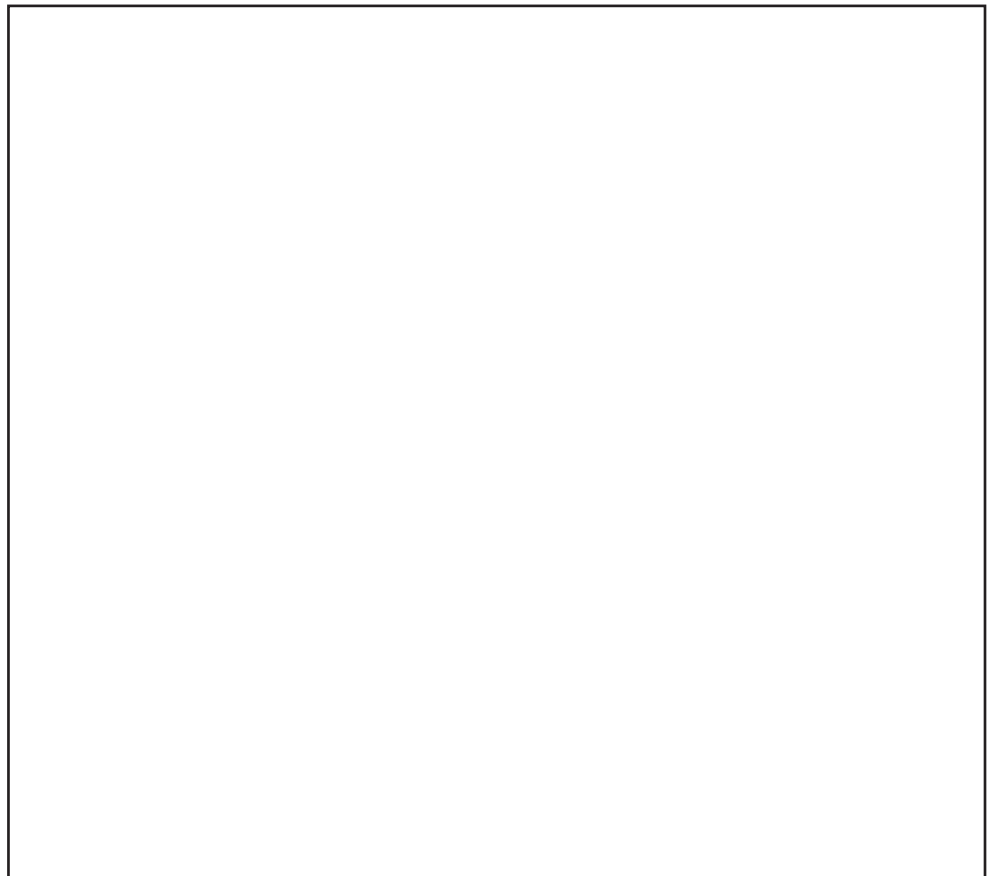




Eurofound

Tackling undeclared work in Montenegro



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Executive summary

Introduction

The aim of this report is to provide a systematic overview of the extent and nature of undeclared work, and how it is being tackled, in the EU candidate country of Montenegro. Montenegro has been classified by the World Bank as an ‘upper middle income’ country, having a GNI per capita of USD 6,690 in 2012. The objectives of the report are to analyse the prevalence and character of undeclared work in Montenegro, to examine how the fight against undeclared work is organised, and to review relevant policy approaches and measures adopted. Throughout the report, the situation in Montenegro is compared with the EU27 wherever feasible.

This report forms part of a research study into undeclared work in five countries: four candidate countries for EU membership (Iceland, Montenegro, Turkey and the former Yugoslav Republic of Macedonia) and one acceding country, Croatia.¹

Policy context

Montenegro has a large undeclared economy relative to the EU27. Although comparative data are not available on the size of its undeclared economy relative to the EU27, it has been estimated that 22.6% of all jobs are informal, of which 77% are in formal sector enterprises and 23% are in informal sector enterprises. In addition to this, many formal employees receive an undeclared ‘envelope wage’ from their employer as well as their official declared salary. The Institute for Strategic Studies and Prognoses (ISSP) found that a further 17.5% of registered employed people receive such an envelope wage and that their overall net wage is some 30% higher than their declared salary. For most, remuneration from undeclared work is their main income and is undertaken regularly (Miheš et al, 2010).

Much of the undeclared work in Montenegro is in the form of waged employment, which is similar to southern EU countries and is in stark contrast to northern EU countries, where most is conducted on an own-account basis. According to research conducted by the ISSP, such undeclared work mostly takes place in retail (38.1%), agriculture (18.2%), catering (19.1%), construction (10.8%) and transport (9.6%). This finding is reinforced by the World Bank Enterprise Survey 2009, which also found that the retail sector was most likely to experience competition from unregistered firms, and to view such work as a major constraint on its business, followed by manufacturing and then other service industries. Large firms, exporting businesses and foreign-owned businesses are less affected by informal businesses, and less likely to view them as a major constraint, than are smaller and medium-sized businesses, non-exporting businesses and domestically owned businesses.

There are, however, significant regional variations. While 77.5% of businesses in the relatively deprived northern region stated that they compete against unregistered or informal businesses, this figure is just 28.6% in the central and southern regions and 21.4% in the coastal region. Similarly, a greater proportion of businesses in the north viewed unregistered businesses as a major constraint.

