



Employment and Social Affairs Platform

**Recommendations for Tackling Undeclared
Work in Montenegro**

Draft

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Abbreviations

EU – European Union

GDP – Gross domestic product

ILO – International Labour Organisation

ISSP – Institute for Strategic Studies and Projections

IT – information Technology

KPI – Key performance indicators

LI – labour inspection

MLSW – Ministry of Labour and Social Welfare

MONSTAT – Montenegro Statistical Office

NHDR – National Human Development Report

OECD – Organisation for Economic Cooperation and Development

POS - Point-of-sale

RCC – Regional Cooperation Council

SSCG - Association of Unions Montenegro

UNDP – United Nations Development Program

UPCG - Association of Employers of Montenegro

USSCG - Association of Free Unions of Montenegro

VAT – Value-added tax

1. Background

This report proposes a comprehensive approach for the formalisation of undeclared work in Montenegro as well as the creation of an environment whereby jobs are predominately created in the declared economy. The proposed policy approach includes a mix of measures including improvement in the regulatory environment, detection and inspection approach. The first section provides a background context which is based on the diagnostic work under the umbrella of the RCC initiative to review and evaluate existing policy approaches aimed at alleviation of undeclared work in Montenegro using a holistic approach as well as to provide policy recommendations. The second part gives recommendations for combating undeclared work.

1.1. Extent, character and drivers of the undeclared economy in Montenegro

The most recent surveys on undeclared work in Montenegro (IPSOS, 2014) shows that 29.2% of the working age population (15+) worked in the declared economy, while about two times less persons worked in the undeclared economy, i.e. 14.2%.¹ In 2014, according to same survey, 46,452 employed persons or 22.3% of all employees in Montenegro were undeclared and they were earning incomes that were not formally recorded. In addition to this 10.3% of all employees, or 23,966 employees, had partly registered salaries, i.e. taxes and contributions were paid only on a part of their salaries (usually on the minimum wage for certain education level), while they received the rest in cash without payment of taxes and contributions.

In addition to undeclared employment and salaries generated in the undeclared sector, the companies also have revenues that are not declared.² IPSOS also estimated having in mind undeclared surpluses that the total undeclared economy in Montenegro is 24.5% of GDP. Observed by the regions, businesses with the headquarters in the central region are most prone to do undeclared activities, and those in the North (as the least developed region) are the least inclined to operate in such a way (42.5% to 26.6%).

Relevant research and policy reviews identify drivers of the high and persistent undeclared work in Montenegro (ISSP 2007, UPCG 2014, UNDP 2016) as follows:

- Insufficient level of the rule of law, reflected in the inefficient public administration, selective implementation of legislation and inefficient inspection services, inconsistent interpretation of legislation by various instances of administrative services;
- Inadequate regulatory framework that primarily refers to high transaction costs, the burdening legislation, complicated, expensive and inadequate registration procedures;
- Rigid labour legislation in terms of administrative burdens and cost of compliance;
- High tax wedge on labour;
- High para-fiscal burdens, often imposed by local-self-governments.

1 The Survey was conducted in November 2014 in the sample of 1,038 households and 409 companies and entrepreneurs.

2 IPSOS (2014), *Informal Employment and Grey Economy in Montenegro*

The policy approach to combat undeclared work will have to combine structural reforms with the implementation of measures that will assume improvement in organisation of fight against undeclared work as well implementation policy initiatives that proved to be successful and applicable, based on identified EU and regional best practice.

1.2. Current organisation of the fight against undeclared work

The current organisation of the fight against undeclared work in Montenegro assumes shared responsibility of different institutions organised under the umbrella of a Government appointed work team - Commission. The composition and tasks of the Commission changed over time, and includes Ministry of Finance, Ministry of Labour and Social Welfare, inspection services as well as representatives of social partners. The ILO report from 2011 identified weaknesses of Montenegro's approach to combat undeclared work as unclear responsibility and leadership, insufficient authorities and poor financial and human resources of inspection services, the insufficient role of all social partners in the process of developing policies, and out-dated and inefficient legislation.

The current Commission for combating undeclared economy appointed in 2017 has only government representatives. The Commission is chaired by the vice-president of the Government in charge for economic policy, while members are representatives of the Ministry of Finance, tax, customs, police and inspection authorities. The set of measures for combating the undeclared economy has been defined in the action plan for every year, including the measures necessary for strengthening institutional capacities and human resources of the state administration bodies responsible for control and collection of revenues.

1.3. Current policy approach

Government strategic documents and action plans do not clearly set a target for combating the undeclared economy. The documents and strategies mainly list activities aimed at combating undeclared employment. One of the reasons for not having clearly set goals and indicators to monitor performance is the lack of a consistent source of data on the undeclared economy. Official statistical agencies do not publish data on the undeclared economy so it is very difficult to set targets, especially numerical targets and to later monitor success of the implemented measures.

Joint strategic approach, having that there is a political will and cooperation, might be implemented. However, there is a need to have a consistent source of data for setting numeric goals and monitoring success.

Enhancement and increased frequency of controls is one of the constant activities in action plans aimed at combating the undeclared economy. The institutional approach to combating undeclared work in Montenegro is rather based on intimidation and penalty policy, as well as on the additional regulation aimed at combating the undeclared economy. One of the basic



goals, in addition to the goal of reducing undeclared employment, was to increase budget revenues. Action plans for combating undeclared employment in the period from 2013 to date are more focused on stricter penalties, increased frequency of controls, imposing fines and sanctions, followed by changes in regulatory framework enabling such policies.

