

Undeclared work in BiH – diagnostic report and policy implications

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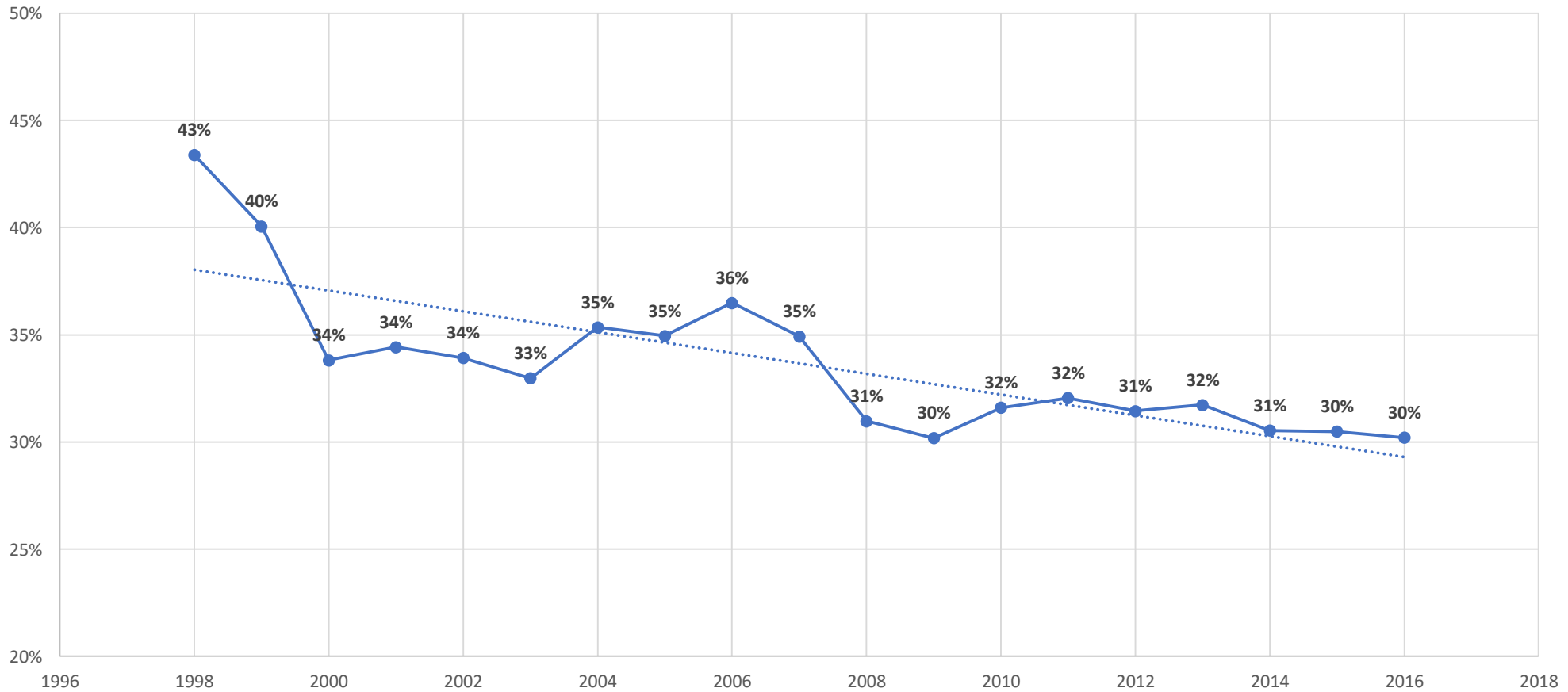
Sarajevo, 11 April 2019

RESEARCH AIMS

- Research focus on **undeclared employment** in BiH
 - Extent
 - Character
 - Potential determinants
 - Current policy approach
- **The data** used in the research:
 - Existing EU literature
 - Secondary data
 - Primary data from representative surveys in BiH from 2015 and 2017
 - Primary data from targeted interviews from 2018

Undeclared economy – primary research

Informal economy in BiH (%GDP)



