represent the interests of the employers, in general, and especially in social partnership and dialogue, to take care of the development and the realization of the rights and freedoms of the employers, collective bargaining, concluding and implementing the General Collective Agreement for the private sector of the country and the collective agreements at the branch level. The involvement of OEM in social dialogue relates to topics related to employer education, social responsibility, safety and health at work, labour and social legislation, taxation, investment, policy of fines and sanctions, financing of businesses, etc.³⁶

³⁵ The ORM generally represents the larger businesses, whereas the BKM mainly small businesses.

³⁶ <http://www.orm.org.mk/index.php/en/about-ormenmenu/about-usenmenu>.



This project is funded by the EU

The Business Confederation of Macedonia (BCM) was established in 2001 as an association of employers and today it includes 8,500 companies clustered in 13 business associations, with two regional offices (in Prilep and Tetovo) and a central office in Skopje.³⁷ The mission of the BCM is to assist and encourage improvement of the business environment in The Former Yugoslav Republic Macedonia, to further build partnerships, to work on the development of the tripartite dialog, to foster the competitiveness and to promote transparency and business ethics. As a confederation of the businesses in The Former Yugoslav Republic Macedonia, BCM monitors the processes of adoption of laws and bylaws, advocates for reduction of administrative barriers and improvement of the business climate in The Former Yugoslav Republic Macedonia.

For both organizations, undeclared work and the unfair competition coming from companies operating on a wholly or partial undeclared basis present a large constraint to formal business. However, they report that there is a widespread acceptance of undeclared work, given that many formal businesses use the services or products of those operating on a wholly or partially undeclared basis.

Employers' organisations in The Former Yugoslav Republic Macedonia primarily encompass larger enterprises in the declared economy and do not represent the owners of the business entities in the undeclared economy nor micro-enterprises, in general. Experiences around the world suggest that employers' organizations can have a pivotal role in the development and implementation of equal level playing field for all businesses, as well as supporting formalization of businesses. For instance, some international experience shows that employers' organisations can provide human and technical services for micro and small enterprises, thus indirectly supporting the formalization of small and micro businesses. However, given that employers' organizations are established on the basis of fees (by its members) and that only formal businesses are their members, they cannot directly represent unregistered business entities or use the members' money to provide support services to businesses operating undeclared. Still, they can use their knowledge and expertise, and partner with the government or some international donors as to undertake such a role. For instance, the Chamber of Craftwork in the country provides some advice to businesses and physical persons regarding how to formalize, as well as to start-ups on how to be a formal.

Given the predominance of the MSE in The Former Yugoslav Republic Macedonia, the coverage of the employers' organizations is relatively low. Small businesses do not have enough financial and human resources as to be members of the employers' organizations. In other words, many MSE are left on their own to deal with the complex business environment and regulation and large administrative burden. Therefore, there is a room for the establishment of service centres which can provide free of charge advice for those companies, including advice on how to become fully formal (i.e., a formalisation service). Current employers' organizations are well placed to serve that role (with financing from

³⁷ More info can be found at: <http://bcm.mk/en/the-mission-objectives-and-activities/>.

government or other parties), since there can be larger trust established between businesses, rather than between a business and government.

Trade unions

The rising globalization, liberalization and outsourcing, which undermined safe employment and incomes in the declared economy underlined the importance of trade unions even more. Trade unions rise to even greater challenges in the performance of their dominant role – worker protection – due to the increasingly flexible labour relations, new types of employment, new forms of undeclared work, as well as the frequent (though not adequate) adjustment of the labour law to these novel processes. Trade unions commonly advocate against insecure types of employment that are especially high among women and youth.

Despite the important social role of the trade unions, their activities and resources are bound towards protecting only declared workers. Due to the legislation and the setup of trade union organisations in The Former Yugoslav Republic Macedonia, trade unions cannot involve, i.e. register and represent the interests of undeclared workers. In addition, there are barriers to trade union organisation of undeclared workers, a process that increasingly develops on a global level, especially in developing countries. In addition, international labour law, including the Freedom of Association and Protection of the Right to Organise Convention of the ILO (No. 87) apply to all workers, no matter whether they are declared or undeclared. Hence the conclusion is that this international convention is not duly applied in The Former Yugoslav Republic Macedonia.

Workers' rights in The Former Yugoslav Republic Macedonia within the Economic-Social Council are represented by the Federation of Trade Unions of Macedonia (FTUM). The FTUM brings together 15 trade unions from different sectors of the economy and is the partner within the tripartite dialogue. FTUM is a legal entity. The members of the FTUM affiliate on democratic and voluntary basis for representing the economic and social interests of the membership. It is an autonomous organization, independent of government, employers, political parties and other organizations and institutions.

The main objectives of FTUM are: protection of workers' rights, social justice, financial security of workers, health care, pension and disability insurance, legal protection, solid housing policy, qualification and training of workers. Methods for achievement of these objectives are: strengthening of social dialogue and social partnership, participation in decision-making institutions, collective bargaining, protection of workers, international cooperation, education of members and provision of objective information for the general public. The preferred way to achieve the objectives is by negotiations and agreements with the social partners. If negotiations do not give results, industrial action is organized, including strikes.

FTUM stands for the application of international standards, conventions and recommendations. Trade union' rights and freedoms are contained in the Universal Declaration of Human Rights of the United Nations (1948), the European Social Charter of the Council of Europe (1961) and in several Conventions of the ILO. The Former Yugoslav Republic Macedonia has ratified ILO Conventions 87 and 98, being also implemented in the Constitution of the country.

The basic aims and tasks of FTUM are:



- establishing and providing democratic, legal and social state;
- monitoring of the implementation of laws and other regulations concerning the worker's rights and the collective agreements and implementation of the international conventions, directives and other recommendations;
- institutional implementation of the constitutional right to manage and to participate in the decision-making based on labour;
- representing the common worker's interests in the institutions of the system by direct participation or by submitting demands, initiatives, proposals and opinions;
- ensuring economic and material security of workers, but also supporting the general economic development, economic and social policy and wage' policy;
- participating in the collective bargaining at a country level;
- participating in preparation of laws in the social and economic area through respective institutional forms of acting;
- improving of the working conditions, environment and health of the workers;
- protection at work and the rights acquired on the basis of work (such as pension, disability, and health insurance, etc.);
- employment and material support during an unemployment period; etc.

5.3 Bodies of Social Dialogue

Social dialogue can play a prominent role in the creation of effective policies for transforming undeclared work into declared work. Positive experiences suggest that social dialogue does not only presuppose coordinated activities of all social partners, but also inclusion of the actors in the undeclared economy (employees and business entities) and vulnerable groups.

The Socio-Economic Council (SEC) is a tripartite body established by the Government of The Former Yugoslav Republic Macedonia in 1996, with an aim to bring together the representative employers' and employees' organization in ensuring economic and social stability in the country. The Government, FTUM, BCM and OEM signed the agreement for establishment of the SEC. The ESC consists of 12 members of which 4 are nominated by the Government, 4 by the representative organizations of employers and the remaining 4 by the representative trade unions. The minister of labour and social policy is a president of the ESC.³⁸

The SEC has the following responsibilities and tasks:

- Monitors, analysis and assesses the impact of economic policy and economic measures on social stability and development;
- Monitors, analysis and assesses the impact of the social policy and social policy measures on the economic growth and economic stability;

³⁸ http://www.mtsp.gov.mk/socijalno-partnerstvo-ns_article-ekonomsko-socijalno-socket.nspk.

- Monitors, analysis and assesses the impact of the price level and wages (including the minimum wage setting) on the economic development and stability;
- Informs the minister of labour and social policy on the issues and problems related to reaching collective agreements and their implementation;
- Gives opinions on draft laws and bylaws related to the labour market and social protection;
- Promotes the tripartite dialogue among the social partners for overcoming the economic and social challenges in the country.

Within recent years, there have been efforts by the Government, supported by international organizations and donors, to strengthen social dialogue on a local level. Hence, 15 local socio-economic councils were established, and capacity building trainings were organized for the members of the local councils. The objectives of the local SECs are: to cooperate to support economic and social development and create better opportunities for all; intensified job creation, especially for young persons; improved matching between labour supply and demand; giving suggestions for the need of pre-qualification of the unemployed workers; etc. These activities were supported by USAID, ILO and other donors.

5.4 Towards a joined-up strategic approach

As we discussed, up until recently, a departmental ‘silos’ approach was used in The Former Yugoslav Republic Macedonia with each Ministry and agency working separately on the issue, with no joined-up strategic approach. Neither were there common cross-cutting targets or goals, but these were rather fragmented.

The new Strategy for formalization of the undeclared economy seeks to enhance the coordination and cooperation of the various stakeholders towards a common aim of transforming undeclared work into declared work. In addition, it advocates greater data sharing and matching. Given the horizontal approach of this Strategy, one of the key factors for its successful implementation is a high level of coordination between all stakeholders. The MLSP has a main responsibility for monitoring of the Strategy, but due to the horizontal approach and character of the Strategy, other ministries and institutions will be involved in the realization of the goals and objectives of the Strategy. Moreover, the Economic-Social Council, and the representative social partners will also be involved in the implementation of the Strategy.

The coordination of the Strategy will be a responsibility of Coordinative body that was established by the Government (with the adoption of the Strategy). The Body has a role of coordination of the activities of all involved institutions related to the implementation of the objectives and measures of the Strategy and the action plan. The administrative-technical work for the Coordinative body will be performed by the MLSP. The Ministry is also in charge of the technical coordination of the implementation of the Strategy. As already stated, the Strategy has a potential to introduce the “Cross-Departmental Cooperation” approach towards undeclared work.

However, the success of this new approach will depend on the capacity of the Coordinative body (and the MLSP) to bring together and to coordinate the involved stakeholders, but also on whether the other institutions will prioritize undeclared work over (or at the same level) as their other regular activities. One way to promote the prioritization of transforming



undeclared work into declared work is that the government tasks all involved institutions to include undeclared work in their strategic plans, as a strategic priority. In addition, the Government should require them to set Key Performance Indicators (KPIs) against which progress in transforming undeclared work into declared work can be measured. Although some institutions developed KPIs (related to the undeclared economy), the main problem is that the KPIs reflect the “old” approach towards the undeclared work, which is solely focused on deterrence measures and sanctions. Hence, the common KPI is “number of detected non-registered workers” instead of the “number of formalized work relationships”. These considerations also have to be taken into account in the development of the action plan for formalization of the undeclared economy (based on the Strategy).

6 Current policy approach and measures: an evaluation

To evaluate the current policy approach and measures adopted in The Former Yugoslav Republic Macedonia, both desk-based research was conducted as well as meetings/interviews with a wide array of stakeholders in May and June 2018 (see Annex A for a list of the organisations with whom meetings were held). Table 6 summarises the current policy measures used in The Former Yugoslav Republic Macedonia and compares this with the range of policy measures pursued in European Economic Area (EEA) as reported by Dekker et al. (2010). This reveals that The Former Yugoslav Republic Macedonia focuses upon using deterrence measures to “fight” undeclared work. Only a narrow range of incentive measures are currently being used in the country, in contrast to EEA countries that focus on changing the ‘benefits’ side of the equation by adopting measures to make it easier and more beneficial to operate in the declared economy. In some EEA countries there is a shift from purely the ‘direct controls’ (enforced compliance) approach which changes the cost/benefit ratio that suppliers and purchasers face, and towards an ‘indirect controls’ (voluntary cooperation) approach that seeks to engender a commitment to operating on a declared basis. This is largely absent in The Former Yugoslav Republic Macedonia, reflecting the focus upon reducing undeclared work rather than transforming undeclared work into declared work, which is recommended both by Recommendation 204 of the ILO and the European Commission’s European Platform Tackling Undeclared Work.

Table 6. Policy measures used in The Former Yugoslav Republic Macedonia and 31 other European countries to tackle undeclared work

	Use in The Former Yugoslav Republic Macedonia	% of EEA nations	% of EEA stakeholders stating measure is:		
			Effective	Neutral	Ineffective
Policy					
DIRECT CONTROLS					
Deterrence					
<i>Penalties:</i>		93	50	45	5
Administrative sanctions for purchasers/companies	√	87	46	49	6
Administrative sanctions for suppliers/employees		83	41	59	0
Penal sanctions for purchasers/companies	√	74	59	33	8
Penal sanctions for suppliers/employees	√	52	53	42	5
<i>Measures to improve detection:</i>		100	64	34	2

Data matching and sharing	√	83	72	25	2
Workplace inspections	√	100	75	17	8
Registration of workers prior to starting work or on first day of work	√	74	74	23	3
Coordinating strategy across government		57	56	44	0
Certification of business, certifying payments of social contribution and taxes	√	65	62	33	5
Use of peer-to-peer surveillance (e.g. telephone hotlines)	√	39	20	80	0
Coordination of operations across government	√	61	64	36	0
Coordination of data sharing across government		65	82	19	0
Mandatory ID in the workplace		65	70	30	0
Enabling compliance:					
<i>Preventative measures:</i>		90	45	43	12
Reduce regulations	√	48	56	38	6
Simplify compliance procedures	√	87	62	38	0
Technological innovations (e.g. certified cash registers)	√	43	73	27	0
New categories of work (e.g., for small or mini-jobs)		35	59	33	8
Direct tax incentives (e.g., exemptions, deductions)		61	57	33	10
Social security incentives		35	62	15	23
Ease transition from unemployment into self-employment	√	65	29	63	8
Ease transition from employment into self-employment		44	15	77	8
Changing minimum wage upwards	√	48	24	59	18
Changing minimum wage downwards		9	0	50	50
Training & support to business start-ups	√	61	50	46	4
Micro-finance to business start-ups	√	52	48	52	0
Advice on how to formalise		61	33	67	0
Connecting pension schemes to formal labour	√	61	47	41	12
Introducing supply chain responsibility		17	78	0	22
Restricting free movement of (foreign) workers		43	29	53	18
<i>Curative measures:</i>		64	61	35	4
<i>Stimulate purchasers to buy declared:</i>					
Service vouchers		26	58	42	0
Targeted direct tax incentives		61	65	29	6
Targeted indirect taxes		17	63	25	13
<i>Stimulate suppliers to formalise:</i>					
Society-wide amnesties		9	10	0	0
Individual-level amnesties for voluntary disclosure		17	75	25	0
Formalisation advice to business		30	44	56	0
Formalisation support services to businesses		30	57	29	14
Targeted VAT reductions		17	43	43	14
Free record-keeping software to businesses		13	50	50	0
Fact sheets on record-keeping		22	57	43	0
Free advice/training on record-keeping		22	57	43	0
Gradual formalisation schemes		13	67	33	0
INDIRECT CONTROLS:		69	44	52	4

Change values, norms & beliefs					
Campaigns to inform undeclared workers of risks and costs of working undeclared	√	61	64	36	0
Campaigns to inform undeclared workers of benefits of formalising their work		57	43	47	10
Campaigns to inform users of undeclared work of the risks and costs		61	50	40	10
Campaigns to inform users of undeclared work of the benefits of declared work		52	35	59	6
Use of normative appeals to people to declare their activities		52	33	67	0
Measures to improve tax/social security/labour law knowledge	√	65	50	50	0
Campaigns to encourage a culture of commitment to declaration		39	29	64	7
<i>Reform formal institutions</i>					
Measures to change perceived fairness of the system		26	25	75	0
Measures to improve procedural justice of the system (i.e., degree to which people believe government has treated them in a respectful, impartial and responsible manner)		17	60	40	0
Adoption of commitment rather than compliance approach (e.g., 'responsive regulation')		30	50	40	10

Source: Dekker et al. (2010), and own insertions for The Former Yugoslav Republic Macedonia.

During the diagnostic mission, stakeholders in The Former Yugoslav Republic Macedonia highlighted a number of actions and measures that can help in transforming undeclared work into declared work:

- all interviewees emphasized the importance of indirect measures, i.e. changing the culture, beliefs, tolerance, but also perceptions of the public about the undeclared work through media campaigns;
- some interviewees raised the need for changing the approach to tackling undeclared work from a deterrence approach towards stimulating businesses and persons to voluntary move into the declared economy;
- still, many of them agree that the detection has to be improved and the capacity of the inspection bodies improved;
- there is a need for better alignment of the legislation which is directly related to undeclared work and the specific sector-based regulation (for instance Law on trade, Law on Hospitality, etc.);
- the PRO stressed the need for a specific legislation for small-scale trade and trade companies/physical persons, as well as strong support for a support and advisory service to MSEs;
- introduction of vouchers, especially in agriculture, for seasonal workers;
- increasing the density of worker' and employer' organizations and strengthening of the social dialogue;

- some interviewees also held a view that the tax burden should be reduced for start-ups and especially start-ups of young persons (such as a one-year tax break), but also that the flexibility of the regulation should be increased;
- finding ways as to more effectively educate the citizens and firms about the legislative obligations so as to avoid unintentional non-compliance and undeclared work;
- increasing data sharing and data mining among the institutions so as to effectively (and with less resources) detect undeclared work.