Current organisation of work and lack of measurable results in the fight against undeclared work suggests that there is a significant space to apply some of the best practice policy measures identified among EU member countries, as identified by Eurofound and the European Commission's European Platform Tackling Undeclared Work.

2. POLICY RECOMMENDATIONS

Having in mind to date the organisation of the fight against undeclared work, the lack of reliable sources of verification of success in promoting declared work, as well as the persistence of undeclared work, there is a need to draft a comprehensive structural reform agenda that will tackle identified the key drivers of undeclared work. Comprehensive society wide reforms in areas of education, social and other government services, reforms in efficiency and scope of public sector should be part of such reform agenda as well as general business environment. The issue of undeclared work is complex, cross sectorial and bears significant social consequences; therefore, measures aimed solely at declaration of undeclared work are necessary but not sufficient.

Recommendation 1	Overarching structural reform agenda that will tackle key drivers of undeclared work
Goal	Formalisation of undeclared work and enabling new quality jobs to be created in declared economy
Implementation	Montenegro should define comprehensive cross-government reform agenda that will tackle key issues in social system, education, efficiency of public administration and business environment in terms of regulatory improvement, reduction of administrative cost and tax burdens
Responsible Institutions	Cross-government, including all ministries, social partners and civil society
Outcomes	A coordinated national structural reform agenda with clear strategic goals, responsible institutions, adequate funds and human resources with clearly defined sources of verification
Indicators of achievement	Production of shared cross-cutting strategic objectives and key performance indicators (KPIs) Number of jobs created in formal sector Average wage

Therefore this document proposes such a strategic approach combined with the policy measures or strategic goals aimed at better coordination, detection and declaring of undeclared work.

2.1 Strategic management initiatives

Although there is a coordinating body, the organisation of fight against undeclared work is still fragmented with the emphasis on inspection services work. The Labour Inspection as a part joint Inspection Authority is in charge for breaches of Labour Law and Tax inspection as part of Ministry of Finance is in charged to check compliance with tax and social security legislation. However, often there is no coordination of work of these two inspection authorities. The coordination of the fight against undeclared work (in terms of operations, data sharing and analysis) is currently focused solely to inspection services missing a strategy setting and data mining, and focuses mainly on undeclared work of foreigners as well as illegal trade of excise goods such as tobacco, mineral oils, etc. Thus coordination and a joined-up approach at the level of strategy, operations and data mining, sharing and analysis is required to improve the effectiveness and efficiency of the fight against undeclared work. The strategic coordinated response should benefit from existing platforms for sharing good practice such us the European Platform Tackling Undeclared Work.

Recommendation 2	A holistic integrated strategic approach towards tackling undeclared work.
Goal	To enhance the effectiveness and efficiency of the fight against undeclared work by setting clear approach that will tackle strategy, goals, operations and data mining, data sharing and analysis.
Implementation	Appoint high level coordination body to take responsibility for strategies, operations and data mining, sharing and analysis of all state agencies and social partners involved in the fight against undeclared work.
Responsible Institutions	Cross-government, including Ministry of Finance, Ministry of Labour and Social Welfare, Inspection Authority including Labour Inspection, Tax Administration, Employment Agency of Montenegro, Ministry of Tourism and Sustainable Development, and Ministry of Interior and social partners.
Outcomes	A coordinated national approach towards undeclared work on the level of strategy, operations and data mining, sharing and analysis.
Indicators of achievement	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

The policy goal of the fight against undeclared work is not the elimination of undeclared work but rather its transfer to declared work. Repressive policy aimed at formalization in Montenegro, without adjustments in the formal institutions and gradual formalization, would mean the increase in poverty, since incomes from undeclared activities are an important revenue source for the poor (Katnic, 2016). Moreover, 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’. Like in many countries, the focus of Montenegro’s efforts to alleviate undeclared work has been more on

detering undeclared work rather than ‘preventing’ undeclared work and ‘promoting the declaration of declared work’.

Measuring performance against set strategic targets and operational goals assumes the availability of good sources of verification, i.e. statistical data produced consistently in line with internationally endorsed methodology (ILO) and available in consistent time series. This would mean that measurement of undeclared work should become part of official surveys conducted by the national statistical office, though Labour force survey or specialised survey on undeclared work. Availability of such data would enhance strategic policy design, allow modification of policy interventions and allow assessing success of policy measures.

Recommendation 3	Improvements in measurement of undeclared work
Goal	To provide consistent and comparable data on the scope and characteristics of undeclared work
Implementation	MONSTAT will amend statistical surveys calendar by adding survey dedicated to undeclared work and provide in cooperation with Ministry of Finance secure source of financing for the survey
Responsible Institutions	National Statistical Office – MONSTAT, Ministry of Finance
Outcomes	Better strategic and planning and insight into scope and nature of undeclared work, Improved dialogue on the strategy and policy measures Evaluation of policies based on objective sources of verification
Indicators of achievement	Availability of consistent data on undeclared work published at least once a year

The current range of policy measures in Montenegro is comparable with the experiences of the countries from the region and has some similarities to EU Member States. Having in mind the limited results of such measures, and success of preventative measures such as reduction in tax burden, Montenegro needs to modernise its policy approach and especially work of inspection services as well as to increase level of trust in institutions.

