



**Employment and Social Affairs Platform**

# **Policy Brief**

**on**

## **Undeclared work in Bosnia and Herzegovina**

**-evidence and policy recommendations-**

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## Contents

1. Introduction	4
2. Evidence and analysis	4
2.1. Informal economy	4
2.2. Undeclared work	5
2.3. Policy approaches	7
3. Policy implications and recommendations	8
4. Research parameters	8



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### **List of abbreviations**

**GDP** - Gross Domestic Product

**MIMIC** – Multiple Indicators Multiple Causes

**RCC** – Regional Cooperation Council

**SELDI** - Southeast European Leadership for Development and Integrity

**WB6** – Western Balkans

## 1. Introduction

Undeclared work – work that in itself is legal but not declared to the authorities for tax, social security and/or labour law purposes – plays an important role in all economies in the Western Balkans. This challenge has been recognized both in the national Economic Reform Programmes<sup>1</sup>, prepared annually by the Western Balkan economies as part of their economic governance dialogue with the EU, and the EU strategic documents related to the enlargement process<sup>23</sup>.

In this context, under its Employment and Social Affairs Platform project and in close coordination with Ministries of Labour and Social Affairs, the Regional Cooperation Council (RCC) has commissioned diagnostic reports for each Western Balkan economy, which review and assess in-depth direct and indirect policy approaches with regard to undeclared work and provide rapid appraisal of applicability and transferability of EU policies to the WB6 economies. The insights in these reports will be further discussed in national and regional fora and will provide the trigger for future collaboration and mutual learning in tackling informal employment.

Inspired by the successful experience of the European Platform Tackling Undeclared Work, this work will support the establishment of a WB6 Network for Tackling Undeclared Work, with the immediate objective of enhancing cooperation on tackling undeclared work using a holistic and integrated approach, that joins up on the level of both strategy and operations the policy fields of labour, tax and social security law, and involving social partners.

This policy brief draws on the diagnostic report for Bosnia and Herzegovina and aims to provide information related to the current size, character and drivers of the undeclared work in Bosnia and Herzegovina, a summary of policy measures employed so far by the government and outline some key indicative recommendations for policy makers and other stakeholders to better address undeclared work.

## 2. Evidence and analysis

### 2.1. Informal economy

Bosnia and Herzegovina (BiH) is one of the Western Balkans societies that faces a quite high share of informal economy and employment. If we look at the available estimates of the informal economy for BiH, there are significant differences between different sources, but all

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<sup>1</sup> [https://ec.europa.eu/neighbourhood-enlargement/policy/policy-highlights/economic-governance\\_en](https://ec.europa.eu/neighbourhood-enlargement/policy/policy-highlights/economic-governance_en)

<sup>2</sup> The communication of the European Commission on a credible enlargement perspective for and enhanced EU engagement with the Western Balkans, 2018 recognizes that economic development in the region is hampered by an entrenched grey economy.

<sup>3</sup> In its Communication on EU Enlargement Policy, the European Commission emphasized that all Western Balkan economies face high unemployment rates and persistently high levels of informal economy (European Commission, 2018)



of them are consistent in reporting that the informal economy is a persistent phenomenon in this society. Even a simple check that can be done by looking at the GDP values calculated by different methodologies (e.g. production and expenditure approach) indicates the presence of the informal economy. Still, the available studies provide quite high estimates of the level of the informal economy in BiH over the last two decades. If we look at the latest estimates (2014-2016), they range between 25% to 35% of GDP (Ernst & Young, 2014<sup>4</sup>; Schneider, 2015<sup>5</sup>; Southeast European Leadership for Development and Integrity (SELDI), 2016<sup>6</sup>; Pasovic and Efendic, 2018<sup>7</sup>). Such a high level of informal economy, which remains rather similar over the last years, indicates that BiH has not done enough to tackle the phenomenon and to transfer more informal employers, employees and informal economic activities to the formal sector of the economy. Indeed, such a high percentage of informal economy can lead to a quite high share of undeclared work, which is in our main focus.