Pasovic and Efendic, 2018

Undeclared employment in BiH

	LABOUR FORCE			AGE		GENDER		URBAN			ENTITY		
	BiH	Yes	No	Young (16-35)	Old (35+)	Male	Female	Urban	Suburb	Rural	FBiH	RS	BD
NO	74	79	70	72	74	71	76	80	76	69	75	72	74
YES	26	21	30	28	26	29	24	20	24	31	25	28	26

*Those who have informal employment and activities but not formal employment

- Those respondents who have a formal job which brings them regular income are excluded
- **8% of respondent have formal jobs and some income from informal jobs** – they are also excluded

Undeclared employment model for BiH

1. **Individual determinants** – typical indicators linked to respondents as **age, gender, the level of education and area** of living;
2. **Household background determinants** – include indicators linked to the performance of households as household **size, income and wealth**;
3. **Institutional environment** – here we control for the level of **trust in institutions and general people**, for **administrative structure** in BiH, and for the **municipalities** as the lowest level in our investigation;
4. **Post-conflict specific influences** – here we include **migration status** of respondents as around 50% of the current population migrated either internally or externally, which is typically found to be important influence in socio-economic research focused on such environments.

$$P(\text{UNDECLWORK} = 1 \text{ if } \text{LABFORCE} = 1)$$

$$\begin{aligned} &= \Lambda(\beta_0 + \hat{\beta}_1 \cdot \text{AGE} + \hat{\beta}_2 \cdot \text{MALE} + \hat{\beta}_3 \cdot \text{NOEDUCAT} + \hat{\beta}_4 \cdot \text{PRIMARY_ED} + \hat{\beta}_5 \cdot \text{SECOND_ED} + \hat{\beta}_6 \cdot \text{RURAL} \\ &+ \hat{\beta}_7 \cdot \text{NOCHILD} + \hat{\beta}_8 \cdot \text{NOINCOME} + \hat{\beta}_9 \cdot \text{INC_300} + \hat{\beta}_{10} \cdot \text{INC_700} + \hat{\beta}_{11} \cdot \text{WELFARE} + \hat{\beta}_{12} \cdot \text{FBiH} + \hat{\beta}_{13} \\ &\cdot \text{STATEGOV} + \hat{\beta}_{14} \cdot \text{ENTGOV} + \hat{\beta}_{15} \cdot \text{LOCGOV} + \hat{\beta}_{16} \cdot \text{EXTMIGRANT} + \hat{\beta}_{17} \cdot \text{INTMIGRANT} + \hat{\beta}_{18-161} \\ &\cdot \text{Mncn } ?\text{toMncn } 143) + \hat{\varepsilon} \end{aligned}$$

The dependant variable is *undeclwork*=1 (1 –undeclared income bearing job/s or activities; 0 – other) and labour force participants only