Recommendation 4	Increase level of trust in institutions and especially inspection services through setting strategic objectives and KPIs in relation to undeclared work
Goal	Increase level of trust in Inspection Authority/ Labour Inspection and Tax Authority and enhance quality of services provided
Implementation	Inspection Authority and Tax Inspection should have broadened authority to define as strategic goal transformation of undeclared work into declared work’.
Responsible Institutions	Inspection Administration, Labour Inspectorate and Tax Administration
Outcomes	Adopt Key Performance Indicators with transforming undeclared work into declared work, and preventative measures, which are related to: <ul style="list-style-type: none"> • customer satisfaction survey • the number of businesses offered advice and/or support on how to operate legitimately, • the number of existing businesses offered formalisation advice and/or

		<p>support,</p> <ul style="list-style-type: none"> • % of undeclared which is declared out of total number of detected undeclared workers
Indicators of achievement	of	<p>The number of start-up businesses offered advice and/or support by the on how to operate legitimately;</p> <p>The number of existing businesses offered formalisation advice and/or support.</p>

Performance measurement of individual agencies, customer satisfaction surveys and measurement of results could positively impact on perception of work of inspection services, increase level of trust and thus positively impact of broader national consensus on necessity to combat undeclared work.

2.2 Policy measures to deter undeclared work

Deterrence measures are aimed at detecting and punishing undeclared work and have been central in policy measures in Montenegro aimed at the undeclared work issue. Evidence from survey in Montenegro (IPSOS 2014) indicates that employers are willing to risk to be punished, since they consider the cost of penalties far less expensive than compliance with the labour regulation. In addition to this, they consider enforcement powers of inspection as weak. On the other hand, some cases where imposed fines exceeded financial means of companies and thus leading to business stop to operate, have been registered. Judging from the experience of the EU member countries there are some measures that could be implemented in Montenegro and provide better balance between need to sanction businesses and adverse impact of fines on businesses.

Recommendation 5	Redesign system of fines and penalties
Goal	To allow appropriate treatment of cases of different seriousness
Implementation	Widen the spread of fines giving enforcement bodies a broader width of penalties <u>or</u> System of fines made less rigid to allow more flexibility and proportionality within the sanction system
Responsible Institutions	Ministry of Justice, Ministry of Finance, Ministry of labour and Social Welfare
Outcomes	Sanction system is more balanced and unbiased and match seriousness of offence;
Indicators of achievement	Improved decisions by the courts.

Another realm where improvements can be made is on ensuring that being caught acts as a deterrent.

Recommendation 6	Register of employers fined for undeclared work³
Goal	Labour inspectorate, state bodies, employees, and companies can track record whether an employer was penalised for undeclared work, and design actions

³ Croatia example



	accordingly
Implementation	Create a public register and to develop criteria for listing offenders, similar to Black and White lists of tax payers Consider other implications resulting from listing on the register such as volume or severity of fines imposed in cases of continuous non-compliance with labour and tax regulations
Responsible Institutions	Inspection Authority
Outcomes	Promoting good and beet employers and deterring impact on offenders and opportunity for potential business partners, clients and potential employees to decide whether they want to do business with persons or companies listed on the register
Indicators of achievement	Usage of register for due diligence purposes by public.

Cooperation among state bodies or lack of it is one of the success factors of any policy initiative as well is for the undeclared work fight. Montenegro's administration had a problem due to lack data sharing, due to inertia of state bodies and sometimes due to lack of interoperability of IT systems. This has been partially improved through Social card IT system and cooperation in employment of foreigners, however there is a huge space to improve cooperation, data sharing, data mining, etc.

Recommendation 7	Set up a small task force for improvement of the effectiveness of electronic systems for data mining, data sharing and data analysis.
Goal	Improved detection of businesses and individuals engaged in undeclared work
Implementation	Establish centralised task force for detection Use of the e-government initiative to secure IT platforms for data sharing and mining for team institutions and allow for businesses and citizens to file complaints and seek information anonymously.
Responsible Institutions	Ministry of Finance, Ministry for Public Administration, MLSW, Inspection Authority, Tax Authority
Outcomes	IT bridging of existing data bases would enable more effective data mining, sharing and analysis across government Improved risk based inspection plans Effective and efficient use of inspection capacities
Indicators of achievement	Improved rate of detection of undeclared work

Experiences indicate that using government procurement and public investments could be good mechanism to promote declared work. The usual means to promote such policy is to include a clause in the public works contracts that the company will not use undeclared work and that in case of engaging sub-contractors they will make sure that subcontractor will not employ undeclared workers. In addition to this, it is suggested to use bank guarantees that the company will pay the salaries, taxes and social security contributions.

Recommendation 8	Apply supply chain responsibility in public works contracts
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Goal	Improved detection of undeclared work and promotion of law-abiding businesses
Implementation	Introduce into public works contracts a clause that the winning company or its partners will not use undeclared work and guarantees that they will pay salaries and corresponding taxes and contributions
Responsible Institutions	Ministry of Finance
Outcomes	Improved accountability of companies engaged in public contracts Reduces opportunities for undeclared work. Sharing resistibility for detection of undeclared work Imposing safeguards for public fund use and collection as well as for workers
Indicators of achievement	Pilot inspection of companies working on public work contracts.

2.3 Incentives to formalize: supply-side policy measures

Incentive measures in the area of undeclared work should be aimed at easing transition from undeclared to declared work. Having in mind fact that the 70% of undeclared workers in Montenegro are self-employed persons, that one quarter of social assistance are welfare beneficiaries (UNDP, 2016), formalisation cost according to the tax benefit model is very high (Koettl, and others 2013). Incentive measures should be twofold – firstly they should enable the least painful transition to the declared economy and secondly to support that new jobs are created in declared economy. There are a set of measures used by the EU member countries, some of them include measures to promote law-abiding companies and some to assist transfers to declared economy. Having that Montenegro already uses White lists of taxpayers, and having in mind the structure of undeclared work, the emphasis of supply side measures should be on ease of transfer to declared economy.