This stresses a need for a holistic approach towards tackling the undeclared work, which will be based on a better institutional coordination, combination of restrictive and stimulating measures, and policies needed to eventually increase tax morality of citizens and entrepreneurs.

## 2.2. Undeclared work

The existing literature provides a few estimations of undeclared work for BiH, ranging between 10% to 40% of the workforce in the period 2000-2016. The estimates for the last couple of years range between 10% and 25% (Economic Institute Sarajevo, 2015<sup>8</sup>; SELDI, 2016). Roughly, this would mean that between 120,000 and 300,000 people are working informally (fully or partly), as the labour force in 2016 accounted for approximately one million people (BiH Agency for statistics, 2017<sup>9</sup>).

According to BiH representative survey data from 2015<sup>10</sup>, there are around 30% of respondents with undeclared work or unreported income, while 26% of respondents report to have their income that is fully coming from informal jobs. The distribution between different

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<sup>4</sup> Ernst & Young (2014). Reducing the shadow economy through electronic payments: Bosnia and Herzegovina. *Better Government EY Programme*.

<sup>5</sup> Schneider, F. (2015). Size and development of the shadow economy of 31 European and 5 other OECD countries from 2003 to 2014: different developments?. *Journal of Self-Governance & Management Economics* 3(4): 7-29.

<sup>6</sup> Southeast European Leadership for Development and Integrity (SELDI) (2016). *Hidden Economy Fact Sheets 2016*. Available at: <http://seldi.net/publications/publications/hidden-economy-fact-sheets-2016/>. Accessed in August 2017.

<sup>7</sup> Pasovic, E. and Efendic, A. (2018). Informal economy in Bosnia and Herzegovina – an empirical investigation using MIMIC approach. *ICES2018 conference paper*.

<sup>8</sup> Ekonomski institut Sarajevo (EI). (2015). *Dijagnoza tržišta rada. Sarajevo: EI Sarajevo*.

<sup>9</sup> BiH Agency for statistics. (2017). *Demography and social statistics: Labour force survey 2017*. Sarajevo: *BiH Agency for Statistics*.

<sup>10</sup> The primary survey data has been collected by a professional research agency, as part of another research project implemented in BiH in 2015. The total of 6,021 randomly selected respondents between 16 and 65 years of age participated in the survey. The survey was conducted via computer-assisted telephone interviewing (CATI). It was prepared in a special survey program The Survey System 9.0; the telephone database used for this survey had almost one million active numbers. The survey was designed so that each municipality has at least 40 participants, so the total number of participants amounts to over 6,000.



age and gender categories is similar (a bit higher participation by younger and males), while the majority of undeclared work participants are from rural areas.

Table 1. Distribution of informally employed over labour force and demographic variables

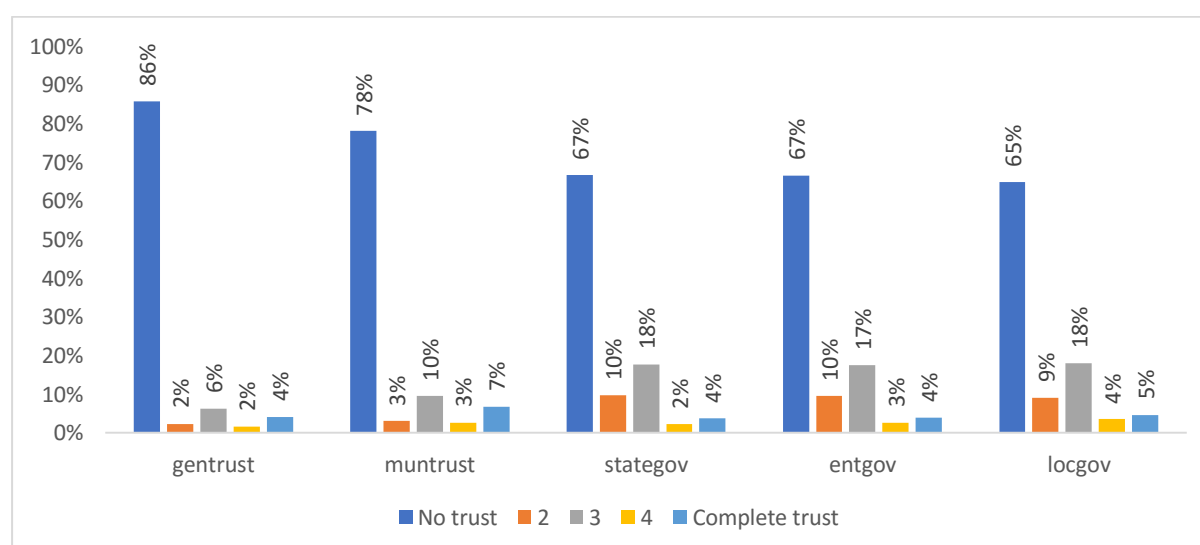
%	LABOUR FORCE			AGE		GENDER		URBAN		
	BiH	Yes	No	Young (16-35)	Old (35+)	Male	Female	Urban	Suburb	Rural
NO	74	79	70	72	74	71	76	80	76	69
YES	26	21	30	28	26	29	24	20	24	31