The annual World Bank Doing Business surveys analyse how easy or difficult it is for a local entrepreneur to open and run a small-to-medium-sized business when complying with relevant regulations. Comparing the findings with 182 other countries, Montenegro was ranked 56th out of 183 in 2011 and 2012 in terms of ease of doing business, compared with the EU27 as a composite, which was ranked 38th in 2012. Doing business is therefore more difficult in Montenegro than in the EU27. In terms of ease of starting a business, Montenegro was ranked 47th out of 183 countries, compared with

¹ At the time of writing, Croatia was expected to become an EU Member State on 1 July 2013.

66th for the EU27 as a composite. In Montenegro, starting a business requires six procedures, takes 10 days and costs 1.8% of income per capita. In relation to ease of paying taxes, Montenegro stands at 108th in the ranking of 183 economies, compared with 71st for the EU27 as a composite. On average, firms in Montenegro make 42 tax payments a year, spend 372 hours a year filing, preparing and paying taxes, and pay total taxes amounting to 7.1% of profit. Compared with the EU27, starting a business is easier in Montenegro while paying taxes is more difficult.

Key findings

Organisation of efforts against undeclared work

A 2010 study of 31 European countries (Dekker et al, 2010) found that only eight countries (26%) had either a single agency responsible for the fight against undeclared work or a central coordinating committee responsible for ensuring coordinated action by the multifarious departments involved in tackling undeclared work. In most of the remaining 23 countries, a main department was responsible. In Montenegro, no one single compliance unit or central committee is responsible for tackling undeclared work. Neither is there a leading department. Instead, different governmental organisations are responsible for different aspects of undeclared work. The Labour Relations department of the Ministry of Health, Labour and Social Welfare deals with the preparation, monitoring and improvement of labour legislation. The implementation of these laws is mainly undertaken by the Labour Inspectorate and the Safety at Work Inspection. Furthermore, the Employment Agency of Montenegro, the National Pension Fund, the Health Care Fund and others are included in both the drafting and implementation of labour market policies.

Involvement of social partners occurs through the Social Council of Montenegro, involving the Confederation of Trade Unions (CITUM) and the Association of Employers of Montenegro. An action plan for the suppression of undeclared work, developed with assistance from the International Labour Organization (ILO), has been adopted by the Social Council, with a focus on awareness-raising and information campaigns.

Policy approaches

In Montenegro, the drive against undeclared work is in its infancy. Although deterrence measures have been given primary importance, there are only 27 labour inspectors, so this approach is far from being effective. The institutions and structures being employed to tackle undeclared work are young and developing, as is the organisation of tripartite social dialogue. When these issues are considered alongside the fact that the number of formal companies has rapidly expanded recently, it must be recognised that it has been difficult to develop an adequate institutional framework. Although deterrence measures have been created, as have a range of mostly preventative and curative measures, the institutional framework in Montenegro requires further development before it can become more effective in tackling undeclared work.

Policy pointers

Montenegro needs to develop a greater deterrence capability; to introduce a wider range of enabling policy measures, especially to transform undeclared work into declared work; to pursue 'softer' measures to engender a commitment to tax morality; and to better coordinate the campaign against undeclared work, by establishing a single agency or coordinating committee, or by delegating responsibility to one government department. This report provides evidence of a strong correlation between countries in which there is greater labour market intervention, social protection, redistribution and equality and smaller undeclared economies.

Introduction

Europe's struggle with economic recession and historically high unemployment levels has put the issue of undeclared work high on the political agenda, not least due to the significant impact it has on public finances and employment participation rates. This report forms part of a research study into undeclared work in five countries: four candidate countries for EU membership (Iceland, the former Yugoslav Republic of Macedonia, Montenegro and Turkey) and one acceding country, Croatia.

Aims of the report

The aim of this report is to provide a systematic overview of the extent and nature of undeclared work, and how it is being tackled, in Montenegro. The objectives are to analyse the prevalence and character of undeclared work in Montenegro, to examine how the fight against undeclared work is organised, and to review the relevant policy approaches and measures adopted. Throughout this report, the intention is to compare the extent and nature of undeclared work and how it is being tackled in Montenegro with the situation in Europe. The main questions being addressed are:

- What is the extent and nature of undeclared work in Montenegro and how does this compare with the rest of Europe?
- What institutional structures and policy approaches are used in Montenegro to tackle undeclared work and how do these compare with the EU27?
- Which specific policy measures have been adopted that appear to be effective in tackling undeclared work?
- What lessons might be learnt from Europe more widely in terms of policy measures when tackling undeclared work in Montenegro?
- What lessons can the EU27 learn from practices in Montenegro?

Methodology and data collection

First a comprehensive literature review was conducted, which included academic sources, literature published by the government and social partners, and statistical research. The completed review comprises three elements, outlined below.

- ***A review of surveys of undeclared work in Montenegro:*** As with other European and EU candidate countries, Montenegro is included in cross-national databases such as the World Bank Enterprise Surveys, the World Bank Doing Business surveys, as well as many cross-national surveys using indirect measurement methods (see Schneider, 2011; European Commission, 2008). National-level surveys and 'grey literature' reporting the extent and nature of undeclared work are also available, and where feasible, these are compared with the situation in the rest of Europe.
- ***A desk-based review of the institutional approach to fighting undeclared work in Montenegro:*** This includes both published and grey literature on the organisation of the fight against undeclared work in Croatia. Findings are compared with approaches taken in the EU27, using typologies developed for comparing the Member States (Dekker et al, 2010).
- ***A desk-based survey of policy measures and initiatives:*** The range of policy instruments used in Montenegro, including those undertaken by social partners and sector-specific organisations, are reported and compared with the rest of Europe.