Recommendation 9	Incentives for gradual formalisation of self-employment
Goal	Provide a two-year gradual formalisation of self-employed undeclared workers
Implementation	Design a program that will involve tailor-made gradual transition to formal sector including gradual abolishment of welfare benefits Design of special tax treatment of such self-employees
Responsible Institutions	Ministry of Finance and Ministry of Labour and Social Welfare
Outcomes	Provides an incentive and positive benefit of formalisation by allowing relatively long transition period.
Indicators of achievement	Increase in number of registered self-employed individuals

A further way of encouraging businesses to formalise is to reduce administrative barriers for formalisation of jobs such as nannies and housemaids. Currently it is very complicated for

households to register an employee and is expensive. The procedures for registering employees and administrative cost are complicated and thus expensive.

Recommendation 10	Simplification of the procedures and taxation for registration of workers such as nannies, housemaids and similar jobs
Goal	Provide simple one-stop-shop for registration of jobs such as nannies, housemaids and similar jobs
Implementation	Design one-stop-shop for registration of jobs such as nannies, housemaids and similar jobs Design a taxation plan for such jobs, following mini-jobs German experience
Responsible Institutions	Ministry of Finance and Ministry of Labour and Social Welfare
Outcomes	Provides an incentive and positive benefit of formalisation by allowing relatively long transition period.
Indicators of achievement	Increase in number of registered self-employed individuals

In order to smooth the transition from unemployment to self-employment, especially among the young, there is a need to design measures to enable people to make a transition from unemployment to self-employment. The Employment Agency for Montenegro already implements some measures supporting self-employment, however effects and efficiency of such measures has not been properly evaluated.

2.4 Incentives to formalize: demand-side policy measures

Incentive measures on the demand side assume targeting customers of companies that sell goods and services in the undeclared economy. Montenegro applied such measures back in 2002 when the VAT was introduced in tax system. Since then, these measures have been seldom used. One of the recent initiatives was “Be responsible” initiative where using mobile application citizens have reported irregularities. A certain amount of fines imposed on those breaching the rules was awarded to various initiatives and society project with opportunity for citizens to vote for projects.

Recommendation 11	Decrease incentives to use cash and increase incentives to use electronic payments to reduce undeclared work
Goal	Incentivise consumers to purchase declared goods and services
Implementation	To discourage the use of cash and incentivise an increase in electronic payments, Montenegro should: <ul style="list-style-type: none"> • enable online and using POS terminals payment of taxes and other duties to the government, • make point-of-sale (POS) terminals available across all sectors, including the mandatory acceptance of digital payments



Responsible Institutions	All government departments Social partners
Outcomes	<ul style="list-style-type: none"> • Tax revenues increase with the growth of the use of payment cards. 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.
Indicators of achievement	<ul style="list-style-type: none"> • Decreased use of cash and increased use of electronic payments.

EU countries experience and surveys indicate that significant share of undeclared work is engaged in home repair and renovation, and domestic services i.e. households employing workers. Some of applied policy measures include providing homeowners with a tax rebate when they employ registered workers as a measure to engage declared persons to provide such services. Tax rebate schemes for domestic services, and home repair and renovation, have been applied in some EU Member States (Denmark, Germany, Belgium, and Sweden, included in policy papers in Croatia) as an incentive to engage declared workers and reject undeclared workers.

Recommendation 12	Introduce 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 renovation services.
Goal	Incentivise consumers to use declared goods and services
Rationale	A pilot study should be undertaken in a particular region for a limited range of activities, to be evaluated after 24 months
Responsible Institutions	Ministry of Finance Tax Administration
Outcomes	Offers an incentive to citizens to employ declared workers and raises awareness of the negative effects of employing undeclared workers. 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.
Indicators of achievement	Survey of pilot study to evaluate whether purchasers would have used undeclared work previously to get the work done

2.5 Changing citizens' values, norms and beliefs

Undeclared work was tolerated by authorities in Montenegro for a long time, especially in the 1990s, since it was recognized as a coping mechanism in a situation when there was no formal job creation. In addition to this, the regulatory framework was quite unfavourable. With the change in the regulatory framework, the emphasis was more on compliance and raising awareness of citizens of undeclared economy. However, focus of policy, have being led by Ministry of Finance was on VAT and excise goods. Economy wide public campaigns on the benefits of declared work are missing.

Lack of discipline including fiscal discipline in state owned enterprises and local self-governments which have accumulated huge amounts of tax arrears did not contribute to change in beliefs of citizens on the necessity to pay taxes. This situation has contributed to beliefs that undeclared activities are socially acceptable. To tackle undeclared work therefore,



there is a need to change policy towards state owned companies and local self-government and to so to say change the social contract.

Activities have to be twofold – on one hand government/state needs to promote more fiscal discipline and to act in a responsible manner as owner and on the other hand promote benefits of declared work and paying taxes. One option is to organise a public awareness campaign on the benefits of declared work to increase the level of voluntary compliance.

Recommendation 13	Public Awareness Campaign on the Benefits of Declared Work
Goal	Change values, norms and beliefs regarding the benefits of declared work and costs of undeclared work
Implementation	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. Ensure full awareness about the MLSW and Inspection Authority competencies for detection of undeclared work and related consequences on individuals
Responsible Institutions	Ministry of Labour and Social Welfare, Labour Inspectorate, other line-ministries
Outcomes	Reducing the tolerance of undeclared work will result in lower levels of undeclared work. The percentage of citizens engaged in undeclared work will fall. Increase in the number of reports to of non-compliance to inspectorates. Broadened tax base More transparency
Indicators of achievement	Decrease in undeclared work

Having in mind that, similarly to other countries in the region, employees as a earning from the work see take home pay, there is a need to raise awareness that each employee actually earns gross wage, including taxes and contribution. A campaign to educate citizens on their actual earning and maybe to transfer responsibility from employers to individuals to pay taxes.