6.1 Direct controls: deterrence measures

Citizens abide by the law either (1) because they fear detection and fines due to the power of authorities (enforced compliance) or (2) because they feel a commitment to be honest and have trust in the authorities (voluntary cooperation). In The Former Yugoslav Republic Macedonia, much of the emphasis until now has been on pursuing enforced compliance, not voluntary cooperation. Moreover, enforced compliance has been largely sought not by providing incentives to operate in the declared economy but by increasing the perceived and/or actual costs of working in the undeclared economy. This has been achieved mostly by raising the penalties and sanctions for engaging in undeclared work, but also through increasing the perceived and/or actual risk of detection.

6.2 Penalties and sanctions

The level of penalties in The Former Yugoslav Republic Macedonia was very high until few years ago, based on the premise that such high penalties will change considerably the behaviour of the taxpayers towards full tax and employment reporting. However, as previously argued, too large penalties can actually promote greater non-compliance.

There are high penalties for employers who do not respect the legislation and/or the findings of the inspection. For instance, according to the Law on labour inspectorate, a penalty of EUR 4,000 is applied in cases when: the employer does not cooperate with the inspector and constraints his/her work; does not respect the decision of the inspector to close the operation of the employer until the offense is corrected; employer does not keep the record of previous inspections in the premises, etc. The responsible person of the business is sanctioned with additional 30% of the amount of the penalty. For these same offences, a self-employed person would be fined with EUR 400-600.

The Labour Law sets higher fines than the Law on labour inspectorate, at EUR 7,000 in the cases an employer did not register a worker; does not follow the standards for safety and health at work; does not protect the personal data of employees, etc. In addition, the responsible person of the employer is fined with 30% of the amount of the above fine. Self-employed persons will be fined with EUR 700-1050 for those same offenses. Employers are fined with EUR 3,000 in case they do not keep a work contract in the main premises of the company and did not hand in a copy of the contract to the employee; if the employer does not give a worker a continuous rest of 24 hours during a week; etc. (article 265 of the Labour Law).

The size of penalties (for these offences but also for other fines applied to businesses) was generally seen as too high, especially in the case of micro businesses. If they were applied



consistently, then many of the MSEs would have to close the business, which is against the wanted formalization. So, for instance, in the case of joint inspections which started to be organized related to the Law for prohibition and prevention of unregistered activities, inspectors would sometimes issue a fine for an offence that is least costly, as to still do their job but not to harm businesses too much.

The size of penalties based on the Law for tax procedure (Official Gazette No. 13/2006 and latest amendments in 35/2018)³⁹ range between EUR 2,000-5,000 for the employer (legal persons) and an additional 30% of that amount for the responsible person at the employer. Depending on the type of non-compliance, the fine for physical persons ranges from EUR 150-1,500.

Under pressure by the public in 2015, the Government changed the Law on misdemeanours (Official Gazette No. 124/15), which *inter alia* changes the way in which the level of the penalty is determined. The importance of this law is that it prescribes that penalties should be proportionate with the size of the business, as well as the previous tax behaviour of the business. According to article 39, the level of the penalty for a particular wrongdoing, for a particular company is determined based on:

- total revenues of the company in the previous fiscal year (from 10% to max 70% of the determined level of the penalty based on the total);
- number of employees in the month prior to the month in which the offense was detected (from 5% to 20% of the level of the penalty);
- the previous record of the company with offenses (0% in case the company did not do any offense prior to this one, and 10% in case there was such behaviour in the past).

For instance, a company with annual revenue of MKD 1-3 million, with 10-49 employees and excellent past record in respecting the legislation, will be sanctioned with a penalty that is 40% of the defined level of penalty for the specific offense that has been committed as specified in the Law. A company with revenues of MKD 20-100 mil., over 250 employees and no previous offense record will pay 90% of the amount of the penalty.

This change can be regarded as a positive change as it takes into account the ability of the businesses to pay the penalties, rather than the previous system of fines which was disproportionately harming the micro and small firms.

In sum, the new Law on misdemeanours from 2015 corrected the previous policy of very high sanctions, while still setting the right incentives for formal behaviour of firms and physical persons. The analysis of the factors that support or inhibit non-compliant behaviour of the agents (i.e. demand for undeclared goods) in The Former Yugoslav Republic Macedonia showed that people that perceive that there are high penalties and risk of detection

³⁹ There were many amendments to the Law. The “clean” version is published on the following link (in Macedonian):

http://www.ujp.gov.mk/files/attachment/0000/0900/Zakon_za_danocna_postapka_35_od_23_02_2018.pdf.

are less likely to engage in undeclared work. Hence there is a scope for further increasing the risk of detection or perception of the risk of detection. Moreover, what is important for promoting voluntary compliance is to improve the perception of the fairness of the system and institutions. *Overall, therefore, altering the sanctions and penalties should not be the focus of attention of a national action plan for tackling undeclared work. However, there is a room for better coordination of the specific legislation (for instance, labour regulation, tax regulation, etc.) around the size of the penalties for same/similar wrongdoings.*

6.2.1 Detection measures

Until now in The Former Yugoslav Republic Macedonia, most measures pursued to tackle undeclared work have been focused on improving the perceived and actual risk of detection. Enforced compliance has been sought, therefore, not by providing incentives to operate in the declared economy, but by increasing the perceived and actual risks of detection, to increase the perceived and actual costs of working in the undeclared economy.

There are no studies in The Former Yugoslav Republic Macedonia that assess the perceived risk of detection among the citizens and/or businesses. In the absence of such data, rather arbitrarily, we can report that a perception of the authorities as an all-knowing and all-seeing ‘big brother’ is largely absent in The Former Yugoslav Republic Macedonia. Put another way, the emphasis until now on increasing the perceived and actual risk of detection does not seem to have had the desired effect. However, it is worrisome that firms and citizens perceive labour inspections (and other inspections) as being politically motivated. In other words, citizens believe that the risk of detection is not so much related to the undeclared behaviour but more to the political background or behaviour. Here, therefore, the measures so far pursued are reviewed, and the various means of improving the perceived and actual risk of detection.

Data matching and sharing

The low probability of detection of undeclared work is exasperated by the historical tendency for audits to focus on non-filers and non-active companies, with minimal prospects of collecting additional assessed taxes, leaving high-risk cases unlikely to be audited. In addition, the lack of data matching and sharing prevents inspectors from detecting an undeclared tax liability or non-registered workers when an audit is carried out.

One of the key initiatives in recent years has been the improvement of the risk of detection of tax non-compliance through better data exchange, as well as the introduction of more sophisticated methods/tools for risk-based audits and inspections. One of the priorities of the PRO for the period 2018-2020 is to develop a Risk Evaluation System which will improve the efficiency of the work (greater results with same resources). The Inspection Council also foresees greater focus of all inspection bodies on risk-based management and audits.

Improving the detection of some forms of undeclared work, such as salary under-reporting and envelope wages, however, is difficult. Such a practice is difficult to detect through workplace inspections because these formal employees have a written contract or terms of employment and a declared salary. For this reason, a shift away from workplace inspections is required when detecting under-declared employment. A shift towards data mining and matching is needed. What types of risk assessment could be conducted in The Former

Yugoslav Republic Macedonia, therefore, to identify risky-businesses likely to be involved in paying envelope wages?

A preliminary list of indicators of risky-business likely to be involved in paying envelope wages might include the following:

- Average salary in company compared with average salary in the same sector;
- Average salary in company compared with average salary in region;
- Average salary of a certain occupation/profession in the business does not correspond with the average salary within the same occupation/profession in the country, sector and/or region;
- Large proportion of a company's employees are working part-time compared with other similar businesses;
- Number of employees/total wages paid is not appropriate to the turnover;
- Complaints have been received about undeclared work;
- The business has previous violations related to undeclared work;
- Businesses where a higher proportion of workers receive the minimum wage compared with other similar businesses.

Using dynamic benchmarking to identify anomalies/outliers, is therefore required to detect under-declared employment (i.e., envelope wage payments). Data is needed to analyse for example average earnings in firms, and to cross tabulate this with average salaries in their region and/or sector, or by occupation, to identify outlier businesses paying below the average wage for their region and/or sector, or for particular occupations.

Coordination of data sharing across government

Coordination and data sharing between different institutions was enhanced following the establishment of the Inspection Council. In addition, the Action Plan for tackling undeclared work for 2015 put a large focus on data sharing. On the positive side, the Action Plan also envisaged actions as to enhance data exchange and to unify the work of the inspection bodies dealing with undeclared work:

- Improvement of the coordination of inspection bodies in inspection surveillance, and ensuring similar (if possible same) interventions and penalties for same offenses (we elaborate on this further below);
- Improved data exchange between the institutions competent for fight against the undeclared economy, such as the SLI, the PRO, the State Market Inspectorate, the State Inspectorate for Civil Engineering and Urban Planning, etc., but also with the other public institutions (ESA, National Bank of Republic of Macedonia, etc.);
- Data exchange has been reinforced between the SLI and ESA. Inspectors of the SLI were given direct access to the ESA database to cross check whether all employees in a company are registered (as all working contract are registered in the ESA). Then, SLI is obliged to report to ESA in case it finds non-registered employees on work place so that ESA removes those individuals from its register of unemployed. In 2015, as reported in the Information on the implementation of the 2015 Action Plan, the SLI reported to ESA 221 non-registered employees (though the ESA did not remove any worker from the register). Data exchange was also intensified between the SLI and the temporary work agencies.

- In 2015, the SLI prepared a Guideline on implementation of the Law on prohibition and prevention of unregistered activities, as well as Guidelines on determination of fines according to the Misdemeanour Act. The SLI has also prepared check lists for audits, forms for preparing a report form for the inspection audits, form for decisions issued by the inspectors, form for misdemeanour payment order, methodology for exercise of supervision, etc.
- The National Bank of the Republic of Macedonia (NBRM) and the MLSP concluded an agreement on data exchange on social welfare and permanent financial assistance recipients who receive foreign remittance and/or have savings accounts with the aim of directing social welfare toward the most vulnerable.
- The SLI established a unique procedure for handling the cases of non-registered workers in the inspection surveillance of all inspection bodies.

Despite the improved data sharing between the bodies responsible for tax, social security and labour law compliance, there currently remains a lack of a fully coordinated approach to data sharing. There is no single database and no plans to develop one. Instead, there appears to be a lack of will among the individual bodies involved to freely share their data with others, and each appears to have a desire for their own information system to be the one comprehensive system. To make progress, therefore, one option is for a decision to be made on which system is to be primarily used to collate data to detect instances of undeclared work. This would resolve the current culture of an apparent lack of willingness to share data.

Another more integrated and comprehensive approach is to create one specialist unit that gathers information and conducts data mining investigations into undeclared work. This unit would produce reports on the undeclared economy and investigate, using data mining, specific organizations and persons suspected of engaging in undeclared work at the request of other organizations, such as the SLI, Ministry of Finance/PRO and social security institutions. This unit would have the power to obtain information from the authority that requests the compliance report. The unit would not charge for the preparation of compliance reports and would be entitled to obtain the necessary information free of charge. A compliance report can be used only for the requested purpose, although it can be used as basis for another report requested by the same authority on the same subject (see Box 1).

Box 1 Joining-up data mining

Initiative: Grey Economy Information Unit (*Harmaan talouden selvitysyksikkö*), Finland

Aim: To join-up the previously fragmented function of data-mining.

Description: In Finland, data mining is the responsibility of the Grey Economy Information Unit (*Harmaan talouden selvitysyksikkö*). Established on 1 January 2011, this specialist unit within the tax administration (in the Ministry of Finance) gathers information and conducts investigations into undeclared work. This unit produces reports on the undeclared economy and investigates specific organizations and persons suspected of engaging in undeclared work at the request of other organizations, such as the police, customs bureau and Finnish Centre for Pensions as well as authorities dealing with work safety, debt recovery and bankruptcies. The unit has the power to obtain information from the authority that requests the compliance report. A compliance investigation can also be a general phenomenon report. The unit does not charge for the preparation of compliance reports and is entitled to obtain the necessary information free of charge. A compliance report can be used only for the requested purpose, although it can be used as basis for another report requested by the same authority on the

same subject. The Grey Economy Information Unit is authorised to keep a database within the meaning of the Data Protection Directive (95/46/EC, 1995), containing information necessary for the preparation of reports. The data controller is the tax administration.

Evaluation: Its budget in 2011, the unit's first year, was €1.6 million and €1.9 million in 2012. Some 20 persons are employed. After a year and a half of operation, the unit completed over 40 information gathering and dissemination tasks. It also produced approximately 11,000 compliance reports to other authorities (this mandate started in July 2011). During 2011, 732 tax audits were conducted on information provided, resulting in €42 million of undeclared wages and €65 million in undeclared sales being recovered (Virtanen, 2013).

Targeting of workplace inspections

According to article 116 of the Labour Law, employers in The Former Yugoslav Republic Macedonia who employ 25+ workers are obliged to use electronic labour cards to register all working time. Other employers have to keep a register (attendance lists) for the employees in which the start and end time of the work-day are reported. Non-compliance is punished with sanctions. Labour cards display automatically the times of arrival, departure and pauses of workers. However, this information is kept with the employer and is not sent electronically to some database (labour inspectors should have access to this information when performing on-site audits). This improves the effectiveness of inspections, but the potential use of the data is much larger than the current solution. As reported, the penalty for employers who do not keep record of the employees' working time (either electronically or in the registers) is as high as EUR 3,000 (article 265 of the Labour Law). Following the increase of the minimum wage in 2017, the Government targeted inspections towards employers who reduced the working time of the workers (potentially as a way to reduce the costs) or in order to pay them envelope wages.

Further improvements in workplace inspections could be achieved. It is not only the number of labour inspectors that hinders the effectiveness of workplace inspections but also the quality of the information systems for data mining to identify targets for inspections. There is currently not only a lack of necessary resources, but also the tools, procedures and coordination with other relevant authorities to prevent, identify and remedy suspected cases of labour law violation. A further problem is the geography of inspections with fewer taking place in remote geographical areas, the focus being on the capital city of Skopje. In recent years, it is usual to assign the inspectors to undertake surveillance and audits in other cities than their place of residence as to avoid the clientelistic behaviour.

Another method to improve the effectiveness of inspections is to use **notification letters** that notify businesses that they may be inspected in the near future, so as to encourage voluntary compliance without the need for a workplace inspection, or that they may be audited in future after submitting their tax return. At present, neither the tax nor labour inspectorates use to any major extent such an approach which is a potentially cost-effective way in which to achieve greater self-compliance. These may also contain normative information on why it is important to be compliant and not to use undeclared work. Though there was some discussion within the Inspection Council as to introduce notification prior to inspections, this proposal was not accepted. Data analysis can be used to identify the risky-businesses that will be subject to such notification letters.

This is a common practice in many EU Member States. In Spain, for example, 14,000 notification letters were sent to businesses with over 25% of their workforce employed part-

time inviting them to revise their information on the registration databases (given that this is an indicator that businesses may be paying envelope wages to workers and registering full-time workers as part-time). 15% of all businesses (1 in 6) revised the records of their employees with the social security and tax offices. This, therefore, is a cost-effective means of facilitating the transformation of undeclared work into declared work.

There is also a need to strengthen the **training of inspectors** in the realm of tackling the undeclared economy. This applies not only (and not particularly) to labour inspectors but also tax inspectors, inspectors of the State Market Inspection, etc., i.e. all inspection bodies who have responsibility under the Law on prohibition and prevention of unregistered activities. The situation improved significantly with the establishment of the Inspection Council, which reviews the work plans of the inspection bodies, organizes training and implements the exam for licencing of the inspectors. There is a room though that the planning and practice of inspection visits should be reassessed to ensure that adequate attention is paid to the incidence of undeclared work, even in situations where a visit's primary objective is not to detect undeclared activities.

Better **targeting inspections** in the labour inspectorate would considerably improve the detection of undeclared work. In addition, there is an under-emphasis put on the educational or promotional function of labour inspectorates to increase awareness among businesses and workers about the rules on undeclared work and how such situations can be avoided or regularized. Instead, they are largely viewed as enforcers handing out fines and penalties. Still, several years ago the legislation was amended as to give an opportunity to businesses to improve their compliance behaviour, especially in cases when the non-compliance was not intentional. This holds both for the SLI and the PRO. In case a wrongdoing is detected, inspectors hand out an invitation for training/education related to the legislation and proper implementation of legislation. Employers are then given a certain time period to correct and to conform to the legislation.

The overall balance between preventive and enforcing services is not systematic or based on strategic objectives, even though such a balance is important for promoting a culture of compliance. Currently, it does not appear that notifications and/or warnings (e.g. improvement or compliance orders) are used to their full potential or in a more regular way. A greater focus upon the **preventative role** of the labour inspectorate (and tax office) rather than the enforcement role would therefore be a useful development. This could include the development of educational materials on the benefits of declared work, a FAQ section on their websites and a more customer-friendly approach, all of which would facilitate the further development of their more facilitative preventative role.

