Employment and Social Affairs Platform

Policy Brief

on

Undeclared work in Serbia

-evidence and policy recommendations-

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Contents

List of abbreviations

GDP - Gross Domestic Product

GoS - Government of Serbia

KPIs - Key Performance Indicators

LFS - Labour Force Survey

MIMIC – Multiple Indicators Multiple Causes

SSO - State Statistical Office

VAT - Value Added Tax

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[1], 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[2][3].

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 Serbia and aims to provide information related to the current size, character and drivers of undeclared work in Serbia, 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

The most recent MIMIC method estimates the size of the shadow economy in Serbia as approximately 27.9% during 2013 (Hassan and Schneider, 2016)[4][5]. Most recently, Krstić and Radulović (2018)[6] used a survey of company managers to measure the size of the shadow economy based on an income approach to measuring GDP. According to the new survey method - the "shadow economy index", which is based on data on undeclared employee salaries and undeclared corporate profits, the volume of informal economy is 14.9% of GDP. Previously, a rather similar approach based on the data derived from the enterprises and entrepreneurs' survey was used to obtain macro-level estimate of Serbia's shadow economy which estimated the undeclared economy

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[1] https://ec.europa.eu/neighbourhood-enlargement/policy/policy-highlights/economic-governance_en
[2] 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.
[3] 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)
[4] Hassan,M. and Schneider,F. (2016). Size and Development of the Shadow Economies of 157 Worldwide Countries: Updated and New Measures from 1999 to 2013, Journal of Global Economy 2016, 4:3.
[5] Unfortunately, there are no more recent data on undeclared economy in Serbia obtained using the MIMIC approach (Medina and Schneider, 2018).
[6] Krstic,G. and Radulovic,B. (2018). Siva ekonomija u Srbiji 2017 - Procena obima, karakteristike učesnika i determinante, NALED.

at a similar scale of 15.4 % of GDP (Schneider at al. 2015)[7]. The survey approach shows that the undeclared economy was reduced from 21.2% in 2012 to 15.4% of GDP in 2017. We should emphasise that these estimates represent the lower margin of the undeclared economy, since both the survey and the "shadow economy index" covered only registered enterprises and entrepreneurs.

Table 1 Size of undeclared economy in Serbia, % of official GDP Survey Methods

Method	Year	Estimate
Schneider et al. (2014)		
Survey Method	2012	21.2
Krstić and Radulović (2018)		
Survey Method	2017	15.4
Shadow Economy Index	2017	14.9

2.2 Undeclared work

In a context marked by a significant 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 Serbia. The current business climate in Serbia 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. Apart from significant negative impacts on the economy and social institutions, undeclared work implies risks for the individual workers, including lack of social security, protection of rights and possibilities for career advancement.

Regarding the structure of the undeclared economy in Serbia, undeclared work, or partial or complete payment of wages in cash, accounts for a much larger part of the undeclared economy than the undeclared profit - about 62 % of the undeclared economy is related to unreported salaries of employees. Since 2012, the share of businesses engaged in the undeclared activities has significantly decreased from 28.4% in 2012 to 16.9% in 2017. Krstić and Radulović (2018) report that 16.9% of registered businesses in Serbia were engaged in undeclared activities in 2017. Approximately one tenth of business entities (10.8%) had undeclared employees, while 6.9% conducted cash payments, even though they were VAT payers.

According to the Labour Inspectorate (2018)[8], although violations in employment relations were present in almost all industries, they were most prevalent in the construction, agriculture (seasonal jobs), catering, trade and craft sectors, as well as in textile and food processing industries. Unregistered activities are also quite common in several professions. When it comes to different types of undeclared work, the 2017 Annual Report of the Labour Inspectorate reveals that the most common recorded violations were employment without a contract of unskilled and semi-skilled workers that are above 40 years of age or that are receiving social assistance. This is followed by non-declaring to pension or health insurance authorities and hiring seasonal workers for seasonal jobs in agriculture on an undeclared basis (Labour Inspectorate, 2018).

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[7] Schneider, F., Krstić, G., Arsić, M., Ranđelović, S. (2015). "What Is the Extent of the Shadow Economy in Serbia?" in *Formalizing the Shadow Economy in Serbia: Policy Measures and Growth Effects* (eds. G. Krstić, and F. Schneider), Chapter 5, pp.47-75, Contributions to Economics, Springer International Publishing.
[8] Labour Inspectorate of the Republic of Serbia. Annual Report 2017 available at
https://www.minrzs.gov.rs/lat/pres/saopstenja/izvestaj-o-radu-inspektorata-za-rad-za-2017-godinu.html

Table 2 Labour Inspectorate Surveillance Activities and Results

Year	Total number of surveillances	Scope of surveillance (number of workers)	Number of undeclared employees	Number of newly registered employees (after surveillance)
2015.	61.776	696.822	16.408	12.250
2016.	53.069	533.119	19.472	17.589
2017.	53.424	510.725	22.411	21.171

These findings are confirmed by the survey of businesses, as the largest share of businesses engaged in the undeclared economy activities are in the agricultural sector (20.8%) and catering (19.6%). These results are similar to results from 2012.