Recommendation 14	Educating citizens about the tax system
Goal	Improve understanding and consequence of purpose of payment of taxes and contribution, norms and beliefs regarding the benefits of declared work and costs of undeclared work
Implementation	Provide invoices to citizens when use insurance based services, such as health services in order to get understand how the tax and contribution money is spent 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 Provide visualisation of budget expenditures
Responsible Institutions	Ministry of Labour and Social Welfare, Ministry of Finance, Tax Administration/Customs; Ministry of Economy, Ministry of Health in close cooperation social partners
Outcomes	Improved citizens understanding about the relationship between paying

	taxes and the public goods and services received
Indicators of achievement	Resultant reduction in undeclared work Greater awareness that taxes pay for public goods and services.

Tolerance of undeclared work is highest among younger age groups in many countries, as well in Montenegro.

Recommendation 15	Educate schoolchildren and university students of the benefits of declared work
Goal	Improve understanding of how government operates and from where the money is coming, as well as explain benefits of declared work and costs of undeclared work
Implementation	Introduce in the education curriculum lessons on why people pay tax, the benefits of social insurance and declared work, and the costs of undeclared work. 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
Responsible Institutions	Ministry of Education in close cooperation with the Ministry of Finance/Tax Administration/Customs; Ministry of Economy
Outcomes	Improved understanding of children and students about the rationale and benefits of paying taxes and social insurance, and working declared.
Indicators of achievement	Greater awareness of benefits of declared work and costs of undeclared work among younger people and reluctance to accept undeclared job offers

2.6 Reforming formal institutions

Formal institutions often represent one of the key sources or drivers of undeclared work, either by being inefficient, unfair or too rigid. Barriers imposed by formal institutions, direct and indirect costs of formal institutions, such as taxes and cost of compliance with regulation in Montenegro are identified as some of the key drivers of undeclared work. The key changes in formal institutions should be:

- Changes in the formal institutions by removing administrative barriers and cost for declared work, as well as reducing tax burdens;
- Improvement in functioning of formal institutions to improve the perception amongst citizens that there is procedural and distributive fairness and justice; and/or
- Improvement in outcomes of the formal institutions through removing disincentives to formal work as well as in the products of formal institutions by pursuing wider economic and social developments (e.g. better targeting of social transfers).

One of the key barriers for declared employment according to businesses in Montenegro is rigid labour regulation, so part of the strategic approach to alleviating undeclared work is inevitably reform of labour legislation, primarily Labour Law.

Recommendation 16	Revising and modernising labour regulation in order to remove
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	obstacles for declared work and to adapt to the new emerging jobs
Goal	Create flexible and enabling labour regulation which will provide good balance between need to provide employees protection and flexibility as well as reduce cost of compliance and not become barrier to new forms of work
Rationale	Current labour regulation are among the most rigid in Europe, create significant administrative burdens and do not support new forms of work which is less national and less linked to a specific work post and office or factory
Responsible Institutions	Ministry of Labour and Social Welfare in cooperation with social partners and other stakeholders
Outcomes	Increased number of declared workers and increased variety of job form. Reduction in undeclared work. Increased employment among young people, females and elderly. Increased activity rate Higher mobility on the labour market
Indicators of achievement	Number of declared workers Unemployment rate among youth Activity rate of working age population Improvements in productivity

Second important aspect of formal institutional change relevant for undeclared work in Montenegro is a tax burden. Reduction in tax burden must be part of any policy agenda aimed at reducing undeclared work, understood in the context of the broken social contract that exists. If the social contract can be re-established, then there will be less need for such a reduction in the tax burden.

Recommendation 17	Reducing tax burden on labour
Goal	Broaden tax base and increase in now jobs generated in declared economy
Rationale	Tax wedge on labour in Montenegro is by 4pp higher than the average in EU Business and citizens consider high tax wedge as key driver of undeclared work especially among self-employed
Responsible Institutions	Ministry of Finance
Outcomes	Broadened tax base, increased fiscal revenues Reduction in undeclared work Generation of jobs in formal economy
Indicators of achievement	Increased number of declared employees Increased tax and contributions revenues

Having in mind envelope wages and declaring workers transfer of responsibility from companies to individuals to pay taxes and contributions, as well as tax authorities to enable such flexible arrangements and support for payment could mean less undeclared work. Also, this could be piloted as an option.

Recommendation 18	Transferring responsibility for payment of taxes and contributions form employers to employees
Goal	Piloting transfer of responsibility from companies to employees

	Reduction of undeclared work and raising awareness of the costs and benefits
Rationale	Payment of net wages and envelope wages, while not paying corresponding taxes is practice of Montenegrin employers leading to accumulation of tax arrears and sometimes missing insurance and insurance history Piloting this concept in several companies could indicate what resources are needed for Tax Administration how to simplify procedure and make payment of taxes easy
Responsible Institutions	Ministry of Finance
Outcomes	Increased fiscal discipline Reduction in undeclared work Reduction in tax arrears Raising awareness of total earnings
Indicators of achievement	Increased number of declared employees Increased tax and contributions revenues

In number of cases such as employment of students, rules make barriers to declared employment.