A better balance between reactive and proactive inspection visits is also required. In a country characterized by SMEs and micro enterprises, the number of labour inspection visits per inspector could be much higher with better planning and with a more adequate composition of the inspection teams, taking into account the economic sectors and local realities. A modern system of management combining strategic objectives, target setting and performance appraisal is not in place in the labour or tax inspectorate.

Coordination of inspections

From a business perspective, joint inspections of the social security, labour and tax inspectorates, would be a customer-friendly development. The coordination and cooperation

between inspection bodies was strengthened with the establishment of the Inspection Council. In addition, the Law on prohibition and prevention of unregistered activities also raised the need for greater coordination of several inspection bodies (more than 15 bodies) which have an obligation to implement the Law.

Finally, increasing the potential of detection does not always have to lie with state authorities. Social partners can also play a central role. Some 17% of European countries have introduced **supply chain responsibility** to tackle the undeclared economy. In those countries which have done so, 78% of stakeholders view this as an effective policy instrument and the remaining 22% as ineffective. To see how this operates in practice, a case study is provided of the implementation of supply chain responsibility in Finland (see Box 2). In discussions with the working group that prepared the Strategy for formalization of the undeclared economy, there was considerable support for such initiative, though in general terms, and not as a voluntary action of the social partners.

Box 2 Introducing supply chain responsibility

Initiative: Contractor's Obligations and Liability Act, Finland

Aim: To reduce the presence of undeclared work in supply chains.

Description: The 2006 Contractor's Obligations and Liability When Work Is Contracted Out Act requires that the party responsible for a construction project obtains necessary guarantees that subcontractors fulfil their various obligations. The law has been in effect since 2007, but obligations in construction sector expanded in 2012. The 2006 legislation originally exempted established subcontracting relationships from a background check, but this hampered the enforcement of the legislation. These have now been included, as has accident insurance been included on the list of items that now needs checking. The objective of the original legislation as well as the 2012 amendments has been to combat the undeclared economy and promote fair competition between companies, particularly in the construction sector. Long subcontracting chains lead to situations where work is carried out without withholding employee taxes, making VAT payments, making pension payments, or observing conditions laid out in collective bargaining agreements. The legislation placed the responsibility on the users (which tend to be larger businesses) of subcontractors and temporary work agencies that these subcontractors and employment agencies meet their obligations. Contracting parties are required to ask for and obtain documents that verify certain registrations and payment of taxes as well as a reference to applicable collective bargaining agreements or corresponding conditions. Depending on the results of the background check, contracting may be subject to a penalty. The contracting party must inform its employee representatives of subcontracting or the use of employment agency workers. The act is limited to work taking place on the premises or site of the contracting party by employees of a subcontractor or an employment agency.

Evaluation: An early evaluation of the measure found that the law and its contents were known, although this questionnaire-based evaluation also revealed some companies were unaware of them (predominantly small companies). There was more uncertainty of the law's applicability in different sectors and situations, but most respondents regarded it as useful in raising the issue of employer obligations in contracting decisions so as to avoid undeclared work occurring. One problem identified by the respondents of the early evaluation was the additional work required by contracting companies. So too was getting the required information on foreign companies identified as a problem, the penalties were viewed as too

low for some situations and the omission of accident insurance from the documents to be requested was considered a problem. This feedback was taken into account in the 2012 amendments. This set the penalties higher at between €16 000 and €50 000 depending on the size of the contract, included accident insurance on the list of documents to be collected, and dropped existing business relationships from exemption because of the prior difficulties of verifying this. In 2010, there were 872 investigations by the authorities (50% in the construction sector). In total, 2541 contracts were examined and half found to contain violations. By March 2011, penalties totalling €302 500 had been imposed based on the 2010 investigations (Alvesalo and Hakamo, 2009; Työ-ja elinkeinoministeriö, 2011).

6.3 Direct Controls: supply-side incentives

All the measures so far reviewed are deterrents which seek to increase the costs of operating undeclared work by increasing the penalties or risks of detection. Another way of changing the cost-benefit ratio confronting those considering participation in undeclared work is to provide incentives for, or increase the benefits of, declared work. These measures can be either supply-side incentives or benefits that encourage people to engage in declared rather than undeclared work, or demand-side incentives that reduce the purchase of undeclared goods and services by providing rewards for purchasing on a declared basis. In this subsection, the focus is upon supply-side incentives.

One example of a change of the approach towards undeclared work is to switch from the common “black” lists/registers of companies to ‘white’ register of compliant business. Introducing such a registry would provide an incentive for businesses to operate legitimately. One way forward in this regard is to introduce business certification schemes and payment certification of tax and social contributions to create a ‘white list’ of compliant businesses, which a business needs to be listed on in order to tender for public procurement contracts (see Box 3) and/or to be eligible for some tax exemptions or some special support services.

Box 3 Business certification schemes

Initiative: Certification scheme for cleaning companies, Norway

Aim: To reduce the use of undeclared workers in cleaning businesses.

Description: In Norway, the Confederation of Norwegian Enterprise (*Næringslivets Hovedorganisasjon*, NHO) developed a voluntary certification scheme for cleaning businesses known as ‘clean development’ (*Ren utvikling*). All participating cleaning businesses had to provide documentation that their accounts and tax records were in order. User companies were then provided with a list of service providers in the cleaning industry whose activities are in order in relation to the existing rules and standards on tax as well as the working environment and workers’ rights.

Evaluation: In 2008, however, there were just 27 certified businesses, which was a tiny fraction of all businesses in the cleaning industry (Sissel et al., 2011). In 2012 therefore, the certification scheme was made compulsory for Norwegian cleaning companies (*Godkjenningsordningen for renholdsbedrifter*) and it was made illegal to purchase cleaning services from companies not approved by the labour inspectorate. This scheme ensures that any approved business has documented that it meets the requirements for residence permits for all employees and the registration and reporting obligations on public registers for all employees. The companies also need to document that they fulfil important requirements related to health and safety, and that all employees carry identity cards that they receive from

the labour inspectorate. A central register lists the approved companies that customers can use. In 2012, the government allocated 20 million NOK (€2.69m) to implement this approval scheme (Sissel et al., 2011).

Another supply-side incentive is to **simplify compliance**. Simplifying compliance is not the same as de-regulation. The problem in The Former Yugoslav Republic Macedonia is that the regulatory framework is still complex, and there are frequent changes to the legislation. Moreover, there is some inconsistency and lack of coordination within the legislation related to undeclared work (frequently raised as an issue by the inspectors). Therefore, in some cases, and especially for the micro and small firms who do not have a dedicated person for compliance (compliance officer), it is difficult to follow all legislative changes and to fully comply with the legislation. In the past, the Government implemented a reform called “Regulatory guillotine” which aimed at streamlining the regulation and abolishing all unnecessary requirements and administrative burden for firms. Still, there is a room to further proceed with simplification of the legislation.

One option to overcome the problems of complex and frequently changing legislation is to provide better advice and support on the existing laws, regulations and codes to help companies comply (e.g., FAQs on the websites of ministries, or software based on decision-trees that enables a business or citizen to ensure that they are being compliant).

Another perhaps preferable option is to simplify the regulatory compliance framework itself. An example would be to simplify tax administration for small businesses (e.g., the number of tax forms and returns, pursuing an integrated approach to audit with a single visit to inspect records rather than separate inspections) and improving support and education to help firms comply.

In 2016, the Government has simplified the tax regime for MSEs with a small turnover. In particular, trade companies classified as small and micro traders and legal entities residents of The Former Yugoslav Republic Macedonia, which lead an accountancy and are preparing annual accounts in accordance with the Law on trade companies (not performing bank, financial, insurance activities, and activities from the area of games of chance and prize games) which realize total income of up to MKD 3 million per year (app. EUR 50,000) are exempted from payment of CIT. For some companies with total income from MKD 3.000.001 to 6.000.000 per year, have the opportunity to choose to pay either annual tax on total income of 1% or CIT of 10%.

Simplifying regulatory compliance however, need not solely concern relatively minor administrative changes such as simplifying the number of procedures and forms, which was significantly improved in The Former Yugoslav Republic Macedonia (number of procedures and time to pay taxes). Measures might also include fundamental changes. The PRO has introduced a ‘pre-filling’ of tax returns for physical persons (from 2019, for the income earned in 2018). A similar simplification can be also implemented in future for the self-employed and small businesses. One example would be introducing a ‘standard deduction’ for the self-employed (see Box 4).

Box 4. Measures to simplify compliance.

Initiative: A ‘standard deduction’ for the self-employed

Aim: To facilitate a higher level of tax compliance by simplifying the compliance system so that it is easy to understand and use, with few loopholes.

Description: In many countries, the self-employed have to complete detailed (often self-assessed) tax returns that require a great deal of time and effort, as well as psychological stress. Indeed, all income has to be recorded, receipts kept for all expenditures and detailed calculations made for all tax deductible items, so that net profit can be calculated. A major change proposed by Elffers and Hessing (1997) is to introduce one overall standard deduction to replace the current complex process (see also Slemrod and Yitzhaki, 1994). This would not be simply a fixed deduction on specific standard tax-deductible items but an overall standard deduction that the self-employed person would deduct from their income to take account of the expenses. This could be either a fixed amount or a percentage of gross income. If implemented, it would eradicate the whole process of deductible items, the keeping and logging of receipts from expenditures and significantly decrease the complexity of the tax system. The usual argument against such a measure is either that it will not work or that it is unfair towards those taxpayers who really do have high costs. The latter could be overcome by allowing taxpayers not wishing to opt for the overall standard deduction to retain the right to continue with the current process if they so wish.

Evaluation: The advantage for the taxpayer of applying this overall deduction, which has operated in the US federal income tax system for many years, is that: this is a safe and certain option; it saves time and trouble; there is no need to pay for a tax advisor; and it reduces uncertainty. The higher the standard deduction, the greater is the chance that they will use this system rather than seek to specify all tax deductible items. Indeed, the fact that this is an attractive option for taxpayers is its take-up in countries where introduced. Gross (1990) reports that in the US in 1990, 71% of taxpayers opted for the standard deduction, in the form of a fixed amount. For tax authorities meanwhile, from the revenue-to-costs viewpoint, it is wholly ineffective to check deductible items claimed on each self-assessment form; it is a matter of small sums of money, which takes tax officials much time to check, let alone discuss and correct. If there were fewer claims with deductible items, this would make an enormous difference to the workload of tax offices. It would also release time either to check those specifying deductible items in more depth or for shifting resources towards enabling compliance rather than detecting non-compliance.

Various options exist for implementing this overall standard deduction. One option is to start by applying it to those filing self-employment tax returns. To estimate the effects on revenue collected under a standard deduction system, three variables require consideration. Firstly, there are the revenues lost or gained by introducing the standard deduction. Secondly, there is the number of taxpayers opting for the overall standard deduction, and third and finally, there is the reduction of work involved for the tax administration. The level of this standard deduction, either a fixed amount or percentage of gross income, so that it is revenue-neutral, could be calculated by auditing existing tax returns across various industries and occupations for the mean or median deductions claimed. It could then be either universally applied (which would be simplest for the tax filer) or applied in the first instance only to those sectors and/or occupations where the shadow economy is rife.

The implementation of a 'standard deduction' for the self-employed in The Former Yugoslav Republic Macedonia may also free some time of the staff in the revenue administration and may make considerable inroads into overcoming the problem of tax collection. There would

be a simple standard deduction based on their reported income, which would prevent appeals and allow a more efficient use of resources in the tax administration.

Indirect taxes, i.e. the Value Added Tax (VAT) are the main source of tax revenues in The Former Yugoslav Republic Macedonia. In 2017, the VAT revenues were 46% of the tax revenues, and 26% of the total budget revenues (tax and non-tax revenues). In an environment of low wages and profits, and an existence of large undeclared economy, **indirect taxes on consumption** dominate in the tax structure. There are two rates of VAT, 18% and a preferential rate of 5% for certain food, medical products, some intermediate agricultural goods, etc. There are no possibilities for using VAT reductions to reduce the level of undeclared work. However, one feasible option is to use **reverse charges for VAT** whereby the buyer, not seller, must file and pay the VAT. Until now, reverse VAT charges have been introduced in several European countries in the construction industry (see Box 5). This could be applicable to The Former Yugoslav Republic Macedonia and introduced in a range of sectors where undeclared work is rife.

Box 5 Reverse VAT charges

Initiative: Reverse charges in the construction industry, Sweden

Aim: To tackle VAT fraud and undeclared work in the construction industry

Description: To tackle VAT fraud and undeclared work in the construction industry, the Swedish government introduced a law on reverse charges for VAT effective from 1 July 2007. A reverse charge means that the buyer, not the seller, must file and pay the VAT. A company selling construction services more than on a temporary basis must pay VAT for its sub-contractors. If the purchaser is not a construction company, the vendor shall add VAT to the invoice. If the purchaser is a construction company, the vendor shall not add VAT to the invoice. Instead, the purchaser will be responsible for reporting the output VAT. Reverse VAT liability does not apply to sales which consist solely of materials.

Evaluation: According to a survey by the Swedish Tax Agency (2011), around 39% of the surveyed companies believed that the reverse charge reduced undeclared work in the construction sector. The Swedish Tax Agency does not find support for this argument when investigating a possible increase in reported payroll taxes. However, it does not preclude that the measure may have affected the prevalence of the undeclared economy concluding that the reverse charge has had positive effects in terms of increased reporting of output tax in the construction sector at SEK 700 million (€82.3 million) in 2008 (Swedish Tax Agency, 2011).

Initiative: Reverse VAT in the construction industry, Finland

Aim: To tackle VAT fraud and undeclared work in the construction industry

Description: In April 2011, Finland similarly introduced reverse VAT where VAT is paid by the buyer (main contractor) rather than seller (subcontractors). This was deemed effective because the tax liability does not as easily disappear into the subcontracting chain and the main contractors tend to be large, established and reputable companies. Subcontractors do not charge VAT to the main responsible party. If there is a chain of subcontracting, as is typical, all invoicing excludes VAT, which is only disbursed at the top of the chain. The reverse system only applies to construction services, not materials, and private individuals as buyers are excluded.

Evaluation: The tax administration estimated that during the first three years the reverse system would annually require 60 work-years to implement, followed by 30 work-years in each subsequent year. In the legislative proposal, the increase in VAT revenue was estimated

at €80-120 million. The disbursement of VAT has been shifting towards the main contractors as intended. Information from a few tax audits based on it have been analysed and reported. They have uncovered both honest mistakes and suspicious activity. There are no reports however, of suspected appearances of ‘front’ organizations as fraudulent main contractors.

To make it easier to work on a declared basis, another approach is to introduce **new categories of declared work** to allow economic activity currently conducted as undeclared work, often out of necessity due to the complex compliance regulations involved, to move into the declared realm. Overall, one-third of the European countries surveyed in 2010 had introduced such measures. Of those adopting this measure, 59% viewed it as effective, 33% as neither effective nor ineffective, and just 8% as ineffective (Dekker et al., 2010). Here therefore, and to see how new categories of declared work can be introduced to make it easier to move work currently conducted out of necessity in the undeclared economy into the declared realm, an example is taken from Hungary where the Simplified Employment Act has made it easier for people to undertake small jobs in the declared economy which would have been impossible beforehand and would be necessary have been undertaken on an undeclared basis, such as doing a small computer repair job for an acquaintance (see Box 6).

Box 6 New forms of declared work

Initiative: Simplified Employment Act (Egyszerűsített foglalkoztatási törvény) 2010, Hungary

Aim: To bring small mini-jobs into the declared economy that would otherwise be conducted on an undeclared basis

Description: In 2010, the Hungarian government introduced the Simplified Employment Act to make seasonal and temporary employment easier to conduct on a declared basis. Before this Act, it was necessary to complete in duplicate an official attendance sheet with 18 pieces of information for every single seasonal worker. This Act frees both the employee and employer of such administrative burdens, and enables the mutually agreed simplified work contract to be notified either by: a simple Text Message (SMS) or electronically via the Client Gate System after they are registered and in the system. It distinguishes two categories of simplified employment: seasonal agricultural work, including seasonal tourism services, and other casual/temporary work (i.e., domestic work). In the first case the employer has to pay taxes of HUF 500 (€1.75), in the second case HUF 1000 (€3.50), on a daily basis. All obligations are fulfilled by entering two codes into the Text Message or into the Client Gate System.

Evaluation: According to data from the Hungarian National Tax and Customs Administration, between April and May 2010, 505,621 simplified employment cases were registered at the tax authority, of which 417 937 entries were for ad hoc/casual employment, 15,877 for seasonal agricultural employment, 6393 tourism employment, 761 at non-profit organizations, and 10,326 in plant cultivation. Of these jobs, 499,987 lasted less than five days and 2,169 longer than five days. By July 2011, there were 512,000 temporary or seasonal jobs registered as simplified employment from 370,000 employers. Between 1 August 2010 and 31 December 2011, around 12.5 million working days were registered across these 17 months and HUF 8 billion (€28 million) flowed into the state’s treasury (Rindt and Krén, 2013).