Second, to provide both up-to-date information and fill gaps in understanding, an online survey and telephone interviews took place with three key stakeholders, including senior officials in government departments involved in combating undeclared work and representatives of social partner organisations. Information was sought on the extent and nature of undeclared work in Montenegro, the organisation of the efforts against it and policy approaches and measures used,

along with their perceived effectiveness. This survey was based on the method recently applied across the EU27, enabling comparative data to be collected (Dekker et al, 2010). Thirdly, a validation workshop took place in November 2012 with experts and representatives of key stakeholders in the four EU candidate countries and Croatia.

The outcome is a wide-ranging review of the extent and nature of undeclared work in Montenegro and how undeclared work is being tackled compared with the situation in the rest of Europe.

Research background

Although there is no official definition of undeclared work in the EU27, the widely accepted definition is that it covers ‘any paid activities that are lawful as regards their nature, but are not declared to the public authorities, taking into account the differences in their regulatory systems between Member States’ (European Commission, 2007a, p. 2).

There is now a considerable body of research and policy documents on undeclared work in the EU27. These reports aim to understand, conceptualise, measure and tackle undeclared work in these countries. Since the turn of the millennium, important research has been commissioned by the European Commission on both the extent and nature of undeclared work in the EU27, on how it is being tackled and what can be done in the future. The situation in Montenegro can be compared to these data.

The studies *Undeclared labour in Europe* (Mateman and Renooy, 2001) and *Undeclared work in an enlarged Europe* (Renooy et al, 2004) provide some of the first estimates of the extent and character of undeclared work in the Member States. The European Employment Observatory (2004) published a further overview, entitled *Fighting the immeasurable? Addressing the phenomenon of undeclared work in the European Union*. More recently, in order to gain a better understanding of the phenomenon, the European Commission instigated both a direct survey (European Commission, 2007b) and a review of indirect survey methods (European Commission, 2009).

During the same period, significant policy shifts occurred. Following the 2003 Council recommendation in Employment Policy Guideline No. 9 to shift away from a deterrence approach and towards the transformation of undeclared work into regular work (rather than simply eradicating it), and the reiteration of this stance in the Commission’s second communication on undeclared work, ‘Stepping up the fight against undeclared work’ (European Commission, 2007a), a number of initiatives have taken place. Eurofound commissioned studies in both 2007 and 2009 to identify how this might be achieved (Eurofound 2008, 2009), as well as compiling a knowledge bank of good practice policy measures (see <http://www.eurofound.europa.eu/areas/labourmarket/tackling/search.php>); this was fully updated in 2013 to include cases from Croatia, Iceland, the former Yugoslav Republic of Macedonia, Montenegro and Turkey. The Commission evaluated the feasibility of developing a European platform to better coordinate the fight against undeclared work across the EU27 (Dekker et al, 2010). All this research provides a solid evidence base against which the extent of undeclared work in Montenegro, and various strategies for tackling it, can be compared.

With a population of 625,516, the World Bank defines Montenegro as an ‘upper middle income’ country, with a GNI per capita of USD 6,690 (World Bank, 2012). In the second quarter of 2010 in Montenegro, the active population was 252,400, of which 202,300 (38.9%) were in employment. In June 2010, the average gross monthly salary in Montenegro was €706, and the average net salary was €473 (Simović, 2011). The minimum wage of an employee working full time for an average of 176 hours a month cannot be lower than 30% of the average wage in Montenegro in the previous six months. In this sense, the minimum wage in 2010 was €160. The unemployment rate in Montenegro in November 2010 was 12% (Simović, 2011).

Extent and nature of undeclared work

Several cross-national surveys enable the extent and nature of undeclared work in Montenegro to be compared with the situation in the rest of Europe and beyond, including the World Bank Enterprise Survey and Doing Business surveys. In addition, two major national surveys have been conducted in Montenegro. The Institute for Strategic Studies and Prognoses (ISSP) conducted a survey in 2007 (ISSP, 2010) and the Union of Free Trade Unions of Montenegro (UFTUM) conducted a survey between June and August 2011 involving 103 respondents who self-identified as engaging in undeclared or under-declared work (UFTUM, 2011). The UFTUM's six regional offices carried out the survey across Montenegro, ensuring geographic representation of the coastal areas (Bar, Herceg Novi), the central region (Nikšić, Podgorica) and the north of the country (Bijelo Polje, Plevlja). Attention was also paid to gender and ethnic parity.

Extent of undeclared work

According to Mihes et al (2010), in the years preceding independence, levels of undeclared work were about 5% of GDP and mostly involved personal services such as home improvement and repair, or the exchange of home-grown agricultural goods. Since hardly any private enterprises existed, it was easy for the labour inspection officers to spot undeclared work. Following the transition to independence, undeclared work spread quickly, with the breaking away of former industries and UN sanctions meaning that even formerly middle class workers were forced to work in the undeclared economy to make a living.

In Montenegro, similar to other countries, there are many estimates regarding the size of the undeclared economy. These estimates vary according to the measurement methodology employed so it is important to be aware of the methods used. Table 1 reports the results of the World Bank Enterprise Survey 2009, which involved interviews with 116 firm owners, with the same questions used across many countries. Over one-quarter (27.3%) of firms reported that they compete against unregistered firms, and 10.7% reported that the practices of informal sector competitors represent a major constraint on the growth of their business (compared with 45.2% and 28.7% in eastern Europe and central Asia respectively). Some 95.5% of the firms surveyed reported that they were formally registered when they started operations. The 4.5% that were not operated on average for just 0.2 years without formal registration.