Recommendation 19	Removing obstacles to formal work of young people/students beneficiaries of scholarships or stipends
Goal	Enable declared work of students beneficiaries of the scholarships
Rationale	Current labour and education regulation define that full time students beneficiaries of scholarships or stipends lose benefits if declare employment
Responsible Institutions	Ministry of Education, Ministry Labour and Social Welfare in cooperation with Ministry of finance and Tax Administration
Outcomes	Increased number of students - declared workers Reduction in undeclared work, especially during the tourist season. Higher mobility on the labour market
Indicators of achievement	Number of declared young workers/students

To support outcomes and improve trust in formal institutions, there is a need to improve knowledge and skills of inspectors.

Recommendation 20	Training of labour inspectors
Goal	Produce more effective trained labour inspectors
Rationale	There is currently limited official training of labour inspectors on tackling undeclared work. The LI should make use of the ILO toolkit for the training of labour inspectors in tackling undeclared work.
Responsible Institutions	Inspection Authority, Labour Inspection Ministry of Labour and Social Welfare ILO trainers
Outcomes	Improved efficiency and effectiveness of inspectors in tackling the

		undeclared economy. Capacity-building of the inspectorate. Facilitates organisational culture change towards a more customer-friendly approach. Monitor via annual staff satisfaction survey
Indicators of achievement	of	Improvements in productivity of staff in achieving KPIs

2.7 Improving the involvement of social partners

Undeclared work is not just a problem for revenue authorities, is also poses a problem to workers as well as to companies in form of unfair competition. Social partners can play an important role in detecting undeclared work working in cooperation with the state. A broader social partner led initiative is to use local ‘role models’ organised by for example chambers of commerce to act as mentors to nascent entrepreneurs starting-up businesses.

Recommendation 21	Employers association could provide advices to formalisation	
Goal		Greater involvement of social partners in the fight against undeclared work
Implementation		Development of a system in employers’ organisation or Chamber of Commerce whereby entrepreneurs could seek advice and help to legitimise, and provide support and advice on legitimate business development.
Responsible Institutions		UPCG, Chamber of Economy
Outcomes		Support to development of declared businesses Alleviation of unfair competition
Indicators of achievement	of	Successful implementation of mentoring system for entrepreneurs

To raise awareness among businesses and undeclared workers of the benefits of declared work (and costs of undeclared work) social partners could run awareness campaigns.

Recommendation 22	Awareness raising campaign among undeclared workers and business community of the benefits of declared work	
Goal		Greater involvement of social partners associations of in the fight against undeclared work
Implementation		Roadshow organised by employers association, trade unions and inspection authorities Establishment of strong network for cooperation, points of contacts for information and advice in employers associations, trade unions and inspection services
Responsible Institutions		Union of Employers Trade unions Tax Administration and Inspection Administration Ministry of labour and Social Welfare



		Ministry of Finance
Outcomes		<ul style="list-style-type: none"> • Reducing the tolerance of undeclared work will result in lower levels of undeclared work. • The percentage engaged in undeclared work will fall. • There will be an increase in the number of reports to inspectorates. • It will widen the tax base • Increase in transparency
Indicators of achievement	of	<ul style="list-style-type: none"> • Number of meetings held and number of participants attending



3 RECOMMENDED ACTIONS FOR TACKLING UNDECLARED WORK

Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement	Start and date of duration
1. Overarching structural reform agenda that will tackle key drivers of undeclared work	Formalisation of undeclared work and enabling new quality jobs to be created in declared economy	Montenegro should define comprehensive cross-government reform agenda that will tackle key issues in social system, education, efficiency of public administration and business environment in terms of regulatory improvement, reduction of administrative cost and tax burdens	Cross-government, including all ministries, social partners and civil society	A coordinated national structural reform agenda with clear strategic goals, responsible institutions, adequate funds and human resources with clearly defined sources of verification	Production of shared cross-cutting strategic objectives and key performance indicators (KPIs) Number of jobs created in formal sector Average wage	Q4 -2018 – Q4 -2019
STRATEGIC MANAGEMENT INITIATIVE						



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Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement	Start and date of duration
2. A holistic integrated strategic approach towards tackling undeclared work.	To enhance the effectiveness and efficiency of the fight against undeclared work by setting clear approach that will tackle strategy, goals, operations and data mining, data sharing and analysis.	Appoint high level coordination body to take responsibility for strategies, operations and data mining, sharing and analysis of all state agencies and social partners involved in the fight against undeclared work.	Cross-government, including Ministry of Finance, Ministry of Labour and Social Welfare, Inspection Authority including Labour Inspection, Tax Administration, Employment Agency of Montenegro, Ministry of Tourism and Sustainable Development, and Ministry of Interior and social partners.	A coordinated national approach towards undeclared work on the level of strategy, operations and data mining, sharing and analysis.	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	Q4 - 2018- Q4 - 2019
3. Improvements in measurement of undeclared work	To provide consistent and comparable data on the scope and characteristics of undeclared work	MONSTAT will amend statistical surveys calendar by adding survey dedicated to undeclared work and provide in cooperation with Ministry of Finance secure source of financing for the survey	National Statistical Office – MONSTAT, Ministry of Finance	Better strategic and planning and insight into scope and nature of undeclared work, Improved dialogue on the strategy and policy measures Evaluation of policies based on objective sources of verification	Availability of consistent data on undeclared work published at least once a year	From 2019 continuously Design Q4 2018 - Q1 2019



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Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement	Start and date of duration
4. Increase level of trust in institutions and especially inspection services through setting strategic objectives and KPIs in relation to undeclared work	Increase level of trust in Inspection Authority/ Labour Inspection and Tax Authority and enhance quality of services provided	Inspection Authority and Tax Inspection should have broadened authority to define as strategic goal transformation of undeclared work into declared work'.	Inspection Administration, Labour Inspectorate and Tax Administration	Adopt Key Performance Indicators with transforming undeclared work into declared work, and preventative measures, which are related to: customer satisfaction survey , the number of businesses offered advice and/or support on how to operate legitimately, the number of existing businesses offered formalisation advice and/or support, % of undeclared which is declared out of total number of detected undeclared workers	The number of start-up businesses offered advice and/or support by the on how to operate legitimately; The number of existing businesses offered formalisation advice and/or support.	Since Q2 2019 continuously
POLICY MEASURES TO DETER UNDECLARED WORK						