Source: Primary survey data, 2015

Our further empirical (econometric) investigation based on survey data identifies that individuals who are young, less educated, coming from rural areas and from economically weak families have the highest probability of participation in the informal economy in BiH (Efendic and Williams, 2018). Although this finding can be treated as conventional, it provides a good signal to the policy makers about the category of population in BiH which is the most likely to participate in the informal economy, and who should be targeted by, for instance, awareness raising campaigns.

BiH institutional environment is complex, with many governments and overlapping jurisdictions. Different types of institutional failings can influence different aspects of citizens' and entrepreneurs' decisions to turn to informal economy and undeclared work. Inefficient institutional arrangements cause asymmetry between state morality (laws and regulations) and societal morality (norms, values and beliefs regarding those laws and regulations). An indication of it can be captured through the citizens' trust in people (societal morality) and government (state morality). In BiH, trust in institutions and people is very low—more than 60% of respondents have no trust (Figure 1).

Figure 1. Citizen's trust in general people and different levels of governments



(*gentrust*=trust in general people, *muntrust*=trust in local people; the remaining is trust in state, entity and local governments). Source: Primary survey data, 2015

Another possible cause of undeclared work might be inadequate tax policy. The tax wedge in BiH is around 40%. However, a number of researchers find little, if any, evidence that higher tax rates explain higher levels of undeclared work. Moreover, many researchers argue that, to achieve higher tax morality, it is more important to have appropriate use of tax revenues and provision of high quality public goods and services. Unfortunately, tax morality in BiH is rather low. There is around 60% of respondents who find tax evasion as never justified, whereas around 20% see it sometimes justified (INFORM, 2017<sup>11</sup>). Compared to EU residents, BiH citizens have lower intrinsic motivations to pay taxes. This is particularly evident for entrepreneurs who justify tax evasion more than ordinary citizens.

One of the important reasons of low tax morality could be the presence of corruption in a society. Transparency International Corruption Perceptions Index shows that the misuse of power for private benefits has worsened since 2012, hence, the corruption has probably increased. BiH is ranked 89th in the world. In the data from Transparency International<sup>12</sup>, 55% of respondents claimed that the corruption is a serious problem in the country, 82% of respondents believe that the government is handling the issue of corruption badly and 41% respondents feel that the ordinary people can't make a difference.

Inequality has also been brought in connection to undeclared work: the greater the income inequality the greater is the undeclared work. While Scandinavian economies have the lowest income inequality in the world measured by the GINI index (approximately 0.2), the most unequal economies such as South Africa have GINI index around 0.6, Bosnia and Herzegovina is in between, with GINI index ranging between 0.3 and 0.45 (Hadziomerovic-Vajnberger, 2018<sup>13</sup>). This still implies rather high income inequality in the society, which might be a cause of informality as well.