Another supply-side incentive is to use **social security and direct tax incentives** to prevent citizens and businesses entering the undeclared economy. In The Former Yugoslav Republic Macedonia there are no such initiatives at the moment.

A further supply-side incentive to encourage declared work is the provision of **support and advice on formalisation** both by government and by social partners. Although some inspectorates in The Former Yugoslav Republic Macedonia operate helplines where offenses can be reported (including the SLI, but also the trade union runs a hotline), there are no helplines which provide an advice on tax, social security and labour law. In 2017, the PRO has further advanced in the efforts to offer better services to the taxpayers but establishing a Contact Center, constructing a specialized website (kontaktcentar.ujp.gov.mk) and the two new services of the PRO "SCHEDULE A MEETING" and "INFORMA".

These initiatives are good but there is a need for provision of services for formalisation advice to current businesses that operate on a partially undeclared basis about how they can put their affairs in order. The use of non-governmental bodies to provide this advice is important so that there is greater willingness and less fear from businesses of approaching them for such advice. A broader initiative might also include the use of 'role models' organised by for example chambers of commerce.

Beyond such limited initiatives, there is little support at present given to businesses to facilitate their formalisation in The Former Yugoslav Republic Macedonia. There is no free provision of record-keeping software to businesses, no fact sheets on record-keeping, and no free advice or training on record-keeping.

Box 7 Business walking routes in Greece

Another notable initiative that provides an incentive for business to formalise is the 'Business walking routes' initiative of the Institute of Commerce and Services (INEMY), which is the scientific institute of the Hellenic Confederation of Commerce and Entrepreneurship (ESEE), co-financed by Greek and European funds. This mapped and proposes to citizens and visitors six walking routes in the city centre of Athens, each themed for specific goods. Only businesses are included which are formal registered businesses that have no compliance issues outstanding. The routes are termed as Lets go for a gift walk (Plaka area), Lets go for a books and music walk (Exarcheia area); Lets go for a footwear and leather walk (Ermou street), etc. This provides an incentive for businesses to be formal by providing them with free marketing for their business, and could be significantly extended to other districts and sectors.

6.4 Direct Controls: demand-side incentives

Besides providing supply-side incentives to operate in the declared economy, recent years have witnessed the expansion of demand-side incentives to encourage the purchase of declared goods and services. One option is to give straightforward income tax relief, claimed on tax returns, to customers using declared labour to do specific tasks (e.g., roof maintenance,

outside painting, domestic cleaning) commonly conducted in the undeclared economy, so that the wage costs of employing workers on a declared basis become equivalent or better than the wage costs of employing somebody on an undeclared basis (see Box 9).

Box 8 Tackling the demand-side: the use of tax deductions

Initiative: Tax deductions for household work, Sweden

Aim: To use direct tax incentives to bring domestic services provided in the undeclared economy into the declared realm

Description: Since 8 December 2008, Swedish citizens have been able to apply for a tax deduction amounting to 50% of the labour cost for the renovation, conversion and extension of homes (ROT), and also for household services (RUT), including cleaning, laundry, basic gardening and babysitting. The maximum annual tax deduction that can be applied for is SEK 50 000 (€6000) for each individual. In the government bill from 2007 where the RUT deduction was proposed, the measure was estimated to cost SEK1.3 billion per year (€155 million). The ROT-deduction was in the spring budget bill in 2009 and was calculated to cost SEK 13.5 billion per year (€416 million) (Swedish Tax Agency, 2011). As of 1 July 2009, companies performing household services charge the customer the costs of materials and half the labour costs, including VAT. The company performing the work then requests the outstanding sum from the Swedish Tax Agency. As a result, the customers only pay half of the labour cost at the point of purchase of the service.

Evaluation: Comparing data from 2005 and 2011, the Swedish Tax Agency (2011) display that undeclared work has decreased by about 10% within the categories of jobs covered by the ROT and RUT-deduction. In the autumn of 2011, the Swedish Federation of Business Owners (*Företagarna*) conducted a survey of 2447 construction companies. The results show that nearly 90% felt that the ROT-deduction had a positive impact on reducing undeclared work in the sector compared with 78% in 2009. In 2010, 1.1 million people bought household services with a tax deduction (RUT and ROT) and the Swedish Tax Agency paid out SEK 1.4 billion (€166 million) in RUT deductions and SEK 13.5 billion (€1.6 billion) in ROT-deductions. This means that around 7.6 million hours of cleaning and household (ROT) services and 53 million hours of renovation work (ROT) were performed using these schemes (Brunk, 2013).

Initiative: Home-job plan, home-job tax deduction, Denmark

Aim: To use direct tax incentives to bring domestic services provided in the undeclared economy into the declared realm

Description: Since 1 June 2011 until the end of 2013, it has been possible for each member of the household over 18 years of age to deduct from their taxes up to DKK 15 000 (€2000) the costs of employing craftspeople and domestic helpers under a pilot project called 'Home-Job Plan' (*Bolig-Jobplan*). The major difference compared with the Swedish scheme therefore, is that whilst Sweden has a maximum tax deduction of €6600, the cap is €2000 in Denmark. The activities covered include cleaning, indoor-outdoor maintenance of the house, gardening and babysitting. The cost to the government is estimated to be DKK 1 billion (€134 million) in 2011 and around DKK 1.75 billion (€234 million) in 2012 and 2013. The expenses and the company involved is informed digitally by the buyer of the services to the tax authorities in a special template, who then deduct 15% of the amount in the yearly tax or fiscal income. The action involved for the buyer of these services resembles an ordinary payment transfer, and the system does the rest.

Evaluation: Relative to expectations, the pilot project has so far been a success. Some 270 000 people used the deduction in 2011 and most of the work involved home improvement, maintenance and repair. They have on average reported deductions of DKK 9800 (€1315) per person. In total, the deductions reported constitute DKK 2.7 billion (€362 million). The tax value of those deductions is around DKK 900 million (€121 million) (Jørgensen, 2013).

Another option is to use **service voucher schemes**. In The Former Yugoslav Republic Macedonia there are no examples of use of vouchers in any form. There is an interest of authorities to introduce voucher scheme for seasonal agricultural workers, as well as in domestic work, such as home cleaning, gardening, maintenance services, private lessons, baby-sitting and elder care, however the idea is still only in explorative phase. The Strategy for formalization of undeclared economy (and the draft action plan) does argue for the need for introduction of voucher schemes and/or tax deductions as to strengthen the demand-side incentives for formalization. Social partners also argue for the need to introduce vouchers especially in agriculture. Vouchers should be carefully planned and designed as not to replace formal waged employment but to substitute for undeclared work.

As the European Platform Tackling Undeclared Work (Williams, 2018) concludes, service voucher schemes can be categorised into two broad types of scheme: **social vouchers (SV)** which are used by households (Belgium, France, Austria and the new *libretto famiglia* in Italy) and **enterprise vouchers (EV)** used by companies (Croatia, the old Italian system and the new *contratto di prestazione occasionale* in Italy). It suggests good practice in relation to implementing such service voucher schemes.

- Social Voucher (SV) schemes should:
 - Be used to pay for regular and occasional labour.
 - Be used to formalise household services (including caring services), with service vouchers limited to the specific tasks where undeclared work is prevalent. This will vary by Member State.
 - Allow the direct employment of a private individual by a household, as well as establish authorised provider organisations which employ service voucher workers.
- Enterprise voucher (EV) schemes should:
 - Only be used to pay for occasional labour.
 - Target the agricultural sector and only be used in other sectors if they protect workers' rights.
- Both Social Voucher (SV) and Enterprise Voucher (EV) schemes should:
 - Be targeted only at spheres where undeclared work is prevalent.
 - Target spheres where labour inspection is difficult (e.g., households).
 - Set a limit on the number of service vouchers an employer can purchase, not on the level of income of a service voucher worker.
 - Allow users to acquire and submit vouchers online.
 - Be costed at the minimum price an employer pays for one hour's work.
 - Conduct prior research to decide price of service voucher for a user (and level of subsidy required), so that they are competitively priced compared to using undeclared work.
 - Enable workers to gain access to key social security benefits comparable to those held by people employed, and cover unemployment benefits, accident insurance, pension benefits, sickness benefits, maternity leave and health benefits.

When implementing service voucher schemes, moreover, pilot initiatives should be used in a particular locality/ies, or specific tasks/sectors where undeclared work is prevalent, and ex-ante and ex-post evaluations should be conducted.

The two key indicators of the success of a service voucher scheme should be:

- The extent to which the service voucher scheme reduces undeclared work/transforms undeclared work into declared work.
- That they do not substitute for permanent formal employment contracts.

Given that a large proportion of payments for work in the undeclared economy are in the form of cash, one way forward is to **incentivise electronic payments** and in doing so, shift away from cash payments. To transfer from cash to electronic payments, a first option is for governments to introduce a ceiling for cash transactions. Indeed, there is a ceiling on cash payments in The Former Yugoslav Republic Macedonia at EUR 15,000, however there are proposals by the Ministry of Finance (coordinated with the NBRM and the larger commercial banks) to reduce the limit to EUR 2,000. This would be more in line with most EU Member States who have introduced a cash limit. A second option is to make point-of-sale terminals available across all sectors, such as bars and taxis. Introducing them can reduce the use of cash. This has been largely introduced in The Former Yugoslav Republic Macedonia. A third option is for governments to shift more fully towards electronic payments. A fourth option is to discourage easy access to cash. The presence of no-fee automated teller machines (ATMs) provides uninhibited access to cash and subsequent cash payment at the point-of-sale. A fifth and final option is to provide incentives for using cards at the point-of-sale. Many day-to-day transactions, especially those worth less than €15, remain cash-based. Developing incentives for individuals to use cards is a way forward. Argentina for example, offers a 5% VAT discount on debit card transactions and 3% on credit card purchases.

Apart from the state, the use of electronic means of payment has also been incentivised by some financial institutions. Some banks, for instance, implement loyalty programmes that provide rewards for the use of credit and debit cards. The programmes usually entail the collection of reward points for each transaction and exchange of the points for discounts in participating stores, but there are also examples when banks offer a return of cash at the end of an administrative period (e.g., a month). The Ministry of Finance and NBRM (along with the largest commercial banks) are currently working on a strategy for reduction of the cash in circulation.

Some measures that could be adopted in this regard are compulsory installation of POS terminals, the imposition of fines in case that a digital payment is refused, incentives to the consumers that have justifiably reported a digital payment refusal and incentives to very small enterprises, such as a subsidy for the installation of point-of-sale terminals with a corresponding reduction of the bank fees and the possibility to participate in a lottery.

6.5 Indirect controls

Until now, all the measures proposed have been direct controls which seek to change the cost/benefit ratio confronting businesses and citizens when considering participation in undeclared work either by increasing the costs of undeclared work or the benefits of declared work. As shown in section 2.2 however, business and citizens are not always simply rational economic actors. They are also often social actors who do not comply because they either



lack trust in the state, or do not understand or believe in what the state is seeking to achieve (i.e. they lack ‘vertical’ trust), or they believe that many others are operating undeclared so see no reason that they should operate on a declared basis (i.e., they lack ‘horizontal’ trust).

To tackle undeclared work, the root causes that lead to the values, norms and beliefs of citizens not being aligned with the laws and regulations, needs to be tackled. This is what indirect controls seek to achieve by dealing with the formal institutional imperfections and failures that lead to the decision to engage in the undeclared economy. Until now, The Former Yugoslav Republic Macedonia has paid little if any attention to such indirect controls as a means of tackling the undeclared economy. No strategy has been developed to foster trust in government and to align the norms, values and beliefs of citizens regarding compliance with the codified laws and regulations. Two sets of initiatives are required to achieve this. Firstly, initiatives can be pursued to alter the norms, values and beliefs of citizens so that they align with the laws and regulations and secondly, and for this to be achieved, it is also necessary to deal with the formal institutional failings and imperfections so as to foster greater self-compliance in the population.

6.5.1 Altering informal institutions: awareness raising campaigns

Many citizens do not fully understand why they pay their taxes and/or what these taxes are used for by governments; they do not fully make the connection between the public goods and services they receive (e.g., hospitals, schools, transport infrastructure) and the taxes they pay. Until now, governments have generally undertaken very little marketing to help citizens make this connection. However, if the norms, values and beliefs of many in the population are to become better aligned with the codified laws and regulations of formal institutions and voluntary cooperation is to ensue, educating citizens about this is important. The advantage of pursuing voluntary cooperation, rather than enforced compliance, is that this is potentially a far cheaper, more effective and sustainable means of tackling violations of tax, social security and labour law related to undeclared work than having an army of inspectors to police non-compliant behaviour and using incentives to effectively ‘bribe’ the population to operate on a declared basis.

To achieve such voluntary cooperation, two broad forms of education are required. On the one hand, and to prevent unintentional non-compliance, citizens need to be educated and informed about what the current system requires of them. On the other hand, and more broadly, citizens need to be educated about the benefits and value of paying tax and being compliant with labour law and social insurance regulations, by educating them about the benefits of paying taxes and social insurance contributions, and complying with labour law, in order to develop their intrinsic motivation to do so and facilitate greater self-regulation.

The first type of education requires the provision of easily understood information regarding their responsibilities with regard to the tax, social security and labour law. A significant portion of non-compliance is unintentional, arising from both the complexity of the compliance system as well as a lack of knowledge, misunderstanding and ambiguous interpretation of tax and labour law (Hasseldine and Li, 1999; Natrah, 2013). In consequence, one way forward is to provide greater information to citizens (Internal Revenue Service, 2007; Vossler et al., 2011). At present, few if any initiatives in this regard have been pursued in The Former Yugoslav Republic Macedonia. Besides simplifying compliance (discussed in

section 6.3), a frequently asked questions (FAQ) section on ministerial websites might be helpful.

The second and perhaps more important type of education is that which seeks to educate citizens about the benefits and value of being compliant with labour, tax and social insurance regulations. One potential and partial remedy, therefore, is to educate citizens about the activities on which their taxes are spent, and the value of pensions and abiding by labour law. If citizens are informed and knowledgeable about the current and potential public goods and services which they are receiving for their money, and the value of having a pension, they may be more willing to pay their taxes and social contributions (Bird et al., 2006; Saeed and Shah, 2011). One direct way of doing this is to provide information to tax payers regarding where their taxes are being spent and how much they are contributing to which activities of government. Indeed, such initiative was present in the country in early 2000s, when through TV ads the state budget was presented a pizza and public was informed on how the pizza slices are then spread across different public services and needs (health, social protection, education, etc.). This set out what portion of the taxes that individuals and companies pay is spent on which public goods and services. In 2017, under the auspices of the new minister of finance, the Ministry of Finance published a so-called “citizens’ budget” in which many aspects of the budgeting, budget revenues and expenditures were presented in a friendly manner. Though, the reach of such an initiative was rather small (bound to people who follow the activities of the Ministry, i.e. the informed citizens). Some NGOs in the past have also prepared such “citizens’ budgets” but again the stretch of those initiatives was rather low, leaving aside most of the general public. Another simple way of doing this is to display signs such as ‘your taxes are paying for this’ on public construction projects (e.g., new roads), on ambulances, in doctor’s waiting rooms, in hospitals and schools, which convey a clear message to the public that the taxes they pay are being used to provide these public goods and services.

In 2015, civic education projects were implemented, for instance, the “Youth Fiscal Education” project targeting the secondary school and university students, the secondary school student education via the project “Refuse an undeclared job”, etc. The MLSP, Ministry of Education and Science, ESA and agencies for temporary employment jointly implemented the project “Refuse an undeclared work” in 51 schools around the country.

In Canada for example, the Tax System Learning Unit provides information about the tax system as well as how the government spends the tax dollars collected. This Unit until now has targeted junior and high school students to educate citizens before they start participating in the tax system. While the initiative has enjoyed success in getting participation from education institutions, its impact on compliance has not been measured, since there is no mechanism to track the compliance behaviour of those taking the modules against a control group who have not. Austria has adopted a similar initiative targeted at schools whereby tax officials provide training on future responsibilities for compliance, as have the Internal Revenue Service in the USA (Internal Revenue Service, 2007).

Although information and advice is provided during inspection visits, no concerted awareness raising campaign has been launched about the costs of undeclared work and benefits of declared work. It is more information on *obligations* that is provided by the tax, labour and social security bodies. An awareness raising campaign, meanwhile, can either: inform those working in the undeclared economy of the costs and risks of doing so; inform



potential users of undeclared labour of the risks and costs; inform those working in the undeclared economy of the benefits of being legitimate, and/or inform potential users of undeclared labour of the benefits of formal labour.

There is tentative evidence that emphasising the benefits of working declared rather than the costs and risks of engaging in undeclared labour is more effective. As Thurman et al. (1984) explain, publicising the adverse consequences of engaging in undeclared labour is ineffective because those working in the undeclared economy tend to neutralise their guilt, such as by seeing themselves as small players with little impact compared with the big players. If an awareness-raising campaign does decide to focus upon the costs of undeclared work, therefore, then it will need to ensure that these rationalisations are not available to participants in the undeclared economy, such as by advertising the average level of non-compliance so that people will not view their own activity as ‘minor’ compared with others.