Table 1: *Prevalence of undeclared work in Montenegro*

| | Montenegro | Eastern Europe and Central Asia | World |
|---|------------|---------------------------------|---------|
| Firms competing against unregistered firms (%) | 1.9 | 675,614 | 194,288 |
| Firms identifying practices of competitors in informal sector as a major constraint (%) | 13.1 | 296,690 | 69,189 |
| Firms formally registered when they began operating (%) | 29.8 | 321,229 | 72,346 |
| Years operated without formal registration (no.) | 914.6 | 816,406 | 191,414 |

Source: *World Bank Enterprise Survey, 2009*

Until recently, as highlighted by Sisevic et al (2005), reliance was placed on indirect measurement methods using proxy indicators when measuring the extent of undeclared work. In 2007, however, the ISSP conducted a direct survey on undeclared work. This revealed that 22.6% of all jobs are informal, amounting to about 50,000 people, of whom 77% are working in formal sector enterprises and 23% are working in informal sector enterprises (ISSP, 2007, 2010). Under-declared employment also emerged, whereby registered employees receive from their employer two wages – an official declared salary and an unofficial undeclared ‘envelope’ wage. ISSP (2010) found that 17.5% of registered employed persons receive such an envelope wage and that their overall net wage is some 30% higher than their declared salary. For most of these undeclared workers, their remuneration from undeclared work is regarded as their main income and is undertaken regularly (Mihes et al, 2010). Furthermore, around 40% of informally employed workers have been employed for at least two years (Mihes et al, 2010). Some 75% of undeclared workers earn under €400, which is below the national average wage (UFUTM, 2011).

Examining the extent of undeclared work from the demand side, more than 50% of people asked had purchased either goods or services in the undeclared economy within the previous 12 months. Most of the demand was for goods or services associated with personal services, repair services, home improvement and maintenance, and agriculture. Nearly one-third of the people interviewed had undertaken undeclared work themselves in the previous 12 months (Sivec, 2008).

Nature of undeclared work

Sector variations

According to research conducted by the ISSP (2010), undeclared work mostly takes place in retail (38.1%), agriculture (18.2%), catering (19.1%), construction (10.8%) and transport (9.6%). The World Bank Enterprise Survey (2009) provides data that enable a cross-national, comparative analysis of variations in the undeclared economy across sectors in Montenegro. In 2009, and as Table 2 shows, businesses in the retail sector were most likely to witness competition from unregistered firms, followed by manufacturing and then other service industries. The activities of unregistered businesses were more likely to be perceived as a major constraint on formal businesses by those in the retail sector, followed by manufacturing and then other services; this reinforces the findings of national-level survey research by ISSP (2010).

Table 2: *Competition from the undeclared economy in Montenegro*

| | Firms competing against unregistered or informal firms (%) | Firms identifying practices of competitors in informal sector as a major constraint (%) | Firms formally registered when started operations in country (%) | Years operated without formal registration (no.) |
|------------------------------|--|---|--|--|
| All | 27.3 | 10.7 | 95.5 | 0.2 |
| By sector: | | | | |
| Manufacturing | 27.5 | 10.6 | 84.9 | 1.0 |
| Retail | 34.5 | 14.0 | 94.3 | 0.2 |
| Other services | 22.2 | 8.9 | 98.9 | 0.0 |
| By firm size: | | | | |
| Small (5-19 employees) | 25.6 | 8.4 | 96.7 | 0.2 |
| Medium (20-99 employees) | 35.1 | 21.6 | 90.4 | 0.1 |
| Large (100+ employees) | 23.3 | 11.0 | 92.0 | 0.3 |
| By location: | | | | |
| Central and south | 28.6 | 13.4 | 93.8 | 0.3 |
| Coast | 21.4 | 4.3 | 98.6 | 0.0 |
| North | 77.5 | 19.5 | 93.4 | 0.5 |
| By exporting status: | | | | |
| Direct exports 10%+ of sales | 2.1 | 9.5 | 100.0 | 0.0 |
| Non-exporter | 29.3 | 10.7 | 95.1 | 0.2 |
| By exporting status: | | | | |
| Domestically owned | 24.3 | 11.1 | 95.3 | 0.2 |
| Foreign owned | 82.4 | N.A. | 100.0 | 0.0 |

Note: N= 116

Source: World Bank Enterprise Survey 2009

Socioeconomic, business and geographical variations

Table 2 shows that large and small firms appear to be less affected by the existence of unregistered businesses than medium-sized businesses. While over one-third of medium-sized businesses assert that they compete against unregistered firms, only one-quarter of small and large firms assert that this is the case. Indeed, medium-sized businesses are far more likely than small or large businesses to assert that unregistered businesses represent a major constraint. Related to this, non-exporting businesses are more likely to experience competition from unregistered businesses and are more likely state that the undeclared economy constrains their business than are exporting businesses, perhaps reflecting the prevalence of the undeclared economy in the retail sector.

Significant regional variations also occur in the prevalence of the undeclared economy. While 77.5% of businesses in the northern region state that they compete against unregistered businesses, this figure is just 28.6% in the central and southern region and 21.4% in the coastal region. Similarly, a greater proportion of businesses in the northern region view unregistered businesses as a major constraint.

There are, furthermore, marked variations in terms of who engages in undeclared work in Montenegro.