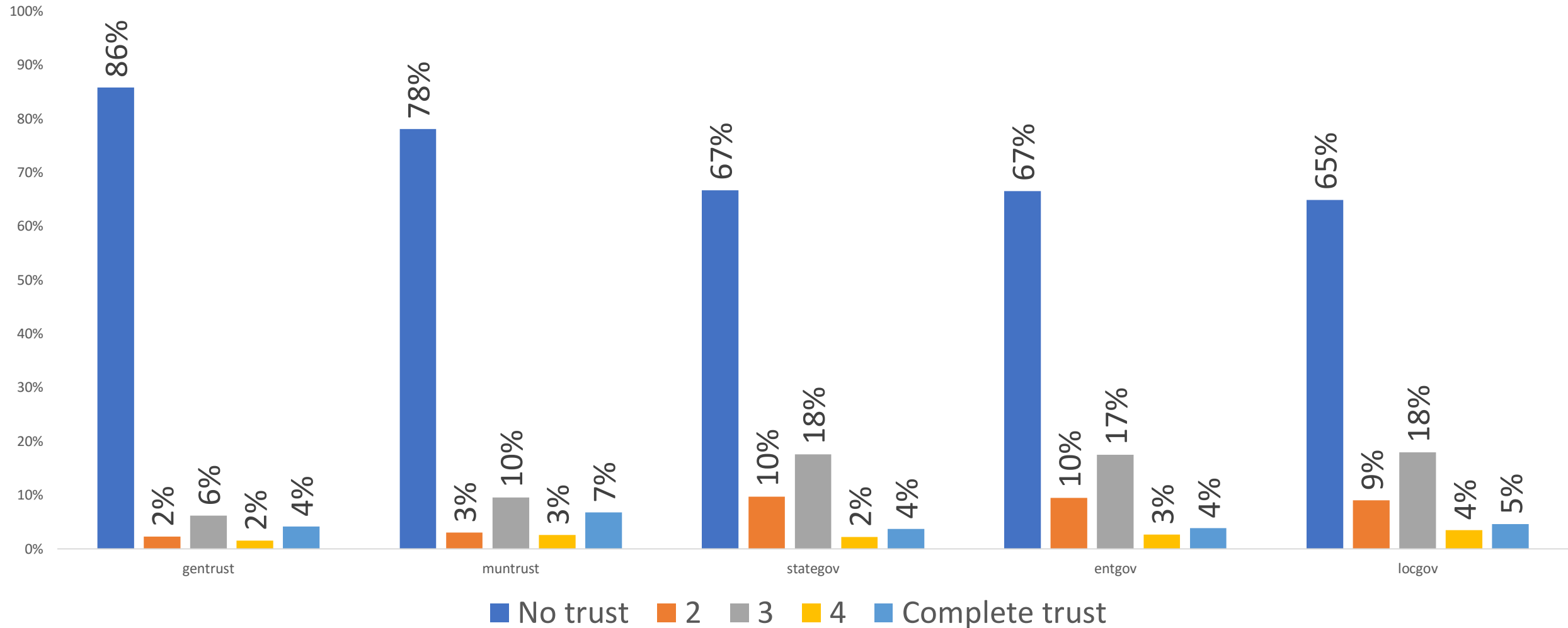
Variable	Explanation of the variables	dy/dx (%)	P > Z
Individual determinants			
age	Age of respondents: from 16 to 65	-0.01 (-1%)	0.000
male	Gender of respondents: 1=male; 0=female	0.06 (6%)	0.001
noeducat*	Education: 1=no education; 0=other	0.21 (21%)	0.033
primary_ed*	Education: 1=primary education; 0=other	0.10 (10%)	0.003
second_ed*	Education: 1=secondary education; 0=other	0.07 (7%)	0.000
rural	Survey area: 1=rural; 0=other	0.04 (4%)	0.061
Household background determinants			
nochild	Number of children: from 0 to 11	0.01	0.832
noincome*	Household income: 1=no income; 0=other	0.26 (26%)	0.000
inc_300	Household income: 1=up to 300 BAM; 0=other	0.17 (17%)	0.000
inc_700	Household income: 1=301-700 BAM; 0=other	0.07 (7%)	0.001
welfare	Wealth: constructed variable: (savings + house + insurance + car + computer)/5	-0.16 (-16%)	0.000
Institutional environment and BiH specific data			
fbih	Region: 1=Federation BiH; 0=other	-0.09 (-9%)	0.000
stategov	Trust in state government: 1=very little, 2, 3, 4, 5=very much	0.03	0.171
entgov	Trust in entity government: 1=very little, 2, 3, 4, 5=very much	0.01	0.929
locgov	Trust in local government: 1=very little, 2, 3, 4, 5=very much	-0.04 (-4%)	0.033
Post-conflict BiH specific data			
extmigrant*	Migration status: 1=external migrant; 0=other	0.08 (8%)	0.009
intmigrant*	Migration status: 1=internal migrant; 0=other	-0.01	0.495
Number of observations		2,359	

A PROFILE OF TYPICAL UNDECLARED EMPLOYED INDIVIDUAL IN BiH

- Labour force participant in BiH who are
 - **YOUNG** and **MALE** INDIVIDUALS
 - **LESS EDUCATED**
 - **COMING FROM RURAL AREAS**
 - **ECONOMICALLY WEAK FAMILIES**
 - The effects between determinants built:
 - E.g. Education Income (1 1) vs (0 0) | 70%)
- Targeted group for policy makers