For a campaign to be effective however, it has to use tailored advertisements that will need to vary in form and content depending on the audience targeted. The language, media used, word style and slogans that will be effective for one population group such as younger people, will not be for another group such as the elderly. Similarly, effective media for one target group, such as newspaper adverts for older people, will not be for the internet-oriented younger generation. As shown in other realms of advertising, harnessing the power of celebrities can also be effective in influencing the target audience. If celebrities and/or opinion leaders are used by administrations, then as Lessing and Park (1978) identify, it is necessary to differentiate three types of campaign. These are firstly, information campaigns where citizens lacking knowledge refer to opinion leaders for information, such as highly respected economic experts via television commercials, talk shows and newspaper articles, secondly, utilitarian campaigns when citizens are motivated by hearing about others rewarded or punished, such as when names are published of those who pay taxes and do not and, third and finally, value-expressive campaigns when citizens are encouraged to associate themselves with positive role models, such as by publicising the tax payments of famous television and movie stars, athletes, scientists, politicians and business tycoons, holding them up as role models for the law-abiding citizen to follow.

Moreover, it does not always have to be governments leading such awareness raising campaigns. It can also be social partners such as employer or employee representative organizations either independently or in cooperation with the state. In Sweden for example, employers have led campaigns to tackle the undeclared economy and undeclared labour in both the construction industry and the taxi-driving sector. The Bulgarian Industrial Association, meanwhile, has run an ‘In the Light’ (www.nasvetlo.net) campaign since 2007 and sought to encourage greater awareness of the negative implications of the undeclared economy and undeclared labour, whilst in Canada, a national awareness advertising campaign, ‘Get it in Writing’, to inform purchasers of undeclared labour of the risks involved in dealing with home repair and maintenance contractors has been developed in partnership between the tax administration and the Canadian Home Builders’ Association. In The Former Yugoslav Republic Macedonia, a similar campaign was run in the past by the trade unions (i.e. FTUM), called “Stop Black market work” as to motivate and support undeclared workers not to accept unregistered work and to report employers who informally employ workers (a hotline for reporting was also opened). There was no assessment of the effectiveness of the campaign and no information of how many employers were reported by the workers as several workers were reporting same employers. Moreover, at the time the

campaign was run, labour inspectors could not issue themselves a fine, but they were reporting the wrongdoings to the courts, and usually such procedures were not resolved in the prescribed time period (due to large backlogs of the courts).

6.5.2 Reforming formal institutions

There is little point in seeking to change norms, values and beliefs, however, unless one addresses the formal institutional failings that cause the non-alignment of citizen morality with state morality, and thus the prevalence of undeclared work. In light of the scarce resources, there is always a tension between the conflicting goals of achieving fiscal savings in the short run and modernizing public administration over the longer run. To tackle these formal institutional failings so that citizens become more committed to being compliant, therefore, two broad approaches are required. On the one hand, the processes of formal institutions need to be changed. On the other hand, the products of formal institutions need to be addressed. These related to tackling formal institutional voids (e.g., a lack of welfare protection). Here, each is considered in turn, starting with the processes of formal institutions. Changing the processes of formal institutions addresses two key types of formal institutional failure. On the one hand, changing the processes of formal institutions tackles formal institutional inefficiencies, or resource misallocations by formal institutions, such as when formal institutions seek to protect or maximize economic rents for elites, or when state capture occurs by such elites, resulting in the majority not receiving a fair share in return for their contributions, or suffering from overly burdensome taxes, registration and licensing regulations and costs. On the other hand, changing the processes of formal institutions tackles formal institutional weaknesses and instability, manifested in their lack of capacity and capability to enforce legislation and/or there are continuous changes in the formal ‘rules of the game’ about what is acceptable, which leads citizens to reject the continuously changing formal rules of the game in favour of their own more stable unwritten socially shared rules. These malfunctions lead to a non-alignment between state morality and citizen morality. To change this, processes need to be altered to ensure that there is procedural justice, procedural fairness and distributive fairness. This net result will be a shift in public institutions away from a ‘cops and robbers’ approach and towards a more customer-friendly orientation. Each is here considered in turn.

Procedural justice. The extent to which citizens perceive government to treat them in a respectful, impartial and responsible manner significantly affects whether citizens engage in voluntary cooperation (Hartner et al, 2008; Murphy et al., 2009; Torgler and Schneider, 2007). Leventhal (1980) formulated the following six rules regarding procedural justice:

1. The consistency rule - procedures should be consistent across people and time; nobody should be favoured or disadvantaged.
2. bias suppression rule - egoistic intentions and prejudice on the part of the decision-makers should be avoided;
3. accuracy rule - all relevant sources of information should be exhausted, in order that decisions are based on well-founded information;
4. correctability rule - the possibility of the adjustment or revision of decisions made;
5. representativeness rule - the opinions and interests of all parties should be considered, and
6. ethicality rule - procedures should align with the prevailing moral and ethical values.



Leventhal's rules deal primarily with the decision-making process. However, Bies and Moag (1986) argue that it is also important to consider interpersonal interactions and whether there is respectful and fair treatment (i.e., interactional fairness). Compliance is significantly higher when citizens perceive there to be interactional fairness. Being treated politely, in a dignified manner and with respect, being given a say, and having genuine respect shown for one rights and social status all improve compliance (Gangl et al., 2013; Hartner et al., 2008).

Consequently, it is necessary for the state to move towards a customer-oriented service approach that treats citizens with respect and dignity. This shift from a coercive to cooperative approach seeks to reduce the need for enforced compliance. The more regulatory interactions are grounded in trust, the greater is the likelihood of self-regulation or voluntary compliance.

Procedural fairness. People who receive procedurally fair treatment by an organization will be more likely to trust that organization and will be more inclined to accept its decisions and follow its directions (Murphy, 2005). If one citizen caught violating the law pays no fines, but others caught have to pay, s/he will view themselves as being treated unfairly. Fairness is one of the most important determinants of compliance (Hartner et al., 2011; Kirchgässner, 2010, 2011; Molero and Pujol, 2012). If citizens feel that they are not receiving fair treatment, non-compliance increases (Bird et al., 2006). Where grievance exists either in absolute terms (e.g., those who feel that taxes are too high, those who feel that public funds are wasted) or in relative terms (e.g., the suspected level of others' tax evasion), the result is greater non-compliance. Indeed, and as shown above, citizens can justify their own non-compliance in the perceived non-compliance of others. If the undeclared economy is perceived as extensive, then this justifies citizens engaging in non-compliant behaviour themselves. This obviously has implications for administrations. If the authorities advertise that the undeclared economy is extensive, then they create the conditions for widespread grievance and for greater participation in the undeclared economy of those who might not have otherwise done so. Similarly, if an offender believes that administrations are communicating disapproval to them through disrespect or stigmatising them, such as by labelling them with negative identities (e.g., thief, tax cheat), re-offending results since the individual externalizes the blame and feels alienated (Murphy and Harris, 2007).

Distributive fairness. Whether a citizen adheres to the codified laws and regulations and does not engage in the undeclared economy is heavily determined by whether they believe that they receive the goods and services they deserve given the taxes they pay (Richardson and Sawyer, 2001). Taxes, after all, are prices for the public goods and services provided by the government. If citizens view their interests as properly represented in formal institutions and they receive what they view as appropriate public goods and services for the taxes they pay, their identification with the state increases and their willingness to contribute is greater.

The government in The Former Yugoslav Republic Macedonia has plans to increase the taxation and return back to progressive taxation, however the main issue with such policy is that it puts the whole burden on those that are by easy-to-tax, salaried employees, whereas the richer, such as the self-employed (e.g., doctors, lawyers), as well as those working informally (which is large share of the total employment and total profits) will continue to stay outside the tax net. Moreover, it has been announced that the upper bound of the tax bracket for higher tax rate will be EUR 1,000 per month, but the main disapproval in the public is that people earning more than EUR 1,000 per month are not rich people, but middle class, and



people who are relatively successful and who decided to stay in the country (amid the large emigration and brain drain).

If citizens do not receive the goods and services that they think they deserve given the taxes they pay, non-compliance increases. This may occur for example, when corruption is extensive and the citizen has little trust in formal institutions. In such situations, there will be a low incentive to cooperate. Corruption generally undermines the willingness of citizens to comply, causing them to become frustrated. Citizens will feel cheated if they believe that corruption is widespread and their tax burden is not spent well (Torgler, 2007, 2012). As Kirchgässner (2010, p. 28) thus puts it, ‘If the willingness to pay taxes is to be enforced, a responsible use of tax revenue by the public authorities is necessary as well as a partnership relation (and not a magisterial one) between them’. The result is that governments need to educate citizens about where their taxes are spent. In situations where citizens do not know, or do not fully understand that public goods and services are due to taxes, then compliance will be lower than in situations where citizens are fully aware of the public goods and services they receive for their taxes and agree with how their taxes are spent (Lillemets, 2009). It is therefore important that the government of The Former Yugoslav Republic Macedonia explains to taxpayers how their money is spent.

6.5.3 Changing the products of formal institutions

It is not purely changes in the processes of formal institutions which are required to increase voluntary compliance. As outlined in section 2.1 and section 4, broader work and welfare regimes influence the size of the undeclared economy in a country. Larger undeclared economies are associated with lower levels of GDP per capita, a low quality of bureaucracy and higher levels of perceived public sector corruption, lower levels of expenditure on social protection, less effective social transfer systems and greater inequality and deprivation. Tackling the undeclared economy, therefore, is not solely about changing the penalties and risks of detection, or providing incentives to work in the declared economy. It also requires changes in the macro-level economic and social conditions, if it is to be reduced. Unless this is achieved, there will continue to be an asymmetry between the undeclared and formal institutions in a country and undeclared work will remain rife.

7 Policy recommendations and sequencing

Until recently, governments have largely sought to tackle undeclared work by seeking to repress this sphere. Today however, most governments are no longer seeking to eradicate the undeclared economy. Rather, there has been growing recognition across governments that they are seeking to move the undeclared economy into the declared economy (Dekker et al., 2010; Eurofound, 2013; European Commission, 2007, ILO, 2015; Small Business Council, 2004, Williams, 2006; Williams and Nadin, 2012, 2013, 2014). The rationale for this shift is several-fold.

For governments, the benefits of moving undeclared work into the declared economy are that it improves the level of public revenue, thus enabling governments to pursue higher expenditure on social integration and mobility projects (Williams and Windebank, 1998). It also enables the creation of more declared jobs and facilitates a joining-up of policy towards the undeclared economy with the policy approaches towards entrepreneurship and social inclusion (Dekker et al., 2010; European Commission, 2007). Given that a large proportion of undeclared work is self-employment, seeking to eradicate the undeclared economy would result in one hand of government repressing precisely the entrepreneurship and enterprise culture that with other hands they are seeking to foster. Similarly, given that much work in the undeclared economy is composed of paid favours between close social relations conducted for redistributive rationales and to help out others, repressing the undeclared economy would also result in one hand of government eradicating precisely the active citizenship that other hands of government wish to nurture. Seeking to harness endeavour in the undeclared economy by facilitating its transfer into the declared economy, rather than seeking to eradicate it, these contradictions are overcome. There is a joining-up of government policy towards the undeclared economy and policy towards entrepreneurship and active citizenship. It is beneficial not only to governments however, to move the undeclared economy into the declared economy.

For legitimate businesses, it prevents unfair competition and enables the business community to pursue a 'high road' rather than 'low road' approach by shifting towards greater regulatory standards on working conditions such as health and safety and labour standards (Williams and Windebank, 1998). For undeclared workers meanwhile, the key benefits are that they can achieve the same levels of legal protection as declared workers. For customers, furthermore, the advantages of legitimising the undeclared economy are that such customers benefit from legal recourse if a poor job is done, have access to insurance cover, enjoy guarantees with regard to the work conducted, and have more certainty that health and safety regulations are being followed. Across most governments therefore, the aim now is less to stamp out the undeclared economy and more to move the undeclared economy into the declared realm. How, therefore, can this be achieved?

The National Action Plan for tackling undeclared work is an integrated holistic approach based on a diagnostic of the current character of the undeclared economy in The Former Yugoslav Republic Macedonia which tackles this by utilising the full range of direct and indirect controls by concurrently pursuing both enforced compliance and voluntary cooperation. In Table 6, the policy measures that are required in The Former Yugoslav Republic Macedonia to achieve this are outlined.



This project is funded by the EU

RECOMMENDATIONS FOR TACKLING THE UNDECLARED ECONOMY

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
Strategic management initiatives					
1. A holistic integrated strategic approach towards tackling undeclared work.	To enhance the effectiveness and efficiency of the fight against undeclared work by improving coordination across enforcement authorities at the level of strategy, operations and data mining, sharing and analysis.	Establish a coordinating body to take responsibility for joining-up the strategies, operations and data mining, sharing and analysis of all state agencies and social partners involved in tackling undeclared work. The coordinative body established to implement the formalisation strategy can undertake this role.	Cross-government, with a major role of the MLSP, SLI, Employment Service Agency (ESA), Inspection Council, Ministry of Finance, PRO, Customs Office, Ministry of Economy, State Market Inspectorate (SMI), State Statistical Office (SSO), plus social partners.	<ul style="list-style-type: none"> • A coordinated national approach towards undeclared work on the level of strategy, operations and data mining, sharing and analysis. 	<ul style="list-style-type: none"> • Production of shared cross-cutting strategic objectives and key performance indicators (KPIs) across bodies responsible for tackling undeclared work, in addition to the existing agency-level strategic objectives and KPIs. • Greater proportion of operations and inspections conducted on joint/shared basis. • Implement a joined-up strategic plan on data mining, sharing and analysis to tackle undeclared work
2. Modernise the strategic objectives and KPIs of the main inspection bodies (specifically, SLI, PRO and	Broaden the responsibilities of the inspection bodies to include a preventative approach towards undeclared work.	Include as a strategic objective of the SLI, PRO, SMI, as well as the Inspection Council to ‘transform undeclared work into declared work’.	MLSP, SLI, Ministry of Finance, PRO, Ministry of Economy, SMI, but also all other institutions which activities are directly or	<ul style="list-style-type: none"> • Adopt additional KPIs associated with transforming undeclared work into declared work, and preventative measures, which are related to: • the number of businesses offered 	<ul style="list-style-type: none"> • Number of businesses offered advice and/or support by the SLI, PRO and SMI on how to operate legitimately (with a focus on micro businesses and start-ups).



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
SMI in relation to undeclared work			indirectly related to undeclared work	<p>education/training/advice on how to operate legitimately; the success of this goal can be measured by the level of customer satisfaction (grouped by the type of support and advice provided, with the first year used to produce a baseline figure for future years);</p> <ul style="list-style-type: none"> • x% of legitimized labour relations resulting from the total number of controlled labour relations (with the first year used to establish a baseline figure). 	
3. Create a Working Group on “Combating Undeclared Work” within the Economic-Social Council	To strengthen the inclusion and coordination of social partners in tackling undeclared work	<ul style="list-style-type: none"> • A special working group should be established within the Economic-Social Council that will use the combined knowledge of the social partners on undeclared work, but will also serve as a main avenue for discussion and planning of actions for formalization of the undeclared economy 	MLSP, Economic-Social Council	<ul style="list-style-type: none"> • Better coordination of social partners in the fight against undeclared work based on the combined knowledge of undeclared work (for example: in which sectors it is most 	<ul style="list-style-type: none"> • The Working Group produces at least once per year a brief on the main developments in undeclared work, and proposes activities and measures for formalization to the Economic-Social Council • Public support is mobilised



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
				<p>common, which employers are engaged in such activity) detecting and communication of performance both internally within the enforcement agency and to wider stakeholders.</p> <ul style="list-style-type: none"> • Greater dialogue on the best suited measures to formalize undeclared work • All economic and social agents involved in undeclared work get a clear message that the Government is seriously tackling this issue in collaboration with the Social Partners 	<p>against undeclared work.</p>
Deterrence measures					
<p>4. Improving the legal framework by introducing a definition of</p>	<p>To fill-in the gap of the current legal framework in the field of undeclared work,</p>	<ul style="list-style-type: none"> • To adopt the legal amendments regarding a legal definition of undeclared work or to make a list of situations to be considered as undeclared work 	<p>MLSP, SLI</p>	<ul style="list-style-type: none"> • Reduce undeclared work, improve effectiveness of SLI in tackling the undeclared work, 	<ul style="list-style-type: none"> • Improved rate of detection of undeclared work by state bodies. • Improved awareness that certain actions are



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
<p>undeclared work and the prohibition of undeclared work or comparable measures</p>	<p>to increase legal certainty, to ease the finding which actions are to be considered as undeclared work for the public as well as for labour inspectors</p>	<ul style="list-style-type: none"> to adopt the legal amendments regarding the prohibition of undeclared work 		<p>allow SLI to focus on undeclared work</p>	<p>undeclared work</p>
<p>5. Set up an Undeclared Economy Information Unit</p>	<p>To improve the effectiveness and efficiency of the inspection and enforcement bodies through better systems of data mining, data sharing and data analysis</p>	<ul style="list-style-type: none"> A single centralised database should be created which will gather data from all units/bodies dealing with undeclared work. This can be based on the Finish system of “Grey Economy Information Unit” or the Belgian system of “MiningWatch” The unit will be tasked to investigate specific organisations and persons suspected of engaging in undeclared work. The unit has the power to obtain information from the authority that requests the compliance report. After the analysis, the Unit prepares a compliance report. A compliance investigation can also be based on a general phenomenon report. As an important step in strengthening the data mining, all involved institutions should make 	<p>MLSP, Ministry of Finance, SLI, PRO</p>	<ul style="list-style-type: none"> Join-up the various data-sets and enable more effective data mining, sharing and analysis across government Inspectors will receive better information to plan more effective inspections which will increase the efficiency of inspections Inspectors will receive data on which are the risky businesses that can be targeted by preventative measures Inspectors will be able to develop segmentation strategies that focus 	<p>Improved rate of detection of undeclared work with the same resources</p>



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		<p>efforts within their scope of work to collect more information, in a systematic and electronic format. For instance, despite that employers are obliged to implement electronic registration of their employees (with ID cards), this information is not collected in some centralized system. Data and data warehouses should feed the Undeclared Economy Information Unit</p> <ul style="list-style-type: none"> • A first step is to arrange a study visit to the Grey Economy Information Unit in Finland and/or MiningWatch in Belgium. • A plan can then be prepared on the organisation of how such a unit would operate in The Former Yugoslav Republic Macedonia 		resources where the risks are the greatest.	
6. Normative notification letters (using data mining)	To improve the perceived and actual risk of detection of businesses engaged in under-declared employment	<ul style="list-style-type: none"> • Databases should be used to detect businesses perceived to be potentially engaging under-declared workers by identifying ‘outliers’ who have below average wage rates for their sector or size, or occupations employed. These ‘outliers’ should be sent friendly normative notification letters to push them towards compliance. The selection of suitable cases should be 	PRO, SLI	<ul style="list-style-type: none"> • Businesses paying ‘envelope wages’ will be encouraged to put their affairs in order in a cost-effective manner. • Widens tax base • Improves the social protection of workers 	<ul style="list-style-type: none"> • Proportion of businesses contacted that improved their compliance and reported increased wage levels.