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Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement	Start and date of duration
5. Redesign system of fines and penalties	To allow appropriate treatment of cases of different seriousness	Widen the spread of fines giving enforcement bodies a broader width of penalties <u>or System of fines made less rigid to allow more flexibility and proportionality within the sanction system</u>	Ministry of Justice, Ministry of Finance, Ministry of labour and Social Welfare	Sanction system is more balanced and unbiased and match seriousness of offence;	Improved decisions by the courts.	Q2 - 2019
6. Register of employers fined for undeclared work	Labour inspectorate, state bodies, employees, and companies can track record whether an employer was penalised for undeclared work, and design actions accordingly	Create a public register and to develop criteria for listing offenders, similar to Black and White lists of tax payers	Inspection Authority	Promoting good and beet employers and deterring impact on offenders and opportunity for potential business partners, clients and potential employees to decide whether they want to do business with persons or companies listed on the register	Usage of register for due diligence purposes by public.	Since Q1 - 2020 continuously
7. Set up a small task force for improvement of the effectiveness of electronic systems for data mining, data sharing and data analysis.	Improved detection of businesses and individuals engaged in undeclared work	Establish centralised task force for detection Use of the e-government initiative to secure IT platforms for data sharing and mining for team institutions and allow for businesses and citizens to file complaints and seek information anonymously.	Ministry of Finance, MLSW, Ministry for Public Administration, Inspection Authority, Tax Authority	IT bridging of existing data bases would enable more effective data mining, sharing and analysis across government. Improved risk based inspection plans. Effective and efficient use of	Improved rate of detection of undeclared work	Q4 2018 – establishment, work continuously



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Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement	Start and date of duration
				inspection capacities		
8. Apply supply chain responsibility in public works contracts	Improved detection of undeclared work and promotion of law-abiding businesses	Introduce into public works contracts a clause that the winning company or its partners will not use undeclared work and guarantees that they will pay salaries and corresponding taxes and contributions	Ministry of Finance	Improved accountability of companies engaged in public contracts Reduces opportunities for undeclared work. Imposing safeguards for public fund use and collection as well as for workers	Pilot inspection of companies working on public work contracts.	Since Q1 2020
INCENTIVES TO FORMALIZE: SUPPLY-SIDE POLICY MEASURES						
9. Incentives for gradual formalisation of self-employment	Provide a two-year gradual formalisation of self-employed undeclared workers	Design a program that will involve tailor-made gradual transition to formal sector including gradual abolishment of welfare benefits Design of special tax treatment of such self-employees	Ministry of Finance and Ministry of Labour and Social Welfare	Provides an incentive and positive benefit of formalisation by allowing relatively long transition period.	Increase in number of registered self-employed individuals	Q3 - 2019



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Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement	Start and date of duration
10. Simplification of the procedures and taxation for registration of workers such as nannies, housemaids and similar jobs	Provide simple one-stop-shop for registration of jobs such as nannies, housemaids and similar jobs	Design one-stop-shop for registration of jobs such as nannies, housemaids and similar jobs Design a taxation plan for such jobs, following mini-jobs German experience	Ministry of Finance and Ministry of Labour and Social Welfare	Provides an incentive and positive benefit of formalisation by allowing relatively long transition period.	Increase in number of registered self-employed individuals	Q2 – Q2 2019
INCENTIVES TO FORMALIZE: DEMAND-SIDE POLICY MEASURES						
11. Decrease incentives to use cash and increase incentives to use electronic payments to reduce undeclared work	Incentivise consumers to purchase declared goods and services	To discourage the use of cash and incentivise an increase in electronic payments, Montenegro should: <ul style="list-style-type: none"> · enable online and using POS terminals payment of taxes and other duties to the government, make point-of-sale (POS) terminals available across all sectors, including the mandatory acceptance of digital payments 	All government departments Social partners	Tax revenues increase with the growth of the use of payment cards. 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.	Decreased use of cash and increased use of electronic payments.	Since Q1 2020 continuously



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Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement	Start and date of duration
12. Introduce 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 renovation services .	Incentivise consumers to use declared goods and services	A pilot study should be undertaken in a particular region for a limited range of activities, to be evaluated after 24 months	Ministry of Finance Tax Administration	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. Offers an incentive to citizens to employ declared workers and raises awareness of the negative effects of employing undeclared workers.	Survey of pilot study to evaluate whether purchasers would have used undeclared work previously to get the work done	Q3 – Q4 2019
CHANGING CITIZENS VALUES, NORMS AND BELIEFS						



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Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement	Start and date of duration
13. Public Awareness Campaign on the Benefits of Declared Work	Change values, norms and beliefs regarding the benefits of declared work and costs of undeclared work	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. Ensure full awareness about the MLSW and Inspection Authority competencies for detection of undeclared work and related consequences on individuals	Ministry of Labour and Social Welfare, Labour Inspectorate, other line-ministries	Reducing the tolerance of undeclared work will result in lower levels of undeclared work. The percentage of citizens engaged in undeclared work will fall. Increase in the number of reports to of non-compliance to inspectorates. Broadened tax base More transparency	Decrease in undeclared work	Since Q1 2019-continuously
14. Educating citizens about the tax system	Improve understanding and consequence of purpose of payment of taxes and contribution, norms and beliefs regarding the benefits of declared work and costs of undeclared work	Provide invoices to citizens when use insurance based services, such as health services in order to get understand how the tax and contribution money is spent 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 Provide visualisation of budget expenditures	Ministry of Labour and Social Welfare, Ministry of Finance, Tax Administration/Customs; Ministry of Economy, Ministry of Health in close cooperation social partners	Improved citizens understanding about the relationship between paying taxes and the public goods and services received	Resultant reduction in undeclared work Greater awareness that taxes pay for public goods and services.	Q1 to Q4 - 2019