### 2.3. Policy approaches

Current policy approach in BiH used to tackle undeclared work can be described as rather repressive and static. The range of policy measures which relevant institutions/departments have at their disposal is based more on “stick” measures, i.e. to **increase the costs of non-compliance by increasing penalties and risk of detection**. Due to complex institutional system and possibility for political interference at various levels, institutions/departments involved often fail to meet the expectations within the scope of this narrow deterrence approach. On the other hand, there is a limited effort in fixing the formal institutional failings to improve the services offered, trust in institutions and support the intrinsic feelings of being tax compliant. Several **awareness raising campaigns** by the governments in BiH were implemented in 2016 and 2017. However, the approach in the campaigns was not efficient

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<sup>11</sup> INFORM (2017). Report on formal and informal economy. Available at: [http://www.formal-informal.eu/files/news/2017/Deliverables%20and%20Milestones%202017/Study%20on%20formal%20and%20informal%20economy\\_upd\\_27122017.pdf](http://www.formal-informal.eu/files/news/2017/Deliverables%20and%20Milestones%202017/Study%20on%20formal%20and%20informal%20economy_upd_27122017.pdf).

<sup>12</sup> Transparency International. (2016). People and corruption. Europe and Central Asia 2016. Available at: <https://www.transparency.org/whatwedo/publication/7493>.

<sup>13</sup> Hadziomerovic-Vajnberger, Dz. (2018). Public spending and income distribution in South East European countries. *Master thesis defended at the School of Economics and Business, University of Sarajevo, and Faculty of Economics, University of Ljubljana.*

enough to draw a line between grey (informal) economy and ‘black economy’ or corruption, and promoted “the fight against informal economy” mainly through **inspections and more restrictive penalties**. Therefore, there is a need to shift from this deterrence approach towards a more encompassing and proactive one. The array of policy measures should be widened in the current deterrence strategy, but also include policy measures which incentivize transfers from undeclared to declared work, which improve formal and informal institutions, and narrow the gap between state and societal morality in the very end.

### 3. Policy implications and recommendations

Some key recommendations to tackle undeclared work in BiH more successfully are listed below:

- Introduction of a **holistic integrated strategic approach** towards tackling undeclared work. The goal should be to enhance the effectiveness and efficiency of the activities against undeclared work by improving coordination across enforcement authorities at the level of strategy, operations and data gathering, sharing and analysis.
- Consider introducing a **coordinating body for informal economy** (composed from representatives of all relevant institutions) to take responsibility for joining-up the strategies, operations and data management of all state agencies and social partners involved in the tackling activities of undeclared work. This body should also bring to harmonization of legislation related to undeclared work, simplification of administrative procedures and restructuring of responsibilities between different institutions to improve efficiency.
- To tackle the undeclared work, relevant institutions **should not only rely on repressive but use stimulative measures as well**. It would be beneficial that institutions in BiH establish “white lists” of compliant companies (currently, there is a “black list”) and provide clear benefits for them, like business walking routes for tourists that promote those from white lists, ability to take part in public procurement for the tax compliant companies, and similar. This should be accompanied by easing procedures for companies to transfer to formal work and finding themselves on white lists.
- Working more to **improve tax morality in the country**. This should start by improving relevant services offered by formal institutions, which should increase institutional trust. It is important to improve human resources policy so to insist on continuous education and training of personnel and tailor its redistributive justice to tackle those that are in greatest need (below the poverty line). Also, public awareness raising campaigns about the benefits of formal work should be launched among business community and citizens as well. Insisting on marketing tools that trigger emotions result in voluntary compliance and longer-term improvements in tax morality.

### 4. Research parameters





This brief draws from the undeclared work diagnostic report and action plan for Bosnia and Herzegovina prepared as part of a regional exercise by a team of experts for the RCC. The methodology includes a review of existing surveys on undeclared work, a desk-based survey of policy measures initiatives to explore the policy instruments used by the government, social partners and employers' organizations, and in-depth interviews with representatives of Tax Administration, Labour Inspectorate, and economic experts.

## References

- Efendic, A. and Williams, C.C. (2018) Diagnostic Report on Undeclared Work in Bosnia and Herzegovina, Regional Cooperation Council, Sarajevo.
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