- A total of 60% of undeclared workers are men (ISSP, 2010). In a study by the Union of Free Trade Unions of Montenegro (UFTUM), women made up 49% of the sample and had nearly identical educational levels to the men surveyed, but were overwhelmingly concentrated in the lower tier in terms of the wages received for undeclared work (UTUFM, 2011). The study also found that undeclared women workers were twice as likely as men to want to join a trade union.
- Regarding age, 14.1% of participants in the undeclared economy are under 25 years old, 40.4% are between 26 and 40 years old, while the highest proportion (45.6%) are over 41 years old (ISSP, 2010). Among the 10% of those aged 65 years and over who are still in employment, almost all are engaged in undeclared employment, 95% on an irregular basis, although regular jobs are becoming more common over time (ISSP, 2010). According to UNDP (2002) surveys, 27% of undeclared workers are pensioners, indicating that pensions are too low to cover basic expenditures.
- The majority (63.8%) of undeclared workers have a second-level education, 27.2% have a college degree, 6.5% have a primary school qualification, while 2.5% have not completed primary school.
- The highest share of those engaged in the undeclared economy are those who have completed the four years of secondary school (45%) and those who have completed three years of school (27.2%). No one with a PhD, only 0.5% of those with a postgraduate degree and 0.4% of those who have not completed school engage in undeclared work (ISSP, 2010).
- The majority of undeclared workers (54%) live in urban areas, with 46% living in rural areas of the country. Montenegro is divided into 21 municipalities within three administrative regions: the centre, with the capital Podgorica; the south, a mainly coastal region where the tourism sector is concentrated; and the northern mountainous area. There are significant regional differences, with the north lagging behind in terms of economic development and labour market performance, and with the highest level of undeclared work: 45.6% of undeclared work in the country takes place in the north, 30.6% in the south, and 23.8% in the centre (ISSP, 2009, 2010). This reinforces the findings in Table 2 above. The poverty rate in the northern region in 2007 was 14%, while in the central region it was 6.3% and in the south it was 2.2%. The poverty rate in rural areas was more than twice that in urban areas.

Types of undeclared work

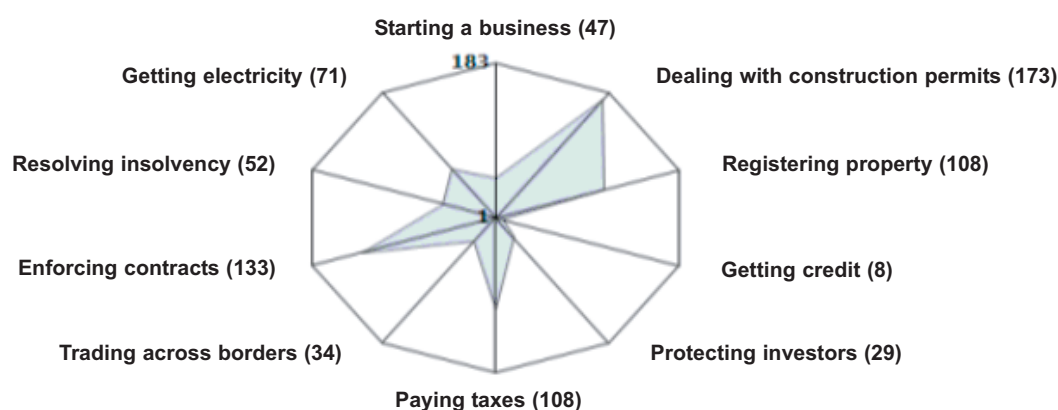
In the EU27, it is now recognised that both undeclared work (which might be waged employment, undeclared self-employment or paid favours conducted for closer social relations) and under-declared work (‘envelope wages’) exist. In Montenegro, according to the ISSP (2010), 22.6% of all employment is in informal sector companies or is informal employment in formal companies, and 17.5% of registered employed persons receive an envelope wage. More than 50% of those interviewed claimed to prefer regular wages over envelope wages (Miheš et al, 2010).

Simović (2011), reporting data from Monstat (the Statistical Office of Montenegro), arrived at a broadly similar conclusion, having found that 96.7% of employees had a written employment contract, 2.6% had a verbal contract with their employer and 0.7% had no contract of employment, although these data only relate to formal businesses. The occurrence of envelope wages is widespread in Montenegro, especially in the construction sector where the majority of workers are paid partially through envelope wages (Sisević, 2008) with only the national minimum wage being registered as the official salary.

Barriers to formalisation

The annual World Bank Doing Business surveys comprise one of the few data sources on the barriers to formalisation in Montenegro. These provide data on how easy or difficult it is for a local entrepreneur to open and run a small-to-medium-sized business when complying with relevant regulations. As the survey is conducted annually in 183 countries, these data can be compared with the situation in other countries. It measures and tracks changes in regulations affecting 10 areas in the life cycle of a business: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency. Montenegro was ranked 56th out of 183 in both 2011 and 2012 in terms of ease of doing business, while the EU27 as a composite was ranked 38th in 2012. Montenegro performs better in some doing-business indicators than in others, relative to other countries (see Figure 1).

Figure 1: Montenegro’s rankings on aspects of doing business



Source: World Bank (2012, Figure 1.3)

Montenegro was ranked 47th out of 183 countries in terms of ease of starting a business, while the EU27 was ranked 66th. In Montenegro, starting a business requires six procedures, takes 10 days, costs 1.8% of income per capita and requires paid-in minimum capital of 0% of income per capita. In 2010, efforts were made to simplify the process of starting a business; registration for taxes, social security, and employment, as well as the process of obtaining a municipal license were all made easier. In 2011, Montenegro eliminated several procedures for business start-up by

introducing a single registration form for submission to the tax administration, while in 2012 it made starting a business easier by implementing a one-stop shop (World Bank, 2012, p. 20).