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Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement	Start and date of duration
15. Educate schoolchildren and university students of the benefits of declared work	Improve understanding of how government operates and from where the money is coming, as well as explain benefits of declared work and costs of undeclared work	Introduce in the education curriculum lessons on why people pay tax, the benefits of social insurance and declared work, and the costs of undeclared work. 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	Ministry of Education in close cooperation with the Ministry of Finance/Tax Administration/Customs; Ministry of Economy	Improved understanding of children and students about the rationale and benefits of paying taxes and social insurance, and working declared.	Greater awareness of benefits of declared work and costs of undeclared work among younger people and reluctance to accept undeclared job offers	Q3 2020
REFORMING FORMAL INSTITUTIONS						
16. Revising and modernising labour regulation in order to remove obstacles for declared work and to adapt to the new emerging jobs	Create flexible and enabling labour regulation which will provide good balance between need to provide employees protection and flexibility as well as reduce cost of	Current labour regulation are among the most rigid in Europe, create significant administrative burdens and do not support new forms of work which is less national and less linked to a specific work post and office or factory	Ministry of Labour and Social Welfare in cooperation with social partners and other stakeholders	Increased number of declared workers and increased variety of job form. Reduction in undeclared work. Increased employment among young people, females and elderly. Increased activity rate Higher mobility on the labour market	Number of declared workers Unemployment rate among youth Activity rate of working age population Improvements in productivity	Q2 - 2019



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Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement	Start and date of duration
	compliance and not become barrier to new forms of work					
17. Reducing tax burden on labour	Broaden tax base and increase in now jobs generated in declared economy	Tax wedge on labour in Montenegro is by 4pp higher than the average in EU Business and citizens consider high tax wedge as key driver of undeclared work especially among self-employed	Ministry of Finance	Broadened tax base, increased fiscal revenues Reduction in undeclared work Generation of jobs in formal economy	Increased number of declared employees Increased tax and contributions revenues	Q4 - 2018
18. Transferring responsibility for payment of taxes and contributions form employers to employees	Piloting transfer of responsibility from companies to employees Reduction of undeclared work and raising awareness of the costs and benefits	Payment of net wages and envelope wages, while not paying corresponding taxes is practice of Montenegrin employers leading to accumulation of tax arrears and sometimes missing insurance and insurance history Piloting this concept in several companies could indicate what resources are needed for Tax Administration how to simplify procedure and make payment of taxes easy	Ministry of Finance	Increased fiscal discipline Reduction in undeclared work Reduction i tax arrears Raising awareness of total earnings	Increased number of declared employees Increased tax and contributions revenues	Q4 - 2020



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Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement	Start and date of duration
19. Removing obstacles to formal work of young people/students beneficiaries of scholarships or stipends	Enable declared work of students beneficiaries of the scholarships	Current labour and education regulation define that full time students beneficiaries of scholarships or stipends lose benefits is declare employment	Ministry of Education, Ministry Labour and Social Welfare in cooperation with Ministry of finance and Tax Administration	Increased number of students - declared workers Reduction in undeclared work, especially during the tourist season. Higher mobility on the labour market	Number of declared young workers/students	Q2 2019
20. Training of labour inspectors	Produce more effective trained labour inspectors	There is currently limited official training of labour inspectors on tackling undeclared work. The LI should make use of the ILO toolkit for the training of labour inspectors in tackling undeclared work.	Inspection Authority, Labour Inspection Ministry of Labour and Social Welfare ILO trainers	Improved efficiency and effectiveness of inspectors in tackling the undeclared economy. Capacity-building of the inspectorate. Facilitates organisational culture change towards a more customer-friendly approach. Monitor via annual staff satisfaction survey	Improvements in productivity of staff in achieving KPIs	Q2 – 2019 continuously
IMPROVING THE INVOLVEMENT OF SOCIAL PARTNERS						
21. Employers association could provide advices to formalisation	Greater involvement of social partners in the fight against undeclared work	Development of a system in employers' organisation or Chamber of Commerce whereby entrepreneurs could seek advice and help to legitimise, and provide support and advice on legitimate business development.	UPCG, Chamber of Economy	Support to development of declared businesses Alleviation of unfair competition	Successful implementation of mentoring system for entrepreneurs	Q2 – 2019 continuously



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Recommendation	Goal	Implementation	Responsible Institutions	Outcomes	Indicators of achievement	Start and date of duration
Awareness raising campaign among undeclared workers and business community of the benefits of declared work	Greater involvement of social partners associations of in the fight against undeclared work	Roadshow organised by employers association, trade unions and inspection authorities Establishment of strong network for cooperation, points of contacts for information and advice in employers associations, trade unions and inspection services	Union of Employers Trade unions Tax Administration and Inspection Administration Ministry of labour and Social Welfare Ministry of Finance	Reducing the tolerance of undeclared work will result in lower levels of undeclared work. The percentage of engaged in undeclared work will fall. Increase in the number of reports to inspectorates. It will widen tax base Increase in transparency	Number of meetings held and number of participants attending	Since 2019 continuously

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