

**Employment and Social Affairs Platform**

**Policy Brief**

**on**

**Undeclared work in Kosovo\*<sup>1</sup>**

**-evidence and policy recommendations-**

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<sup>1</sup>This designation is without prejudice to positions on status, and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence.



## **Contents**

1. Introduction .....	4
2. Evidence and analysis .....	5
2.1 Informal economy.....	5
2.2 Undeclared work.....	6
2.3 Policy approaches .....	8
3. Policy implications and recommendations.....	9
4. Research parameters .....	10

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### **List of abbreviations**

**KTA** - Kosovo\* Tax Administration

**KPI** - Key Performance Indicators

**LFS** - Labour Force Survey

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

**WBES** - World Bank Enterprise Survey

**WB** – 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>2</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>34</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 undeclared work.

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 Kosovo\* and aims to provide information related to the current size, character and drivers of undeclared work in Kosovo\*, 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.

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<sup>2</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>3</sup> The communication of the European Commission on a credible enlargement perspective for an enhanced EU engagement with the Western Balkans, 2018 recognizes that economic development in the region is hampered by an entrenched grey economy.

<sup>4</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)

## 2. Evidence and analysis

### 2.1 Informal economy

Although informal economy is considered a major concern in Kosovo\*, there are no systematic estimates of the size of informality. The most recent assessment on informal economy was conducted in 2017, through EU-funded project, “Further Support to Kosovo\* Institutions in the Fight against Organized Crime, Corruption and Violent Extremism”. The process was led by the Ministry of Finance and coordinated among other line ministries, independent government agencies, and the Central Bank of Kosovo\*. The assessment was derived based on 2015 data, covering information contained in the payment of taxes, such as personal income tax, rental tax, interest and profit, as well as consumption taxes (KTA, 2018, pg.58<sup>5</sup>). Findings of this assessment, show that informal economy in Kosovo\* accounts for 31.7% of GDP, a one percentage point drop from 2013 (KTA, 2018, pg. 58). By sector, informality is highest in agriculture, construction sector, the wholesale and retail sector, the real estate sector, the financial activity sector, the insurance sector, and freelancers. This study, estimates that in Kosovo\*, there are about 45 thousand employees working full time in the informal sector, with estimated loss of 60.1 million Euros annually from non-payment of personal income tax and corporate income tax. Only in the construction sector, it is estimated that the number of informal workers is 9,978, amounting to a loss of € 3.2 million in personal income tax and € 5.2 million in corporate income tax - informality being four times higher than in the agricultural sector.

An alternative estimate of the informal economy is the 2013 World Bank Enterprise Survey (WBES)<sup>6</sup>. As data provided in Table 1 reveal, 94.4% of these enterprises were registered when they started operations and remained unregistered, on average, for 1.5 years, significantly higher when compared to the Europe and Central Asia (0.3 years) and World Bank global region (0.7 years). In 2013, two thirds of surveyed formal enterprises in Kosovo\* assert that they compete against unregistered or informal firms, and 58.8% identify the practices of competitors in the informal sector as a major constraint.

**Table 1: Prevalence of informal enterprises in Kosovo\*, 2013**

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<sup>5</sup> ATK, 2018, Annual report: January-December 2017: <http://www.atk-ks.org/wp-content/uploads/2018/05/RaportiVjetor2017Vfinal.pdf>.

<sup>6</sup> World Bank Enterprise Survey, 2013: [http://www.enterprisesurveys.org/data/exploreeconomies/2013/Kosovo\\*](http://www.enterprisesurveys.org/data/exploreeconomies/2013/Kosovo*).

	Percent of firms formally registered when they started operations in the economy	Number of years firm operated without formal registration	Percent of firms competing against unregistered or informal firms	Percent of firms identifying practices of competitors in the informal sector as a major constraint
All economies globally	88.8	0.7	54.2	28.2
Europe & Central Asia	98.0	0.3	38.1	19.5
<b>Kosovo* 2013</b>	<b>94.4</b>	<b>1.5</b>	<b>65.6</b>	<b>58.8</b>

Source: World Bank Enterprise Survey 2013.

WBES data, reveal that small formal businesses (5-19 employees) were more likely to have started-up unregistered than businesses with 20-99 employees, whilst all enterprises with 100 and more employees, were formally registered when they started operations in the economy. Small business also remain longer as unregistered, with average duration of 2.4 years, compared to firms with 20-99 employees that remain informal for a quarter of a year. By sector, according to WBES, starting-up unregistered is only present among manufacturing sector enterprises but not within the service sector. The average duration as informal for the manufacturing sector is 3.3 years. Manufacturing business, are more likely to state that they compete against unregistered or informal firms than service sector businesses (66.2% compared with 65.0%).