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		<p>done by executive personnel and be supported by selection guidelines.</p> <ul style="list-style-type: none"> • These normative notification letters should inform the businesses that: (i) the tax, labour and/or social security authorities have identified possible discrepancies in their business; (ii) that they may well be targeted in the near future for an inspection, and (iii) highlight to them the benefits of being declared and costs of undeclared work both to society and legitimate businesses. They could also state how the vast majority of businesses are compliant in their area and/or sector, so as to improve horizontal trust. • This should be initially implemented as a pilot study in a particular sector, industry or locality, and various kinds of notification letter should be used to evaluate which types work and which do not. 			
<p>7. Introduce risk-based approaches in targeting and planning inspections</p>	<p>To improve the perceived and actual risk of detection of businesses engaged in undeclared work</p>	<ul style="list-style-type: none"> • Develop a risk-based system for assessing which are risky businesses, and whether an inspection should take place, supported by data mining. • Use the inspectors' time freed from following-up on reported violations 	<p>Inspection Council, PRO, SLI</p>	<ul style="list-style-type: none"> • Improved rate of detection of labour law violations, tax non-compliance and social insurance fraud. • Set a target of 	<ul style="list-style-type: none"> • To increase by x% per year the number of inspections which are targeted inspections and to decrease the overall percentage of inspections which are responses to



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		<p>by developing a strategic targeted approach towards inspections based on those sectors and business types in which undeclared work is more prevalent.</p> <ul style="list-style-type: none"> • Coordinate inspections between various enforcement authorities targeted at the same business, which would increase impact, and be more business-friendly. 		<p>conducting x% of inspections based on a more strategic and targeted approach.</p> <ul style="list-style-type: none"> • Set a target of conducting x% of inspections as joint inspections with other inspectorates 	<p>reports of violations.</p> <ul style="list-style-type: none"> • x% of inspections to be conducted as joint inspections.
Supply side measures					
<p>8. ‘White list’ of legitimate employers (not ‘black list’) for public procurement contracts</p>	<p>To provide supply-side incentives to engage in undeclared work</p>	<ul style="list-style-type: none"> • The PRO and SLI (as a joint effort) prepare and publish a white list of companies who comply fully with the tax and labour regulation. The criteria for firms that can be part of the white list will be set by the Coordinative body and approved by the Economic-Social Council. Despite the reputational benefit, the “white firms” will also have a preferential position with public tenders. They will be issued a ‘Clearance Certificate’. • Pilot study in a selected Ministry in relation to public procurement in a specific industrial sector where undeclared work is prevalent. • At the end of the pilot period, assess 	<p>Selected Ministry</p>	<ul style="list-style-type: none"> • Provides an incentive and positive benefit of being compliant by rewarding those who are compliant with access to bidding for public contracts. 	<p>Increase of the number of firms who are part of the “white list”</p>



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		<p>whether both recommendation 10 and 11 should be implemented on a national level, one of them, or maybe combine them into a one incentive.</p>			
<p>9. ‘Business Walking Routes’ leaflet for tourists and/or ‘service providers leaflet’ in sectors where undeclared work is prevalent</p>	<p>Provide incentives for business to formalise</p>	<ul style="list-style-type: none"> • In Skopje, a ‘Business Walking Routes’ leaflet for tourists could provide free marketing for businesses that operate formally (and are on the ‘white list’) by advertising their services to tourists to increase opportunities for trade. • This could be extended to leaflets for citizens providing information on service providers in sectors where it is known that undeclared work is prevalent (e.g., home repair services, electricians, plumbers) in order to provide an incentive for businesses to operate on a declared basis using the ‘carrot’ of free advertising and marketing. • Conduct pilot study in a specific locality and sector, and evaluate its feasibility. • Another alternative would be to develop a smartphone app which can be developed by university students as a competition for best app. 	<p>Ministry of Economy, Employers’ organizations, Crafts’ Chamber of Commerce</p>	<ul style="list-style-type: none"> • Provides an incentive and benefit for firms that operate legitimately by providing them with free marketing • Incentivises declared work 	<ul style="list-style-type: none"> • Evidence that businesses wish to be included on these leaflets in pilot study in a specific locality and sector. • Successful production and distribution of leaflets in pilot study in specific locality and sector.
<p>10. Introduce a</p>	<p>Provide</p>	<ul style="list-style-type: none"> • SLI Inspectors state that they have a 	<p>MLSP, SLI,</p>	<ul style="list-style-type: none"> • Reduce undeclared 	<ul style="list-style-type: none"> • X% increase in the number



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
<p>system of ID cards for all workers in the construction industry</p>	<p>incentives for business to formalise</p>	<p>significant problem in detecting undeclared work in the construction industry due to workers they encounter on building sites having no formal identification and giving false names. Research in The Former Yugoslav Republic Macedonia indicates that, in common with other European countries, the level of undeclared work is high in the construction sector.</p> <ul style="list-style-type: none"> In practice there would be a legal requirement that everyone who attends a construction site must carry valid, SLI issued, identification. A subcontractor would be obliged by law to register the employees in advance with the main contractor. Employers in the construction industry would be obliged to hold a daily attendance record on each construction sites and would be liable to a fine if they do not do so or if they have a worker found on site who is not listed on the daily attendance record. <p>Construction workers would be obliged by law to register on a daily basis on the attendance record at the workplace. The daily registration</p>	<p>Ministry of Finance, PRO, social partners (particularly trade unions and employers' organisations with a strong construction sector membership)</p>	<p>work in construction sector</p>	<p>of detected undeclared workers in construction sector</p>



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		would be retained for two years and must be available at the site in case of a control visit from the SLI. Under legislation the main contractor has the right to remove anyone from the construction site who is not registered.			
11. Reverse VAT scheme in the construction industry	Prevent VAT fraud in case of subcontracting	<ul style="list-style-type: none"> The reverse VAT system presupposes that the VAT is paid by the buyer (main contractor) as opposed to the seller (subcontractors), which is a common practice. This will prevent the cases of VAT fraud, when the tax liability “disappears” into the subcontracting chain. Main contractors are usually larger, established and trustworthy companies. The reverse system would apply only to construction services and not materials (private individuals as buyers are also excluded). 	Ministry of Finance, PRO	<ul style="list-style-type: none"> The tax fraud in construction is reduced and tax revenues increased Fair competition among construction companies 	X% increase in the VAT revenues form construction sector
12. Remove barriers to formalization, especially among micro and small firms	Reduces both intentional and unintentional non-compliance by reducing the costs (financial and administrative) for being formal	Currently, there is no comprehensive analysis of the real expenses for companies arising from the legislation. Studies generally show that micro firms face large costs of being formal. Given the dominance of the micro and small enterprises (MSE) in The Former Yugoslav Republic Macedonia, the government should	Ministry of Economy, MLSP, SLI, Ministry of Finance, etc.	<ul style="list-style-type: none"> The ex-ante MSE test is applied in practice The quality of the RIA is improved and a special reference is made to the MSE within the RIA 	The compliance costs for the MSE (as well as for all businesses)



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		<p>implement a new approach to legislation as “Think small first”. This recommendation consists of several steps/ elements:</p> <ul style="list-style-type: none"> - In the first stage, an analysis will be carried out for the costs of legislative compliance for micro and small businesses (including the administrative costs, such as number of hours needed to follow the changes in legislation, to ensure compliance, pay taxes, etc.). This will be set as a baseline cost/scenario and will be monitored each year; - Strengthen the use of the Regulatory Impact Assessment (RIA) which is in place but according to employers’ organizations, is used only pro-forma. Besides the general RIA which has to be reported in any new draft law sent to the government, a specific reference will be made to the impact of legislation on micro and small firms; - In line with the previous, an ex-ante MSE test will be implemented for each new law or amendments to the legislation; - Based on the findings of the previous actions, changes to the legislation on MSE will be considered (whether a 		<ul style="list-style-type: none"> • Reduced compliance costs for businesses 	



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		<p>new specific law for MSE will be adopted, whether some special provisions in the laws that govern their work will be made, etc.). Experiences of other countries in this respect will be taken into account (for instance, the experience of Hungary with the Simplified Employment Act which allows for work contract to be notified by a simple text message (SMS) or electronically via specialized software system.</p>			
<p>13. Provide free record-keeping software to businesses</p>	<p>Make easier to comply and incentivise compliance</p>	<p>The government can promote and incentivise compliance by providing to businesses free record-keeping software, fact sheets on record keeping and/or free advice or training on record-keeping such as telephone hotlines or educational courses. This measure is relatively widespread among EU member states.</p>	<p>Ministry of Economy</p>	<ul style="list-style-type: none"> • All businesses (including the unregistered ones) have access to record-keeping software • All businesses (including the unregistered ones) have skills/knowledge on record-keeping 	<ul style="list-style-type: none"> • Number of businesses using the free record-keeping software • Number of persons trained in record-keeping
<p>14. Provide free formalization advice and support</p>	<p>Support existing and new business (start-ups) to operate on a declared basis</p>	<p>The formalization advice will be provided through two main avenues: 1. A website will be constructed with all the necessary information regarding the legislation (tax regulation, labour laws, trade law, etc.). The website will be interactive, with possibility for specific search. It will provide</p>	<p>Employers' representative organisations in cooperation with Ministry of Finance and MLSP</p>	<ul style="list-style-type: none"> • Enables those business operating on a partially undeclared basis to receive advice on how they can put their affairs in order • Enables business start-ups to do so 	<ul style="list-style-type: none"> • Number of calls and advice provided (separate information for start-ups) • Customer satisfaction with the service



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		<p>practical guide to complaining with the legislation, a check lists of the licences, approvals etc. that a company should possess, etc.</p> <p>2. A hotline will be opened which will provide specialized advice to formal companies in case of ambiguities, to non-formal companies, entrepreneurs (start-ups) and would-be entrepreneurs.</p> <p>A broader initiative might also include the use of ‘role models’ organised by for example chambers of commerce to act as mentors to nascent entrepreneurs starting-up.</p>		legitimately	
Demand-side policy measures					
<p>15. Decrease incentives to use cash and increase incentives to use electronic payments to reduce undeclared work</p>	<p>Incentivise consumers to purchase declared goods and services</p>	<ul style="list-style-type: none"> To discourage the use of cash and incentivise an increase in electronic payments, so as to reduce the opportunities for undeclared work, The Former Yugoslav Republic Macedonia should: (1) implement a lower ceiling on cash transactions, (2) make point-of-sale (POS) terminals available across all sectors, including the mandatory acceptance of digital payments, with a subsidy for the installation of POS terminals in smaller enterprises (focus on 	<p>Banks, Financial institutions, all government departments, social partners</p>	<ul style="list-style-type: none"> Tax revenues increase with the growth of the use of payment cards. A discount of 1.5% for customers of the transaction value for digital payments through POS terminals (payment cards and e-money) is set voluntary here, but it may be further considered by the 	<p>Decreased use of cash and increased use of electronic payments.</p>



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		<p>micro firms) operating in sectors with intermediate or high risk of undeclared transactions, (3) central and regional governments to shift more fully towards electronic payments, and (5) provide incentives for using cards at the point-of-sale. This might involve:</p> <ul style="list-style-type: none"> • A discount can be offered to customers (say in amount of 1.5% of the transaction value for digital payments) who pay through POS terminals (payment cards and e-money) for the purchase of goods and services, or • A refund of 0.8% for suppliers taking electronic payments through POS terminals for the purchase of goods and services. • Few institutions (head by the NBRM and Ministry of Finance) are already cooperating and developing a plan to reduce the use of cash so the measures from that plan can be applied here as well 		<p>authorities.</p> <ul style="list-style-type: none"> • Subsequently, as the electronic payment targets are met, and the use of digital payments consolidates as part of the consumer habits, incentives can be gradually withdrawn, resulting in an increase in the fiscal benefit. 	
<p>16. Introduce a tax rebate incentive scheme for home owners</p>	<p>Incentivise consumers to use declared goods and services</p>	<p>A pilot study should be undertaken in a particular region for a limited range of activities, to be evaluated after 24 months</p>	<p>Ministry of Finance PRO Other responsible institutions depending of the</p>	<ul style="list-style-type: none"> • Offers an incentive to citizens to employ declared workers and raises awareness of the negative effects of 	<p>Survey of pilot study to evaluate whether purchasers would have used undeclared work previously to get the work done</p>



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
<p>to receive a rebate of tax when they employ registered building contractors or registered tradespeople who provide house repair and renovation services</p>			<p>sector chosen for the pilot</p>	<p>employing undeclared workers.</p> <ul style="list-style-type: none"> • Provides fair competition among businesses • It has a two-fold benefit in increasing income possibilities for registered builders and trades persons and it raises the quality of housing repair and maintenance. 	
<p>17. Use of service vouchers, such as in household services and agriculture, to cover payments for tax and health and social contributions</p>	<p>Incentivise consumers to use declared goods and services</p>	<ul style="list-style-type: none"> • The agricultural sector has high levels of temporary seasonal workers. Most workers are employed for short periods and employers and workers benefit from lack of regulation in this sector. The focus has been on facilitating employers in this sector to employ legal workers through a voucher system and making it simple for employers to comply • Household services are similarly a sector in which there are high levels of undeclared work. • These vouchers cover tax, health and social insurance contributions in a lump sum, thus ensuring that the 	<p>Ministry of Finance, MLSP, Ministry of Economy, Ministry of Agriculture, Forestry and Water supply Other responsible institutions depending of the sector chosen for the pilot</p>	<ul style="list-style-type: none"> • Offers an incentive to citizens to employ declared workers and raises awareness of the negative effects of employing undeclared workers. • The agricultural sector which has a high level of seasonal workers who are students, pensioners, second jobbers and Roma will become better regulated and will lead in time to a more robust method of 	<ul style="list-style-type: none"> • Number of registered domestic workers (i.e. domestic workers hired with vouchers) • Number of seasonal workers with covered social security contributions



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		<p>State is receiving tax and social contributions and workers are registered and socially protected. For example: Employers in agriculture should be facilitated to buy vouchers for say 10 workers who can work for up to 30 days in a season with a maximum remuneration of €6,000 in a year. These vouchers will cover tax, health and social insurance contributions in a lump sum, thus ensuring that the employer can legally claim this amount in his own tax returns and thus ensuring that the State is receiving tax and social contributions for undeclared workers. A more sophisticated version of this scheme is where the system allows the agricultural employer to also pay his workers with vouchers which can be exchanged for cash when the workers tax and social insurance number are inserted thereon; this system works well in Croatia, Hungary and other EU Member States.</p> <ul style="list-style-type: none"> • The Government will subsidize part of the face value of the vouchers (either in both sectors or only for 		<p>controlling undeclared work in the sector</p> <ul style="list-style-type: none"> • In household and personal services, it transfers undeclared work into the declared economy. 	