Montenegro currently stands at 108th place in the ranking of 183 economies regarding ease of paying taxes, while the EU27 is ranked 71st. On average, firms make 42 tax payments a year, spend 372 hours a year filing, preparing and paying taxes, and pay total taxes amounting to 7.1% of profit (World Bank, 2012, pp. 71–72). In 2010, the corporate income tax rate was cut by almost half to 9%, and social security tax rates were reduced to 12% for 2009 and again to 9% for 2010. In 2011, an amendment to Montenegro's corporate income tax law removed the obligation for advance payments and abolished the construction land charge. In 2012, Montenegro made paying taxes easier and less costly for firms by abolishing a tax, reducing the social security contribution rate and merging several returns into a single unified one (World Bank, 2012, p. 73).

Organisation of efforts against undeclared work

Cross-government cooperation

Analysing how the fight against undeclared work is organised in 31 European countries, Dekker et al (2010) found that only eight countries (26%) had established one body dedicated to combating undeclared work. This was either a single agency responsible for tackling undeclared work or a central coordinating committee responsible for ensuring coordinated action by the multifarious departments involved in tackling undeclared work.

As Table 3 shows, tax offices, social security administrations and labour inspectorates can take this central role, depending on the country concerned. In Nordic countries, the tax administration tends to take this role, not least because much of the undeclared work there is conducted as self-employment, a type of undeclared work that is of less interest to labour inspectorates. In much of southern and east-central Europe, waged work is a more prominent type of undeclared work and the focus is therefore on employer–employee relations; the labour inspectorate has greater responsibility.

Table 3: *Main authority for tackling undeclared work in 31 European countries*

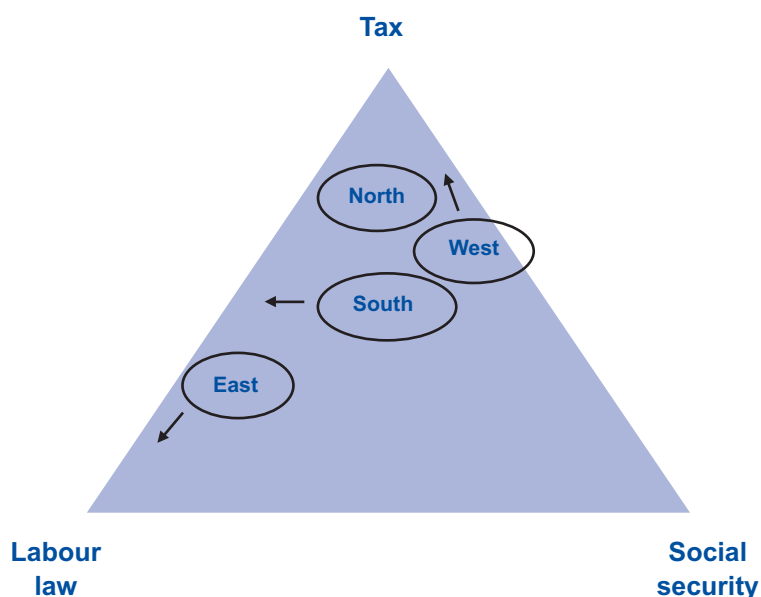
| Labour inspectorate | Social security administration | Tax administration |
|---|---|---|
| Bulgaria, Cyprus, Czech Republic, Greece, Hungary, Italy, Iceland, Latvia, Lithuania, Malta, Luxembourg, Poland, Portugal, Romania, Slovakia, Slovenia, Spain | Belgium, France, Switzerland, Liechtenstein | Austria, Denmark, Estonia, Germany, Finland, Ireland, Netherlands, Norway, Sweden, United Kingdom |

Source: Dekker et al (2010)

Figure 2 summarises where the balance of responsibility lies between the various authorities in different European regions. In northern European countries, it is predominantly the tax authorities who take the leading role in formulating policy on undeclared work. In western European countries, although the tax authorities again take the leading role, greater contributions are made by the social security authorities. In southern European countries, a more equal contribution is made by all three bodies whilst in east-central Europe, responsibility lies much more with the labour inspectorates and less with the tax and social security authorities.

Figure 2 also identifies how the balance of responsibility is shifting over time. Although little if any change has occurred in northern European countries, with the tax authorities remaining predominantly responsible for tackling undeclared work, in western European countries, the dominance of the tax authorities is growing. In southern countries, a shift is occurring away from an equal role played by all three bodies and towards greater responsibility being taken by the tax and labour authorities.

Figure 2: Responsibility for undeclared work in the regions of Europe



In Montenegro, no single agency or coordinating committee is responsible for tackling undeclared work. Neither does any one department take responsibility. Instead, different government agencies take responsibility for varying aspects of the fight against undeclared work. The labour relations department of the Ministry of Health, Labour and Social Welfare deals with the preparation, monitoring and improvement of labour legislation. The implementation of these laws is mainly undertaken by the Labour Inspectorate and the Safety at Work Inspection. The tax office also plays a role. Furthermore, the Employment Agency of Montenegro, the National Pension Fund, the Health Care Fund and others are included in both the drafting and implementation of labour market policies.

The Labour Inspectorate is responsible for dealing with labour law violations associated with undeclared work, although it is relatively poorly resourced, employing only 27 inspectors to tackle undeclared work. In 2008, they managed to inspect one-third of all companies in Montenegro. In 1.1% of all the companies investigated, irregularities were found. Most incidents were discovered in the hotel sector, in trades, agriculture and construction sectors. Although the number of companies in Montenegro increased from around 3,500 to 25,000 between the early 1990s to the present, the resources and competencies of the Labour Inspectorate have not in turn increased, making it very difficult to provide an effective inspection service.