The LFS provides the informal employment rate i.e. the share of persons working without formal contract in the total number of employment. This category includes the employed in unregistered companies, the employed in registered companies but without formal contract and without paying social and pension contributions, as well as unpaid family workers. According to the LFS, the informal employment rate slightly increased from 19.5% in 2015 to 20.7% in 2017. This situation is rather similar to the situation in the neighbouring and EU countries (William, Horodonic, 2015)[9].

Table 3 Labour Force Survey

	2015	2016	2017
Employed - aged 15 and over	2558.4	2719.4	2794.7
Formally employed	2060.5	2120.2	2215.4
Informally employed	497.9	599.2	579.2
Informally employed by status			
Self- employed with employees	2.7	2.5	1.6
Self- employed w/o employees	162.5	245.9	279.4
Employees	125.3	132.9	136.5
Contributing family workers	207.4	217.9	161.6
Informally employed by age			
15-24	48.4	55.3	46.3
25-54	286.9	333.0	219.7
55-64	105.8	128.7	126.0
65 and over	56.7	82.1	87.3
Informal employment rate	19.46%	22.03%	20.72%

2.3 Policy approaches

Tackling the undeclared economy remains a significant challenge despite the efforts made in recent years, including **imposing stricter sanctions, reducing non-wage costs and reducing bureaucratic obligations and the administrative burden**.

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[9] Williams, C., Horodonic, I. (2015). Marginalisation and participation in the informal economy in Central and Eastern European nations, Post-Communist Economies , pp. 153-169

Serbia adopted **cross-departmental cooperation** and has a rather **cohesive and coordinated institutional infrastructure for tackling the undeclared economy**. Coordination against undeclared work was first initiated in 2014. In 2015 the Government adopted a **strategic framework for reducing the shadow economy** in the Republic of Serbia – National Program for Countering the Shadow Economy. The National program contains an **action plan that lists measures for countering the shadow economy**. These measures are aimed at four objectives – 1) **improved monitoring of shadow economy flows**; 2) **Improved functioning of the fiscal system**; 3) **reduction of administrative and parafiscal burdens on businesses and citizens**; 4) **raising awareness among citizens and businesses on the significance of countering the shadow economy** and **motivation for compliance with regulations**. To facilitate the adoption of the National Program and Action Plan the GoS has established the **Coordination Body** for Directing Activities for Reducing the Shadow Economy and the **Expert Group** of the Coordination Body (Expert Group) that was tasked to prepare and submit the Draft National Program along with the Draft Action Plan. Central Coordination Body is responsible for ensuring coordinated action by the multifarious public administration bodies involved in tackling undeclared economy.

In 2017, the Government has adopted **a new Action Plan** for 2017 and 2018. The Action Plan introduces new activities and envisages the continuation of the number of measures aimed at reducing the volume of undeclared work and tax evasion. The new Action Plan contains more than a hundred measures including **KPIs** and mainly focuses on the **establishment of more effective surveillance**, **improved fiscal framework** and the **reduction of the administrative burden on businesses and citizens**. Several **campaigns were rather successful** in raising the awareness and generated a lot of interest and public support for resolving the problem of undeclared work. Consequently, the new action plan **expands the number of measures dedicated to education and raising the awareness**.

3. Policy implications and recommendations

The implementation of the National Program and Action Plan managed to reduce high share of undeclared economy. However, as recognized by the new strategic documents there are a number of weaknesses in the regulatory framework, lack of capacities and inefficiencies of relevant institutions. Serbia is currently using a mixed approach using both deterrence measures and 'enabling compliance' measures to deal with undeclared economy. In that respect Serbia needs to continue with fine tuning and improving of the current approach. Indeed, most of key barriers to formalisation are already well recognized, but some as e.g. tax morality, will take much longer time to deal with.

Some key recommendations are listed below:

- **Policy measures to deter informal employment**, such as for example using existing databases 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 so as to 'nudge' them towards legitimacy. Another potential measure could be the introduction of supply chain responsibility in public procurement contracts (introducing a clause in the contract certifying that the winning firm undertakes not to engage any undeclared workers and will put in place measures to ensure that any sub-contractors engaged will not employ undeclared workers).
- **Demand side policy measures that decrease incentives to use cash and increase incentives to use electronic payments to reduce undeclared work** such as introducing a ceiling for cash transactions for natural persons or introducing such ceiling in selected sectors to discourage the

use of cash and incentivise an increase in electronic payments, so as to reduce the opportunities for undeclared work; or initiating a pilot study to examine the use of service vouchers in household and personal services. Service voucher schemes have various advantages, both for domestic workers and for their employers

- **Supply side policy measures**, such as for instance having all firms who wish to tender for public contracts obtain a 'Clearance Certificate' by the Labour Inspectorate. This certification could be kept simple and refer to the absence of wage, tax and social insurance arrears, and sanctions imposed in recent years.
- **Improving the involvement of social partners** through the provision of one-to-one formalisation advice and support to help informal businesses legitimise.

4. Research parameters

This brief draws from the undeclared work diagnostic report and action plan for Serbia 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

- Radulovic, B and Williams, C.C. (2018) Diagnostic Report on Undeclared Work in Serbia, Regional Cooperation Council, Sarajevo.
- Radulovic, B. and Williams, C.C. (2018) Strategy and Action Plan for Tackling Undeclared Work in Serbia, Regional Cooperation Council, Sarajevo.