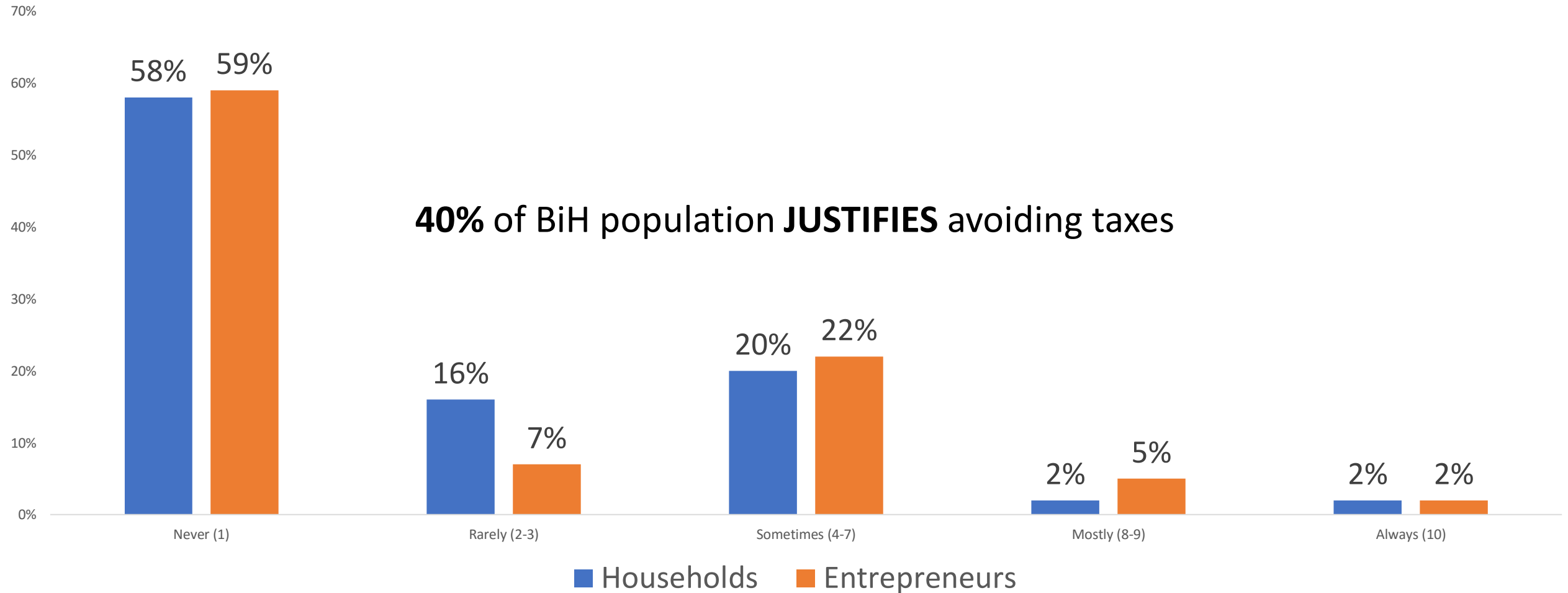


Potential drivers – institutional environment



Source: RRPP, 2015

Potential drivers – avoiding taxes is justified



Source: INFORM, 2017

Complex institutional environment

- At the state level: BiH Ministry of Finance and Treasury are responsible for establishing the principles of tax policy;
- At the entity levels: Ministry of Labour and Social Policy in FBiH and Ministry of Labour, War Veterans and Disabled Persons' Protection in RS are responsible for stipulating the labour law and social policy regulations;
- At the entity levels: the Federal Department for Inspection Affairs in FBiH and the the Republika Srpska Inspectorate are responsible for labour law violations;
- At the entity level: the Federal Ministry of Finance in FBiH and the RS Ministry of Finance are responsible for implementing tax policy following the guidelines and principles established at the state level;
- At the entity level: Tax administrations of FBiH and RS are responsible for the social security frauds.