## 2.2 Undeclared work

Labour Force Survey provides annual data on vulnerable employment (composed of unpaid family work and self-employed without employees) and share of employed individuals without employment contract. LFS data for 2017, show that about 23% of employed persons in Kosovo\* are in vulnerable employment and 22% did not have an employment contract. A recent World Bank report<sup>7</sup>, utilising a wider definition of informality (accounting for unpaid family workers, self-employed workers in small firms, self-employed workers in unprofessional occupations, and workers in small firms-five or fewer employees), calculated that in 2012, just over a third of workers were classified as informal. A similar figure was obtained from the enterprise survey conducted by Riinvest in 2013<sup>8</sup>, a rate of 37%. According

<sup>7</sup> Cojocaru, Alexandru. 2017. *Kosovo jobs diagnostic (English)*. Job series; no. 5. Washington, D.C. : World Bank Group. [http://documents.worldbank.org/curated/en/814361497466817941/Kosovo\\*-jobs-diagnostic](http://documents.worldbank.org/curated/en/814361497466817941/Kosovo*-jobs-diagnostic).

<sup>8</sup> Riinvest Institute, 2013, To Pay or Not to Pay: A Business Perspective of Informality in Kosovo\*: [http://riinvestinstitute.org/uploads/files/2016/October/17/BUSINESS\\_INFORMALITY\\_5mm\\_bleed\\_no\\_inside\\_ENG\\_FINALV\\_313964385731476693005.pdf](http://riinvestinstitute.org/uploads/files/2016/October/17/BUSINESS_INFORMALITY_5mm_bleed_no_inside_ENG_FINALV_313964385731476693005.pdf).

to this survey, 70% of labour is informal in the agricultural sector, in manufacturing it is 46% and it is 39% in human health and social work (pp.22). Since the survey assesses the share of employees reported to the tax authorities in legally-operating businesses, the survey does not capture informal employment in unregistered enterprises.

A significantly higher magnitude on informal economy, has been reported in a recent study, published by Southeast Europe Leadership for Development and Integrity (SELDI) in 2016<sup>9</sup>. The survey was conducted with 1,000 individuals, applying a wide definition, for informality-including whether social security and health insurance is paid on the main job. According to this definition, informal employment Kosovo\* is estimated to be 81%, which is highly overestimated, due to the fact that Kosovo\* still does not have a mandatory health and social insurance. This is confirmed also by further disaggregation of hidden employment, whereby about 40% of the hidden employment is without contract, 87% do not have health insurance and 47% do not have social insurance.

Working without a contract is more prevalent among men (24.4% compared to 18.8% for women) and youth (46.2% as opposed to 21.5% of those aged 15-64), whilst by sector, undeclared work is more present in construction and agriculture sector. For illustration, the Kosovo\* agriculture census of 2014, revealed that the workforce in agriculture sectors amounted to 362,700 individuals<sup>10</sup>, whilst the LFS in the same year depicted only 8,600 persons engaged in the sector (7,500 men and 1,100 women).

A distinct feature of vulnerable employment in Kosovo\* is that unpaid family work constitutes one third of vulnerable employment, a significantly higher than the corresponding average value for the EU28 (10.2%) and new member states (13.9%).<sup>11</sup> This suggests that being informal worker in Kosovo\* is not a voluntary choice, but rather a ‘survival strategy’ in the absence of formal sector opportunities (Krstić and Gashi, 2016)<sup>12</sup>. This also highlights that different policy approaches need to be considered, when opting to incentivise formalisation and fight against undeclared work in Kosovo\*.

With regards to envelope wages, the only available proxy is provided by the SELDI report (2016), which found that on average, 22.6% of wage earners with contracts receive higher

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<sup>9</sup> SELDI (Southeast Europe Leadership for Development and Integrity), 2016, Hidden economy and Good Governance in South East Europe: Regional Assessment report: [file:///C:/Users/ag/Documents/RCC/Informality/Reports/HIDDEN\\_ECONOMY\\_06.pdf](file:///C:/Users/ag/Documents/RCC/Informality/Reports/HIDDEN_ECONOMY_06.pdf).

<sup>10</sup> KAS, 2015, Agriculture Census 2014 – Final results: <http://ask.rks-gov.net/media/1374/rezultatet-perfundimtare.pdf>

<sup>11</sup> According to the Key Indicators of the Labour Market 9th Edition (indicator KILM 3 for 2014). Unweighted average, Malta is not included (software downloaded from <http://kilm.ilo.org/2015/install/>).

<sup>12</sup> Krstic, G. and Gashi, A., 2016, Informal Employment in the Western Balkans, Proceedings from the 4th International Conference on Contemporary Issues in Economics, edituar nga Vesna Stojanović Aleksić, fq. 153-164, ISBN: 978-86-6091-070-9, Business and Management, Faculty of Economics University of Kragujevac, Kragujevac, <http://ebm.ekfak.kg.ac.rs/sites/default/files/download/EBM2016%20Proceedings.pdf>.

salaries (not bonuses) than those written in contracts (% of those employed in a main paid job).