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		<p>domestic workers)</p> <ul style="list-style-type: none"> This system could be extended, where appropriate through tripartite consultation, to more sectors prone to undeclared work. <p>Special concern should be made as to avoid possible substitution of workers (regular workers being replaced with workers hired with a voucher)</p>			
Changing citizens' values, norms and beliefs					
18. Launch of a Public Awareness Campaign on the Detrimental Effects of Undeclared Work on the economic and social future of The Former Yugoslav Republic Macedonia	Change values, norms and beliefs regarding the benefits of declared work and costs of undeclared work	<ul style="list-style-type: none"> Target younger people who are more likely to view undeclared work as socially acceptable, as well as perhaps professional groups such as doctors, lawyers and accountants. The media used and messages need to be tailored to these selected groups. MLSP/SLI website use - landing page as part of ministry's website. Materials uploaded to the MLSP/SLI website Materials uploaded to the Social media (FB, YouTube, etc.) Ensure full awareness about the MLSP/SLI competencies vis-a-vis detection of undeclared work and related consequences on individuals 	MLSP, SLI, other line-ministries (Ministry of Finance/PRO; Ministry of Economy, etc.). Selected journalists dealing with social matters with focus on social fairness	<ul style="list-style-type: none"> Public Opinion will swing towards a lower level of public acceptance of undeclared work. The percentage of citizens engaged in undeclared work will fall. There will be an increase in the number of reports of non-compliance to inspectorates (hotlines). It will widen the tax base More transparency 	<ul style="list-style-type: none"> Decrease in number of reports of non-compliance to inspectorates Reduction in tolerance of undeclared work Decrease in undeclared work
19. Educating	Change values,	<ul style="list-style-type: none"> Send an annual letter to all tax 	MLSP, other line-	improved citizens	<ul style="list-style-type: none"> Resultant reduction in



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
citizens about the tax system and tax morality	norms and beliefs regarding the benefits of declared work and costs of undeclared work	<p>payers which sets out what portion of their taxes is spent on which public goods and services.</p> <ul style="list-style-type: none"> Introduce signs such as ‘your taxes are paying for this’ on public construction projects (e.g., new roads), on ambulances, in doctor’s waiting rooms, in hospitals and schools. This conveys a clear message to the public that their taxes are being used to pay for these public goods and services. 	ministries (Ministry of Finance/PRO/Customs Office; Ministry of Economy, etc.) in close cooperation with trade unions and employers’ associations	understanding about the relationship between paying taxes and the public goods and services received.	<p>undeclared work</p> <ul style="list-style-type: none"> Greater awareness that taxes pay for public goods and services.
20. Educate school children and university students of the benefits of declared work	Change values, norms and beliefs regarding the benefits of declared work and costs of undeclared work	<ul style="list-style-type: none"> Introduce in the civic education curriculum lessons on why people pay tax, the benefits of social insurance and declared work, and the costs of undeclared work. Introduce a national Undeclared Work-week, addressing school children and explaining the benefits of compliance and the costs of being non-compliant. Involve sportspeople, singers or actors in order to have ‘celebrity endorsement’ for a large social media campaign addressed to young people on the benefits of declared work. 	MLSP, SLI, PRO, Ministry of Education and Science, social partners	<ul style="list-style-type: none"> Improved understanding of children and students about the benefits of paying taxes and social insurance, and working declared. Promoting greater tax morale from early age Resultant peer pressure on parents from children will reduce undeclared work. 	Greater awareness of benefits of declared work and costs of undeclared work among younger people
21. National competition on	Change values, norms and beliefs	<ul style="list-style-type: none"> Use a celebrity role model to make a social media video on ‘why pay your 	Ministry of Finance/PRO in	<ul style="list-style-type: none"> Encourages self-reflection by a wide 	Reduced tolerance of participation in undeclared



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
<p>why pay your taxes/why work declared</p>	<p>regarding the benefits of declared work and costs of undeclared work</p>	<p>taxes’ or ‘why reject envelope wages’ or ‘why work declared’ so as to use appropriate role models for the target group for celebrity endorsement.</p> <ul style="list-style-type: none"> • This video will be used to launch a competition for people to make their own video on the subject of ‘why pay your taxes’. A prize fund of €20,000 (for 1st, 2nd, 3rd place etc.) would be awarded for the best social media (e.g., youtube) video on this subject of ‘why pay your taxes’/‘why reject envelope wages’/‘why work declared’. • An additional option is to integrate this competition with the above recommendation to introduce this issue in the civic education curriculum. If this is done, schoolchildren can produce such videos in their civic education classes. • The sequencing of such a competition with other policy measures below is important. It should be run following, rather than prior to, public institutional reforms to be effective. 	<p>close cooperation with the MLSP and the Ministry of Economy</p>	<p>segment of the target population (e.g., young people) to consider the advantages of paying taxes and disadvantages of failing to do so.</p> <ul style="list-style-type: none"> • Rather than preach messages, it encourages self-reflection and self-education. 	<p>work by the target group.</p>
<p>22.Raising</p>	<p>Reduce the</p>	<ul style="list-style-type: none"> • Run a campaign against undeclared 	<p>Ministry of</p>	<ul style="list-style-type: none"> • Reduce the shadow 	<ul style="list-style-type: none"> • Number of tests taken by



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
awareness of the general public about the “shadow” behaviour	engagement of the general public in the undeclared economy	economy (for fair competition) which will include an online test for measuring the impact of an individual’s shadow activity. The test consists of several questions (not too long test) which assess the shadow behaviour of individuals in shops, markets and with service providers (taking or leaving a receipt on purchase), in hospitals (extra payments for doctors), employment (working with or without an employment contract, envelope wages), etc. Participants (i.e. those taking the test) can be advised on how to reduce their impact on the shadow economy.	Finance, MLSP	behaviour of citizens	individuals
Reforming formal institutions					
23. Strengthening the human resources of SLI and training of labour inspectors	Produce more effectively equipped and trained labour inspectors	<ul style="list-style-type: none"> The professional staff at the SLI is ageing and there is no HR planning as to prepare new, professional staff The training of labour inspectors on tackling undeclared work should be well-planned and improved, and focused on prevention and formalization rather than prosecution. The SLI should make use of the 	MLSP, SLI	<ul style="list-style-type: none"> Improved efficiency and effectiveness of inspectors in tackling the undeclared economy. Capacity-building of the inspectorate. Facilitates organisational culture change towards a 	Improvements in productivity of staff in achieving KPIs



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		ILO toolkit for the training of labour inspectors in tackling undeclared work.		<p>more customer-friendly approach.</p> <ul style="list-style-type: none"> • Monitor via annual staff satisfaction survey 	
<p>24. Structural reorganisation of SLI to improve the management of inspection activities at a regional level</p>	<p>Improve the functioning of the SLI and its effectiveness</p>	<ul style="list-style-type: none"> • SLI has an extremely HQ-managed structure which mitigates against the development of regional initiatives and measures to detect, deter and prevent undeclared work at a local level which will be specific to the local environment. There is currently too much responsibility and too few staff at SLI HQ to enable them to manage and oversee local inspection work effectively. • Regional Managers should be appointed to manage staff and manage local inspection activity and report back to HQ regularly. • This reorganisation will have many benefits for the organisation; increased management activity at a local level; creation of promotion possibilities which are non-existent at present; reduce the overload of management work at HQ to enable HQ staff to focus on better management of national inspection 	<p>MLSP, SLI</p>	<ul style="list-style-type: none"> • Improved local focus on inspection activity which suits the environment of each region e.g. tourism sector in some regions, agricultural sector in other regions. • Improved promotional opportunities for SLI Inspectors. • Improved rate of detection of undeclared workers. • Increased public awareness of the risk of being detected will also lead to a reduction in the level of undeclared work. 	<p>Appointed regional managers at the SLI</p>



This project is funded by the EU

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement
		activity.			
Greater involvement of social partners					
25. Introduce employer-led voluntary supply chain responsibility initiative	Greater involvement of social partners in the fight against undeclared work	<ul style="list-style-type: none"> In this voluntary employer-led initiative, firms in the supply-chain could be requested to show those higher in the supply chain that they comply with tax and social security obligations through external auditors and/or refer to the absence of wage, tax and social insurance arrears, and sanctions imposed in recent years. This might be conducted as a pilot initiative by 10-15 larger employers under the auspices of their Corporate Social Responsibility (CSR) strategy. Try to incorporate a provision (i.e. preferential treatment) for these companies in the annual CSR rewards. If the experience is positive and does not present a large burden to firms, it can be expanded to become obligatory for all bidders for public tenders. 	MLSP to approach the largest chambers of commerce	<ul style="list-style-type: none"> Increases detection of undeclared work by involving social partners in its detection. Reduces opportunities for undeclared work. Provides a clear 'demonstration effect' to smaller firms that larger employers take compliance seriously and that they need to similarly do so. Shifts detection of undeclared work beyond solely a state responsibility by involving private businesses in the active detection of undeclared work. 	Successful implementation among a selection of larger employers in The Former Yugoslav Republic Macedonia



7.1 Sequencing of the policy measures

When introducing the above recommended policy measures, it is important to implement:

- measures that seek to improve citizen morality either at the same time as, or after, measures that reform the formal institutions, and
- direct controls that provide incentives to, and bolster the benefits of, working declared, either prior to, or at the same time as, measures that improve the sanctions and risks of detection.

7.2 Specification of a feasible sector and/or region to launch a pilot programme

To support the transition to declared work, it is recommended that a pilot study using this integrated policy framework be conducted to assess its impacts in terms of tackling undeclared work. Rather than select a specific economic sector and/or region at which all measures should be targeted, different population groups, sectors and/or regions could be selected, through tripartite consultation, for the piloting of each of the above policy measures, taking into account the causes, circumstances and forms of undeclared work in The Former Yugoslav Republic Macedonia, as well as the desires, competencies, capacities and capabilities of those involved in the fight against undeclared work. This will enable the effectiveness and efficiency of this multi-stakeholder holistic integrated policy approach to be evaluated in practice, and for any teething problems to be resolved with each measure before its wider implementation.



8 References

- Ahmad, A.N. (2008), Dead men working: time and space in London's ("illegal") migrant economy, *Work, Employment and Society*, 22 (2): 301-18.
- Allingham, M. and A. Sandmo (1972), Income tax evasion: a theoretical analysis, *Journal of Public Economics*, 1(2): 323-38.
- Alm, J. and B. Torgler (2011), Do ethics matter? tax compliance and morality, *Journal of Business Ethics*, 101: 635–51.
- Alm, J., B. Jackson and M. McKee (1993), Fiscal exchange, collective decision institutions and tax compliance, *Journal of Economic Behaviour and Organization*, 22(3): 285-303.
- Alm, J., E. Kirchler, M. Muelhbacher, K. Gangil, E. Hofmann, C. Logler and M. Pollai (2012), Rethinking the research paradigms for analyzing tax compliance behavior, *CESifo forum*, 10: 33-40.
- Alvesalo A and T. Hakamo (2009), Valvontaa ja vastuuta ulkopuolisen työvoiman käyttöön – tutkimus tilaajavastuulain toteutumisesta, *Työ- ja elinkeinoministeriön julkaisuja, Työ ja yrittäjyys*, 51: 1-6.
- Baumol, W.J. and A. Blinder (2008), *Macroeconomics: principles and policy*, Cincinnati, OH: South-Western Publishing.
- Becker, K.F. (2004), *The Informal Economy*, Stockholm: Swedish International Development Agency.
- Bies, R.J. and J.S. Moag (1986), Interactional fairness, in R.J. Lewicki, B.M. Sheppard and M.H. Bazerman (eds.), *Research on Negotiations in Organizations*, Greenwich, CT: JAI, 43-55.
- Bird, R., J. Martinez-Vazquez and B. Torgler (2006), Societal institutions and tax effort in developing countries, in J. Alm, J. Martinez-Vazquez and M. Rider (eds.), *The Challenges of Tax Reform in the Global Economy*, New York: Springer, 283-338.
- Braithwaite V. (2009), *Defiance in Taxation and Governance: resisting and dismissing authority in a democracy*, Cheltenham: Edward Elgar.
- Braithwaite, J. (2002), *Restorative Justice and Responsive Regulation*, New York: Oxford University Press.
- Brunk, T. (2013), Tax deductions for domestic service work, Sweden, available at <http://www.eurofound.europa.eu/areas/labourmarket/tackling/cases/se015.htm> (accessed 11 May 2014).



This project is funded by the EU

Castells, M. and A. Portes (1989), World underneath: the origins, dynamics and effects of the informal economy, in A. Portes, M. Castells and L. Benton (eds), *The Informal Economy: studies in advanced and less developing countries*, Baltimore: John Hopkins University Press, 1-19.

CRPM (2015), *Monitoring the Hidden Economy in Macedonia: Trends and Policy Options*. Skopje: Center for Research and Policy Making.

CRPM (2016), *The Shadow Worker – Hidden Economy and Undeclared Labour in Macedonia, Albania, and Kosovo*, Skopje: Center for Research and Policy Making. Available at: <http://www.crpm.org.mk/wp-content/uploads/2017/01/26.-PB1-RHEM-01.12.2017-MKД-Final.pdf>.

Cullis, J., P. Jones and A. Savoia (2012), Social Norms and Tax Compliance: Framing the Decision to Pay Tax. *Journal of Socio-Economics*, 41:159-168.

Davis, M. (2006), *Planet of Slums*, London: Verso.

De Soto, H. (1989), *The Other Path: the economic answer to terrorism*, London: Harper and Row.

De Soto, H. (2001), *The Mystery of Capital: why capitalism triumphs in the West and fails everywhere else*, London: Black Swan.

Dekker, H., E. Oranje, P. Renooy, F. Rosing and C.C. Williams (2010), *Joining up the fight against undeclared work in the European Union*, Brussels: DG Employment, Social Affairs and Equal Opportunities [Available at <http://ec.europa.eu/social/main.jsp?catId=471&langId=en>].

Dybka, P., M. Kowalczyk, B. Olesinski, M. Rozkrut and A. Torój (2017), Currency demand and MIMIC models: towards a structured hybrid model-based estimation of the shadow economy size. *SGH KAE Working Papers Series*, No. 2017/030 September 2017.

Elffers, H. and D.J. Hessing (1997), Influencing the prospects of tax evasion, *Journal of Economic Psychology*, 18: 289-304.

Eurofound (2013), *Tackling Undeclared Work in 27 European Union Member States and Norway: approaches and measures since 2008*. Dublin: Eurofound.

European Commission (2007) *Stepping up the fight against undeclared work* COM(2007) 628 final. Brussels: European Commission.

Finance Think (2017), Quality of life in Republic of Macedonia: envelope wages. No. 1/2017, available at: http://www.financethink.mk/wp-content/uploads/2017/10/QLife_No-1.pdf. (in Macedonian).

Frey, B. (2003), Deterrence and Tax morale in European Union. *European Review*, 11(3): 385-408.

Friedman, E., S. Johnson, D. Kaufmann and P. Zoido (2000), Dodging the grabbing hand: the determinants of unofficial activity in 69 countries, *Journal of Public Economics*, 76(3): 459-93.



This project is funded by the EU

Gallin, D. (2001), Propositions on trade unions and informal employment in time of globalisation, *Antipode*, 19(4): 531-49.

Gangl, K., S. Muehlbacher, M. de Groot, S. Goslinga, E. Hofmann, C. Kogler, G. Antonides and E. Kirchler (2013), "How can I help you?": perceived service orientation of tax authorities and tax compliance, *Public Finance Analysis*, 69(4): 487-510.

Godfrey, P.C. (2015), Introduction: Why the informal economy matters to management, in P.C. Godfrey (Ed.) *Management, society, and the informal economy*, London, Routledge, 1-20.

Hartner, M., S. Rechberger, E. Kirchler and A. Schabmann (2008), Procedural justice and tax compliance, *Economic Analysis and Policy*, 38(1): 137-152.

Hartner, M., S. Rechberger, E. Kirchler and M. Wenzel (2011), Perceived distributive fairness of EU transfer payments, outcome favourability, identity and EU-tax compliance, *Law and Policy*, 33(1): 22-31.

Hasseldine, J. and Li, Z. (1999), More tax evasion research required in new millennium, *Crime, Law and Social Change*, 31(1): 91-104.

Helmke, G. and Levitsky, S. (2004), Informal institutions and comparative politics: a research agenda, *Perspectives on Politics*, 2(4): 725-740.

Ihrig, J. and K.S. Moe (2000), The influence of government policies on informal labor: implications for long-run growth, *De Economist*, 148 (3): 331-343.

ILO (2013), *Women and Men in the Informal Economy: statistical picture*, available at http://laborsta.ilo.org/informal_economy_E.html (last accessed 18 February 2014).

ILO (2015), Recommendation 204 concerning the transition from the informal to the formal economy, adopted by the conference at its 104th Session, Geneva: ILO.