The tax administration is responsible for collecting taxes and detecting tax non-compliance. In Montenegro, the tax administration is organised into eight regional and one national office. To reduce tax evasion, new laws on corporate tax and personal income tax were introduced that simplified compliance, reducing in both cases the tax rate to a flat rate of 9%. Despite this, tax inspections still discovered irregularities in 50% of all companies inspected in 2008. Inspections in the tourist industry found irregularities in 70% of all checks carried out in 2008 (Miheš et al, 2010).

Historically, government departments in Montenegro have operated separately, in 'silos'; recently, however, they have started to increasingly cooperate with each other and with social partners. The government has combined various inspection bodies in Montenegro in a joint coordinating body, thereby creating synergy and more efficient operations.

For example, in June 2012 the Labour Inspectorate began to intensify inspections in coastal areas. This work is carried out by local inspectors in coastal municipalities, who continue to perform their regular jobs while increasing the amount of data collected required for a more efficient operation of labour inspections during the peak season. In this context, inspectors have established good cooperation with the Employment Agency of Montenegro, which makes available lists of work permits for foreigners. Inspectors also work with local government to access information on employers with temporary seasonal work permits. All these steps aim towards greater success in inspections, as they focus on seasonal employers with special attention placed on controlling the employment of non-resident persons, whose number increases enormously during the tourist season (Pobjeda, 2012).

Without such cooperation the results would have been very different because the national Labour Inspectorate is poorly resourced with only 27 inspectors. This kind of data sharing is a good example of how cross-agency cooperation can increase the effectiveness of detecting undeclared work and is thus far proving successful in Montenegro, especially during times when an increase occurs in the foreign labour force.

Conferences and seminars take place where cooperation takes the form of sharing of ideas and forming strategies to tackle undeclared work. At these events, members from various government departments as well as social partners are present. Educational seminars are also held, with one party taking the lead in either presenting new information on the informal economy or together, departments inform the public of the specificities of action plans being taken or laws being passed. This kind of cooperation is not only fruitful for generating new ideas for tackling undeclared work; it also presents a more unified picture of the government to its citizens, thereby increasing trust.

Role of social partners

In Montenegro, 22 branch level trade unions are organised under the umbrella of the Confederation of Trade Unions (CITUM). Similarly, various branch organisations for employers are organised under the umbrella of the Association of Employers of Montenegro. Both umbrella organisations are becoming more active in the collective bargaining process. In 2001, the Social Council of Montenegro was created and in 2003, the newly amended Labour Law gave the social partners more ownership and involvement in collective agreements. Among the ambitious tasks of the Social Council are the drafting of opinions on government policies and the undertaking of research on national policies, which should serve as the basis of recommendations made to the government. Nevertheless, the Social Council lacks funding and staff and has therefore not yet achieved its objectives (Miheš et al, 2010). It is established as a tripartite body, made up of 11 representatives of the government, representatives of trade unions and of employers.

As no employer representative organisation was in existence before the transition, the organisation had to be established from grassroots level in 2002 with support of the ILO and the International Organisation of Employers (IOE) (Simović, 2011). The representative employers' organisation is the Association of Employers of Montenegro, whose members are entrepreneurs from small and medium enterprises and large businesses. The members of the Association of Employers of Montenegro account for around 80% of the total GDP of the Montenegrin economy and employ more than 50% of the national workforce.

In Montenegro, trade union pluralism emerged in November 2008, leading to the need for the adoption of the Law on Trade Union Representation. This law came into force and 11 representatives of the trade union movement now sit on the Social Council. As noted by Simović (2011), there are two unions at state level: the Confederation of Trade Unions of Montenegro and the Association of Free Trade Unions of Montenegro. According to data from the Association of Free Trade Unions of Montenegro, this association has 22,000 members (19,000 of whom pay affiliation fees), which is 12.5% of the employed workforce.

An action plan for the suppression of undeclared work (developed with ILO assistance) has been adopted by the Social Council. Implementation began with a focus on awareness raising and information gathering for the Labour Inspectorate and social partners (European Commission, 2011). When it comes to creating amendments to relevant laws and regulations on undeclared work, many of the suggestions made by the Association of Montenegrin Employers are respected by legislative policymakers. However, the association is of the belief that scope remains for further improvement in this sphere (Pobjeda, 2012).

In September 2009, the social partners, the Ministry of Health, Labour and Social Welfare (MHLSW) and an ILO delegation met for a national tripartite conference within the framework of the Social Council. This focused on addressing the problem of undeclared work. As a result, an action plan was drafted, which spelled out areas for immediate medium-term and long-term action to tackle informal employment. The action plan proposes active and more direct involvement of the social partners in the realisation, monitoring and evaluation of all measures and activities as a necessary precondition for its successful implementation (Miheš et al, 2010).

Policy approaches to undeclared work

Typology of policy approaches

In the EU27, tackling undeclared work has been traditionally dominated by a repressive approach that seeks to stamp it out through increasing the costs associated with working undeclared. This is achieved by increasing the penalties or the perceived or actual likelihood of being caught. Since the turn of the millennium, however, calls have been made by the European Commission for governments to transform undeclared work into declared work rather than simply repress it, and to do so by adopting measures that change the benefits side of the equation, making it more beneficial and easier to engage in declared work (European Commission, 2003a, 2003b, 2003c). Indeed, at the 2003 Lisbon Summit of the European Council, Employment Policy Guideline No. 9 was published on ‘transforming undeclared work into regular work’, which states:

Member States should develop and implement broad actions and measures ... which combine simplification of the business environment, removing disincentives and providing appropriate incentives in the tax and benefits system, improved law enforcement and the application of sanctions.