### 2.3 Policy approaches

Kosovo\* does not have a single agency tackling informality. So far, policy approaches have mainly focused on **using deterrence measures**, with the main institutions being the Labour Inspectorate operating under the Ministry of Labour and Social Welfare and Tax Administration, in charge of detecting cases of tax evasion. The focus on deterrence approach is also observed from the National Strategy of Kosovo\* for the Prevention of and Fight against Informal Economy, Money Laundering, Terrorist Financing and Financial Crimes 2014-2018<sup>13</sup>. Similarly, a recently approved sectoral strategy of the Ministry of Labour and Social Welfare 2018-2022, explicitly stipulates that fighting undeclared work can only be done through rigorous and consistent control. Hence, the solution to combating undeclared work is through **enhancing human, logistical and infrastructural capacities of the Labour Inspectorate** and **enhancing cooperation and coordination with other relevant bodies in detecting informality**, and signing agreements with main courts to provide priorities to cases reported by Labour Inspectorate.

Data from the Tax Administration of Kosovo\*, show that in period 2015-2017, tax revenues amounted to € 42, 49 and 52 million, respectively (KTA, 2018). On the other hand, in 2016 and 2017, Labour Inspectorate conducted 7,285 and 8,128 inspections and found 1,340 and 1,750 informally employed persons, respectively (Labour Inspectorate, 2017 and 2018a)<sup>14</sup>. Given the higher prevalence of undeclared work in the construction sector, Labour Inspectorate, during peak months in 2017, undertook 1,147 inspections, during which 245 informally employed workers were identified (Labour Inspectorate, 2018b)<sup>15</sup>.

So far, only a narrow range of incentive measures has been used. In 2015, the Ministry of Finance approved an Administrative Instruction Mf-No. 01/2015 on the Use of Fiscal Electronic Devices and Systems, with a specific article (No. 26) on **Incentives and motivation for taking fiscal receipts**. With this initiative, customers collect fiscal receipts and take them to the authorities in order to have a portion of VAT reimbursed. The primary aim was to increase awareness about the importance of fiscal compliance, and secondly to

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<sup>13</sup> Kosovo\* Government, National Strategy of Kosovo\* for the Prevention of and Fight Against Informal Economy, Money Laundering, Terrorist Financing and Financial Crimes 2014-2018: <https://mf.rks-gov.net/desk/inc/media/B2227717-B018-430E-9498-5DA32C104DD9.pdf>

<sup>14</sup> Labour Inspectorate, 2017, Annual Report for construction sector 2016: <https://ip.rks-gov.net/wp-content/uploads/Raporti-2016.xls>.; Labour Inspectorate, 2018a, Annual Report for 2017: <https://ip.rks-gov.net/wp-content/uploads/Raporti-i-Punes-per-vitin-2017-nga-Inspektoriati-i-punes-2.pdf>.

<sup>15</sup> Labour Inspectorate, 2018b, Annual Report for construction sector 2017: <https://ip.rks-gov.net/wp-content/uploads/Raporti-ndertimtari-2.pdf>.



encourage consumers to put pressure on businesses to issue fiscal receipts. In period 2015-2017, in total, € 28.5 million were reimbursed to consumers - 1.25 million in 2015; 14.3 in 2016 and 13 million in 2017 (KTA, 2018)<sup>16</sup>. This activity is ongoing, but since 2018, operates as a 'lottery' model.

Finally, the Tax Administration of Kosovo\*, operates a specific Department for Services and Education of Tax Payers, which organised awareness raising companies and information activities, through seminars, workshops, trainings and information sessions (KTA, 2018).

It is important to note, that to date, there has been no evaluation in assessing the effectiveness of employed policies in combating informality. Moreover, there is no information on formalisation of businesses.

### 3. Policy implications and recommendations

In Kosovo\*, little emphasis is put on improving the benefits of and incentives for declared work, or more indirect preventative tools, 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). There is therefore a need to shift away from such a heavy reliance on deterrence measures to the broader use of preventative incentives, as well as awareness raising and a focus upon targeting and tackling the major drivers of the undeclared economy.

Some key recommendations are listed below:

- **Strategic management initiatives** that will help establish a holistic integrated strategic approach towards tackling undeclared work. This would 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; modernise the Labour Inspectorate's and Tax Administration's strategic objectives and KPIs in relation to undeclared work, by including a preventative approach towards undeclared work;
- **Reform formal institutions**, such as through training of labour inspectorates and facilitating organisational culture change towards a more customer-friendly approach;
- Introduce incentives to formalize, namely **demand-side policy measures**. For example, it would be beneficial to pilot introduction of a tax rebate incentive scheme for home owners to receive a rebate of tax when they employ (i) domestic workers, and (ii) registered building contractors or registered tradespeople who provide house repair and

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<sup>16</sup> ATK, 2018, Annual report: January-December 2017: <http://www.atk-ks.org/wp-content/uploads/2018/05/RaportiVjetor2017Vfinal.pdf>.

renovation services. Another possible avenue could pilot the application of service vouchers (similar to the Belgium case). The services voucher is essentially a wage cost subsidy for labour-intensive, low-skilled domestic work. Residents can buy services vouchers in order to purchase domestic help, ranging from housecleaning, laundry and ironing to sewing, meal preparation and transport for less mobile people.

- **Changing citizens' values, norms and beliefs**, through initiatives such as the launch of a public awareness campaign on the benefits of declared work, for general public, including school children;

#### 4. Research parameters

This brief draws from the undeclared work diagnostic report and action plan for Kosovo\* 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, State Labour Inspectorate, and economic experts.

#### References

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