Complex institutional environment

- HFI 2019: “The highly decentralized government hampers policy coordination and reform, while excessive bureaucracy, weak rule of law, and market segmentation discourage foreign investment. **Public perceptions of government corruption and misuse of taxpayer money motivate many to remain in the large informal economy**”.
- Tax wedge which is around 40%?
- Perception of corruption quite high?
- *War-related social benefits???*
- Other

Current policy approach – DIRECT - deterrence

	Used in BiH	% of EEA nations	% EEA stakeholders stating measure is:		
Policy			Effective	Neutral	Ineffective
DETERRENCE					
Penalties:		93	50	45	5
Administrative sanctions for purchasers/companies	✓	87	46	49	6
Administrative sanctions for suppliers/employees	✓	83	41	59	0
Penal sanctions for purchasers/companies	✓	74	59	33	8
Penal sanctions for suppliers/employees	✓	52	53	42	5
Measures to improve detection:		100	64	34	2
Data matching and sharing	✓*	83	72	25	2
Workplace inspections	✓	100	75	17	8
Registration of workers prior to starting work or on first day of work	✓	74	74	23	3
Coordinating strategy across government		57	56	44	0
Certification of business, certifying payments of social contribution and taxes	✓	65	62	33	5
Use of peer-to-peer surveillance (e.g. telephone hotlines)	✓	39	20	80	0
Coordination of operations across government		61	64	36	0
Coordination of data sharing across government		65	82	19	0
Mandatory ID in the workplace	✓	65	70	30	0

Current policy approach – DIRECT - preventative

	Used in BiH	% of EEA nations	% EEA stakeholders stating measure is:		
ENABLING COMPLIANCE:					
Preventative measures:		90	45	43	12
Reduce regulations		48	56	38	6
Simplify compliance procedures		87	62	38	0
Technological innovations (e.g. certified cash registers)	✓	43	73	27	0
New categories of work (e.g., for small or mini-jobs)		35	59	33	8
Direct tax incentives (e.g., exemptions, deductions)		61	57	33	10
Social security incentives	✓	35	62	15	23
Ease transition from unemployment into self-employment		65	29	63	8
Ease transition from employment into self-employment		44	15	77	8
Changing minimum wage upwards		48	24	59	18
Changing minimum wage downwards		9	0	50	50
Training & support to business start-ups	✓*	61	50	46	4
Micro-finance to business start-ups	✓*	52	48	52	0
Advice on how to formalise		61	33	67	0
Connecting pension schemes to formal labour	✓	61	47	41	12
Introducing supply chain responsibility		17	78	0	22

Current policy approach – INDIRECT – informal

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

TO SUM UP

- Undeclared economy and undeclared employment rather persistent phenomena in BiH economy
- Quite similar situation in the whole Western Balkans
- Current policy approaches need to be further improved using experience of the European Union
- Summary of the policy recommendations will be:
 - Strengthen cooperation among key institutions dealing with undeclared work in the Western Balkans,
 - Provide support to the holistic approach to tackling this challenge, and
 - Provide technical assistance in priority areas using EU support when possible

POLICY RECOMMENDATION FOR BiH

- Follows

POLICY RECOMMENDATIONS

• I. STRATEGIC MANAGAMENT INITIATIVES

- the governments' goal should be to enable the transfer from undeclared to declared economy
- treat undeclared work as a supplementary resource but not a problem that needs to be solved
- Change the narrative from “The fight against undeclared work” to “Transfer undeclared work into declared work”
- distinction between undeclared work and black economy, corruption
- undeclared work and surviving strategies of low-income individuals?