Internal Revenue Service (2007), *Understanding taxes*, available at <http://www.irs.gov/app/understandingTaxes/jsp/> (accessed 14 May 2014)

Ivlevs, A. (2014), Remittances and informal work, *International Journal of Manpower*, 37(7): 1172-1190.

Job, J., A. Stout and R. Smith (2007), Culture change in three taxation administrations: from command and control to responsive regulation, *Law and Policy*, 29 (1): 84-101.

Jørgensen, C. (2013), Home-Job Plan, Denmark, available at <http://www.eurofound.europa.eu/areas/labourmarket/tackling/cases/dk015.htm> (accessed 14 May 2014).



This project is funded by the EU

- Kastlunger, B., E. Lozza, E. Kirchler and A. Schabmann (2013), Powerful authorities and trusting citizens: the slippery slope framework and tax compliance in Italy, *Journal of Economic Psychology*, 34(1): 36-45.
- Khurana, P. and U. Diwan (2014), A comparison of psychological factors for tax compliance: self-employed versus salaried people, *International Journal in Management and Social Science*, 2 (3): 107-24.
- Kirchgässner, G. (2010), *Tax Morale, Tax Evasion and the Shadow Economy*, St. Gallen: Discussion Paper no 2010-17, Department of Economics, University of St. Gallen, St. Gallen, Switzerland.
- Kirchgässner, G. (2011), Tax morale, tax evasion and the shadow economy, in F. Schneider (ed.), *Handbook of the Shadow Economy*, Cheltenham: Edward Elgar, 347-374.
- Kirchler, E. (2007), *The Economic Psychology of Tax Behaviour*, Cambridge: Cambridge University Press.
- Kirchler, E., E. Hoelzl and I. Wahl (2008), Enforced versus voluntary tax compliance: the “slippery slope” framework, *Journal of Economic Psychology*, 29: 210–25.
- Kogler, C., Muelbacher, S. & Kirchler, E. (2015). Testing the “slippery slope framework” among self-employed taxpayers. *Economics of Governance*, 16(2): 125–142.
- Kuehn, Z. (2007), *Tax Rates, Governance and the Informal Economy in High-Income Countries*, Madrid: Universidad Carlos III de Madrid, Economic Series Working Paper No. 07-85.
- Lessing, V.P. and C.W. Park (1978), Promotional perspectives of reference group influence: advertising implications, *Journal of Advertising*, 7(2): 41-47.
- Leventhal, G.S. (1980), What should be done with equity theory? new approaches to the study of fairness in social relationships, in K. Gergen, M. Greenberg and R. Willis (eds.), *Social Exchange: advances in theory and research*, New York: Plenum Press, 27-55.
- Lillemets, K. (2009), Maksumoraal maksukäitumise kujundajana ja selle peamised isikupõhised mõjutegurid’, available at <http://www.riigikogu.ee/rito/index.php?id=14002&op=archive2> (accessed 11 May 2014).
- London, T. and S.L. Hart (2004), Reinventing strategies for emerging markets: beyond the transnational model, *Journal of International Business Studies*, 35(5): 350-70.
- Meagher, K. (2010), *Identity Economics: social networks and the informal economy in Nigeria*, New York: James Currey.
- Mojsoska-Blazevski, N. (2017), Labour market transitions of young women and men in the former Yugoslav Republic of Macedonia. *SEER Journal for Labour and Social Affairs in Eastern Europe*, 20(1): pp. 49-84.



This project is funded by the EU

- Mojsoska-Blazhevski, N. and M. Petreski (2015), *Impact evaluation of active labour market programs in FYR Macedonia: key findings*. Budapest: ILO. Available from: http://www.ilo.org/budapest/what-we-do/publications/WCMS_384854/lang--en/index.htm.
- Molero, J.C. and F. Pujol (2012), Walking inside the potential tax evader's mind: tax morale does matter, *Journal of Business Ethics*, 105: 151-162.
- Muehlbacher, S., C. Kogler and E. Kirchler (2011a), *An Empirical Testing of the Slippery Slope Framework: The Role of Trust and Power in Explaining Tax Compliance*, Vienna: University of Vienna Department of Economics Working Paper.
- Muehlbacher, S., E. Kirchler and H. Schwarzenberger (2011b), Voluntary versus enforced tax compliance: empirical evidence for the "slippery slope" framework", *European Journal of Law and Economics*, 32: 89–97.
- Murphy, K. (2005), Regulating more effectively: the relationship between procedural justice, legitimacy and tax non-compliance, *Journal of Law and Society*, 32(4): 562-89.
- Murphy, K. and N. Harris (2007), Shaming, shame and recidivism: a test of re-integrative shaming theory in the white-collar crime context, *British Journal of Criminology*, 47: 900-17.
- Murphy, K., T. Tyler and A. Curtis (2009), Nurturing regulatory compliance: is procedural fairness effective when people question the legitimacy of the law?, *Regulation and Governance*, 3: 1-26.
- Natrah, S. (2013), Tax knowledge, tax complexity and tax compliance: taxpayers' view, *Procedia: Social and Behavioural Sciences*, 109: 1069-76.
- North, D.C. (1990), *Institutions, Institutional Change and Economic Performance*, Cambridge: Cambridge University Press.
- Novrovska, B. (2012), *The size and measurement of the grey economy in Republic of Macedonia*. Doctoral Dissertation, University of St. Cyril and Methodius, Faculty of Economics, Skopje, Macedonia.
- Nwabuzor, A. (2005), Corruption and development: new initiatives in economic openness and strengthened rule of law, *Journal of Business Ethics*, 59 (1/2): 121-38.
- OECD (2008), *OECD Employment Outlook*, Paris: OECD.
- Petreski, M. and N. Mojsoska-Blazhevski (2017), *Overhaul of the social assistance system in Macedonia: Simulating the effects of introducing Guaranteed Minimum Income (GMI) scheme*. Skopje: Finance Think.
- Prinz, A., S. Muehlbacher and E. Kirchler (2013), The slippery slope framework on tax compliance: an attempt to formalization, *Journal of Economic Psychology*, 40(1): 20-34.



This project is funded by the EU

Richardson, M. and A. Sawyer (2001), A taxonomy of the tax compliance literature: further findings, problems and prospects, *Australian Tax Forum*, 16(2): 137–320.

Rindt, Z. and I. Krén (2013), Simplified Employment Act, Hungary, available at <http://www.eurofound.europa.eu/areas/labourmarket/tackling/cases/hu015.htm> (accessed 11 May 2014).

Ristovska, M., N. Mojsoska-Blazevski and M. Nikolov (2013), An alternative view to the tax evasion: the effect of tax morale on paying taxes in Macedonia and EU countries, *Serbian Journal of Management*, 8(2): 169-183.

Saeed, A. and A. Shah (2011), Enhancing tax morale with marketing tactics: a review of the literature, *African Journal of Business Management*, 5 (35): 13659-13665.

Sauvy, A. (1984), *Le Travail Noir et l'Economie de Demain*, Paris: Calmann-Levy.

Schneider, F., A. Buehn and C.E. Montenegro (2010), New Estimates for the Shadow Economies all over the World. *International Economic Journal*, 24(3): 443-461.

Schneider, F. and D.H. Enste (2000), Shadow Economies: Size, Causes, and Consequences. *Journal of Economic Literature*, 38(1): 77-114.

SELDI (2016), *Hidden economy and good governance in Southeast Europe: regional assessment report 2016*. Center for the Study of Democracy, available at: <http://seldi.net/publications/publications/hidden-economy-and-good-governance-in-southeast-europe-regional-assessment-report/>.

Sissel, T., K. Nergaard, K. Alsos, Ø.M. Berge, M. Bråten and A.M. Ødegård (2011), *Til renholdets pris*, Oslo: Fafo.

Slavnic, Z. (2010), Political economy of informalization, *European Societies*, 12 (1): 3-23.

Slemrod, J. and S. Yitzhaki (1994), Analyzing the standard deduction as a presumptive tax, *International Tax and Public Finance*, 1(1): 25-34.

Small Business Council (2004), *Small Business in the Informal Economy: making the transition to the formal economy*, London: Small Business Council.

SSO (2013), *Business, corruption and criminal in Republic of Macedonia: The impact of bribe and other forms of crime on private companies*. Skopje: State Statistical office (with support of the UN Office On Drugs and Crime, Vienna, available at: <http://www.stat.gov.mk/Dokumenti/MK.pdf>. (only in Macedonian language).

Swedish Tax Agency (2011), *Konsumenterna kan skapa schysst konkurrens och minska skattefelet*, Stockholm: Swedish Tax Agency.



This project is funded by the EU

- Taiwo, O. (2013), Employment choice and mobility in multi-sector labour markets: theoretical model and evidence from Ghana, *International Labour Review*, 152 (3–4): 469–492.
- Thurman, Q.C., C. St. John and L. Riggs (1984), Neutralisation and tax evasion: how effective would a moral appeal be in improving compliance to tax laws?, *Law and Policy*, 6 (3): 309-327.
- Torgler, B. (2003), To evade taxes or not: that is the question, *Journal of Socio-Economics*, 32: 283-302.
- Torgler, B. (2007), Tax morale in Central and Eastern European countries, in N. Hayoz and S. Hug (eds.), *Tax Evasion, Trust and State Capacities: how good is tax morale in Central and Eastern Europe?*, Bern: Peter Lang, 155-186.
- Torgler, B. (2011), *Tax morale and Compliance: review of evidence and case studies for Europe*, Washington DC: World Bank Policy Research Working Paper 5922, World Bank.
- Torgler, B. (2012), Tax morale, Eastern Europe and European enlargement, *Communist and Post-Communist Studies*, 45 (1): 11-25.
- Torgler, B. and F. Schneider (2007), *Shadow economy, tax morale, governance and institutional quality: a panel analysis*, Bonn: IZA Discussion Paper no. 2563.
- Työ- ja elinkeinoministeriö (2011), Talousrikollisuuden ja harmaan talouden torjuminen rakennus- sekä majoitus- ja ravitsemisalalla -työryhmän mietintö. Työ- ja elinkeinoministeriön julkaisuja, Kilpailukyky', available at http://www.tem.fi/files/29563/TEM_17_2011_netti.pdf (accessed 14 May 2014).
- Vanderseypen, G., T. Tchipeva, J. Peschner, P. Rennoy and C.C. Williams (2013), Undeclared work: recent developments, in European Commission (ed.), *Employment and Social Developments in Europe 2013*, Brussels: European Commission, 231-274.
- Vasardani, M. (2013), Tax evasion in Greece: an overview, *Bank of Greece Economic Bulletin*, 35: 15-24.
- Vossler, C.A., M. McKee and M. Jones (2011), Some effects of tax information services reliability and availability on tax reporting behaviour, available at <http://mpr.aub.uni-muenchen.de/38870/> (accessed 11 May 2016).
- Webb, J.W., G.D. Bruton, L. Tihanyi and R.D. Ireland (2013), Research on entrepreneurship in the informal economy: framing a research agenda, *Journal of Business Venturing*, 28: 598-614.
- Webb, J. W. and R. D. Ireland (2015), Laying the foundation for a theory of informal adjustments, in G., Paul (eds), *Management, Society, and the Informal Economy*. New York: Routledge, 21-42.
- Webb, J.W., L. Tihanyi, R.D. Ireland and D.G. Sirmon (2009), You say illegal, I say legitimate: entrepreneurship in the informal economy, *Academy of Management Review*, 34 (3): 492-510.



This project is funded by the EU

Wenzel, M. (2002), The impact of outcome orientation and justice concerns on tax compliance: the role of taxpayers' identity, *Journal of Applied Psychology*, 87: 639-645.

Williams, C.C. (2006), *The Hidden Enterprise Culture: entrepreneurship in the underground economy*, Cheltenham: Edward Elgar.

Williams, C.C. (2014a), *The Informal Economy and Poverty: evidence and policy review*, York: Joseph Rowntree Foundation.

Williams, C.C. (2014b), Explaining cross-national variations in the commonality of informal sector entrepreneurship: an exploratory analysis of 38 emerging economies, *Journal of Small Business and Entrepreneurship*, 27(2): 191-212.

Williams, C.C. (2014c), Explaining cross-national variations in the prevalence and character of undeclared employment in the European Union, *European Spatial Research and Policy*, 21(2): 115-132.

Williams, C.C. (2015a), Explaining cross-national variations in the scale of informal employment: an exploratory analysis of 41 less developed economies, *International Journal of Manpower*, 36(2): 118-135.

Williams, C.C. (2015b), Explaining the informal economy: an exploratory evaluation of competing perspectives', *Relations Industrielles/Industrial Relations*, 70(4): 741-765.

Williams, C.C. (2015c), Out of the margins: classifying economies by the prevalence and character of employment in the informal economy, *International Labour Review*, 154(3): 331-352.

Williams, C.C. (2015d), Tackling informal employment in developing and transition economies: a critical evaluation of the neo-liberal approach, *International Journal of Business and Globalisation*, 14(3): 251-270.

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

Williams, C.C. (2017), Tackling employment in the informal economy: a critical evaluation of the neo-liberal policy approach, *Economic and Industrial Democracy: an International Journal*, 38(1): 145-169.

Williams, C.C. (2018) *Elements of a preventative approach towards undeclared work: an evaluation of service vouchers and awareness raising campaigns*, European Commission, Brussels.

Williams, C.C. and A. Martinez-Perez (2014), Why do consumers purchase goods and services in the informal economy?, *Journal of Business Research*, 67(5): 802-6.

Williams, C.C. and F. Schneider (2016), *Measuring the Global Shadow Economy The Prevalence of Informal Work and Labour*. Edward Elgar Publishing, UK.



This project is funded by the EU

- Williams, C.C. and I. Horodnic (2015a), Evaluating the prevalence of the undeclared economy in Central and Eastern Europe: an institutional asymmetry perspective, *European Journal of Industrial Relations*, 21(4): 389-406.
- Williams, C.C. and I. Horodnic (2015b), Explaining the prevalence of the informal economy in the Baltics: an institutional asymmetry perspective, *European Spatial Research and Policy*, 22(2): 127-144.
- Williams, C.C. and I. Horodnic (2015c), Explaining the prevalence of illegitimate wage practices in Southern Europe: an institutional analysis, *South European Society and Politics*, 20(2): 203-221.
- Williams, C.C. and I. Horodnic (2016), Cross-country variations in the participation of small businesses in the informal economy: an institutional asymmetry perspective, *Journal of Small Business and Enterprise Development*, 23(1): 3–24.
- Williams, C.C. and J. Franic (2016), Explaining participation in the informal economy in post-socialist societies: a study of the asymmetry between formal and informal institutions in Croatia, *Journal of Contemporary Central and Eastern Europe*, DOI:10.1080/0965156X.2015.1118817
- Williams, C.C. and P. Renooy (2013), *Tackling Undeclared Work in 27 European Union Member States and Norway: approaches and measures since 2008*, Dublin: European Foundation for the Improvement of Living and Working Conditions.
- Williams, C.C. and S. Bezeredi (2017a), Explaining consumers' motives for purchasing from the informal economy: some lessons from a study of Bulgaria, Croatia and FYR of Macedonia. *Economic Alternatives*, Issue 4: 515-531.
- Williams, C.C. and S. Bezeredi (2017b), Evaluating the use of personal connections to bypass formal procedures: a study of *vrski* in Republic of Macedonia. *UTMS Journal of Economics*, 8(2): 169-182.
- Williams, C.C. and S. Bezeredi (2018), Evaluating policy approaches towards undeclared work: some lessons from FYR Macedonia. *South-Eastern Europe Journal of Economics (SEEJE)*, ISSN 1109-8597 (In Press).
- Williams, C.C. and S. Nadin (2012), Joining-up the fight against undeclared work in Europe', *Management Decision*, 50(10): 1758-1771.
- Williams, C.C. and S. Nadin (2013), Harnessing the hidden enterprise culture: supporting the formalization of off-the-books business start-ups, *Journal of Small Business and Enterprise Development*, 20(2): 434-47.
- Williams, C.C. and S. Nadin (2014), Evaluating the participation of the unemployed in undeclared work: evidence from a 27 nation European survey, *European Societies*, 16(1): 68-89.



Williams, C.C. and Windebank, J. (1998) *Informal Employment in Advanced economies: implications for work and welfare*, London: Routledge.

ANNEX A: KEY STAKEHOLDERS CONSULTED

Meetings were held with the following key stakeholders

Ministries

Ministry of Labour and Social Policy
State Labour Inspectorate
Ministry of Finance
Public Revenue Office
Finance Police
State Market Inspectorate

Social partners:

EMPLOYERS:

- Organization of Employers of the Former Yugoslav Republic of Macedonia (OEM)
- Business Confederation of the Former Yugoslav Republic of Macedonia (BKM)

Workers:

- Federation of Trade Unions of the Former Yugoslav Republic of Macedonia (FTUM)

Research Centres:

FinanceThink
Center for International Cooperation (MCIC)

Universities:

University American College Skopje

Others:

National Bank