POLICY RECOMMENDATIONS

- **A holistic strategic approach towards tackling undeclared work**
- Establish a coordinating body at the state level
- To take responsibility for joining-up the strategies, operations and data gathering, sharing and analysis of all public agencies and social partners involved in tackling the undeclared work.
- **Harmonization and simplification of relevant legislations and procedures related to undeclared work**
- harmonized legislation that would minimize ambiguous situations in which companies, individuals and inspectors can find themselves

POLICY RECOMMENDATIONS

- **Establish an independent body or tailored teams that will investigate possible abuses in social security benefits**
- Appoint special inspectors to audit social security beneficiaries for possible abuses to restore trust in redistributive function of public policy.
- Special controls of people who enjoy social security benefits and work in undeclared sector is needed
- **Education of administrative staff and inspectors with the aim of transforming undeclared to declared work and tailoring their strategic objectives, KPIs and bonus policy**
- Shifting strategy on undeclared work from “penalization” towards “transformation into declared work”—inspectors should focus on mentoring employers to be tax-compliant instead of penalizing them

POLICY RECOMMENDATIONS

- **II. MEASURES TO DETER UNDECLARED WORK**

- **Harmonizing legislation: harmonizing fines for undeclared work**

- System of fines harmonized

- Predictability of the fines increased, which increases risk of detection

- **Improve efficiency of electronic systems for data gathering, data sharing and analysis**

- Centralise available data on undeclared work and make it available to the centralized body for research and analysis and policy recommendations

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POLICY RECOMMENDATIONS

- **Proactive engagement through normative notification letters**
- Send personalized appeals/notification letters to companies with below average wage levels compared to the sector of economy in which they operate, and those who are more likely to engage in undeclared work
- **Targeting and planning inspections which should implement an integrated control, instead of fragmented and more frequent inspections**
- Coordinate inspections between various enforcement authorities targeted at the same company.
- **Link the white list of companies (not having undeclared workers over the last 3 years) to the selection process for public procurement**
- Establish the white list of companies which can engage in public procurements

POLICY RECOMMENDATIONS

- **III. SUPPLY SIDE INCENTIVES**

- **‘White list’ of legitimate employers (‘black list’ for internal use only)**
- Promote companies who are legitimate employers and who respect labour law stipulations fully.
- **‘Business Walking Routes’ leaflets for tourists and/or ‘service providers leaflet’ in sectors where undeclared work is prevalent**
- Provide support in advertising activities to tourists and customers for white listed companies
- **Introduction of easy procedures (i.e. micro-enterprise tax) for paying taxes and contributions for self-employed and craftsmanship**
- To provide specific incentives to one-person and micro businesses to engage in declared work

POLICY RECOMMENDATIONS

- **IV. DEMAND SIDE INCENTIVES**
- **Giving discounts on electronic payments, instead of the widely-used practice of cash discounts**
- To stimulate electronic payments and decrease the cash operations which give more space for undeclared activities
- Consider discouraging easy access to cash

POLICY RECOMMENDATIONS

- **V. CHANGING CITIZENS' VALUES, NORMS AND BELIEFS**
- **Launch public awareness campaigns on the benefits of declared work**
- Insist on marketing tools to trigger emotions, which should lead to long-term improvements in tax morality
- **Educating citizens about the tax system and tax morality**
- Introduce signs such as “Paying your taxes enabled this!”
- **Incorporate tax compliance crash courses in undergraduate schools and university curriculums**
- **Thematic competitions (e.g. “best essay on”) on why being tax compliant and declaring employees**

POLICY RECOMMENDATIONS

- **VI. REFORMING FORMAL INSTITUTIONS**
- **Continuous training of inspectors**
- To include inspectors in staff-exchange with neighbouring countries, but also EU member states
- **General improvements in services offered by the formal institutions**
- To improve the internal processes of the formal institutions to increase the perceived benefits of being tax compliant
- **Modernisation of management processes in bodies responsible for tackling undeclared work**
- To improve the internal process of the formal institutions involved in transforming undeclared work into declared work

POLICY RECOMMENDATIONS

- **VII. IMPROVING THE INVOLVEMENT OF SOCIAL PARTNERS**
- **Signing a tripartite agreement between Government, Tax and Social security bodies and Social partners to join forces in preventing undeclared work**
- Effective cooperation and exchange of information vis-a-vis a better detection of undeclared work and necessity of increase of social fairness
- **Awareness raising campaign among business community about the benefits of declared work**
- Greater involvement of social partners in tackling the undeclared work