(European Commission, 2003b, pp. 9)

Further stimulation to move in this direction was provided by the European Commission (2007a) in its second communication on undeclared work, which explicitly called for Member States to transform undeclared work into declared work. As the report (2009) notes, three approaches exist: preventative measures that stop from the outset occurrences of non-compliance; curative measures to help those already working undeclared to transfer into the declared realm; and commitment measures that foster an allegiance to tax morality.

Policy approach in Montenegro compared with 31 other European countries

As Table 4 shows, 57% of stakeholders in the European Economic Area (EEA) and Switzerland state that repressive measures are accorded the most importance in their country when tackling undeclared work and just 43% deem measures that transform undeclared work into declared employment as being accorded the most importance. When asked to identify policy measures accorded the least importance, some 84% cited those seeking to transform undeclared work into declared employment, with only 16% citing repressive measures. The clear indication is that despite the call by the European Commission to transform undeclared work into declared employment, most countries remain entrenched in a repressive approach that seeks to stamp out undeclared work. The view that undeclared work needs to be transferred into the declared realm is far from being widely accepted.

Table 4: Stakeholders' views on the importance of different policy approaches in the EEA and Switzerland compared with four candidate countries and Croatia

| Types of measures | Most important | Second most important | Least important |
|---------------------------------------|----------------|-----------------------|-----------------|
| Repressive | 57 (80) | 17 (20) | 16 (0) |
| Preventative | 19 (20) | 46 (60) | 23 (0) |
| Curative | 14 (0) | 19 (20) | 32 (60) |
| Fostering commitment to declared work | 10 (0) | 18 (0) | 29 (40) |

Note: Figures for the other countries (Iceland, Turkey and the former Yugoslav Republic of Macedonia and Croatia) are provided in brackets.

Source: Dekker *et al* (2010)

This is also the case in the four candidate countries and Croatia, where the widespread view is that repression measures to tackle undeclared work are accorded most importance. Montenegro is no exception. Interviews with government officials and social partners strongly confirm that deterrence remains the prominent policy approach, although it is recognised that a much wider range of measures are being introduced, even if they are not yet accorded the same importance as deterrence in the fight against undeclared work.

As Table 5 shows, the 30 EEA countries and Switzerland were continuing to use repressive measures aimed at stamping out undeclared work, with all seeking to improve detection and 93% using penalties or sanctions. However, they are also pursuing measures to change the ‘benefits’ side of the equation by making it easier and more beneficial to operate in the declared economy, as called for by the European Commission. In total, 90% of these countries have adopted one or more preventative policy measure, although the range of measures used is relatively narrow beyond simplifying compliance. In addition, 64% use one or more curative measures, although again the range used is narrow beyond the use of targeted direct tax incentives (such as income tax relief, tax reduction and subsidy schemes). Moreover, recognition has occurred of the need to shift from a ‘harder’ policy approach, which changes the cost/benefit ratio confronting suppliers and purchasers, and towards a ‘softer’ approach that seeks to move away from compliance and towards engendering a commitment to tax morality; 69% of the 31 countries have adopted some commitment measure.

Table 5: Policy measures used in Montenegro and 31 other European countries to tackle undeclared work

| Measures | Used in Montenegro | % of 31 other European countries using measure |
|---|--------------------|--|
| Repressive measures | | |
| <i>Penalties</i> | | 93 |
| Administrative sanctions for purchasers/companies | ✓ | 87 |
| Administrative sanctions for suppliers/employees | | 83 |
| Penal sanctions for purchasers/companies | ✓ | 74 |
| Penal sanctions for suppliers/employees | | 52 |
| Measures to improve detection | | |
| Data matching and sharing | ✓ | 83 |
| Workplace inspections | ✓ | 100 |
| Registration of workers prior to starting work or on first day of work | ✓ | 74 |
| Coordinating strategy across government | ✓ | 57 |
| Certification of business, certifying payments of social contribution and taxes | ✓ | 65 |
| Use of peer-to-peer surveillance (e.g. telephone hotlines) | ✓ | 39 |
| Coordination of operations across government | ✓ | 61 |
| Coordination of data sharing across government | ✓ | 65 |
| Mandatory ID in the workplace | | 65 |
| Measures enabling compliance | | |
| <i>Preventative measures</i> | | 90 |
| Reduce regulations | ✓ | 48 |
| Simplify compliance procedures | ✓ | 87 |
| Technological innovations (e.g. certified cash registers) | ✓ | 43 |
| New categories of work (e.g. for small or mini-jobs) | | 35 |
| Direct tax incentives (e.g. exemptions, deductions) | | 61 |
| Social security incentives | | 35 |
| Ease transition from unemployment into self-employment | ✓ | 65 |
| Ease transition from employment into self-employment | ✓ | 44 |

| Measures | Used in Montenegro | % of 31 other European countries using measure |
|--|--------------------|--|
| Measures enabling compliance | | |
| <i>Preventative measures</i> | | 90 |
| Changing minimum wage upwards | ✓ | 48 |
| Changing minimum wage downwards | | 9 |
| Training and support to business start-ups | ✓ | 61 |
| Micro-finance to business start-ups | ✓ | 52 |
| Advice on how to formalise | ✓ | 61 |
| Connecting pension schemes to formal labour | ✓ | 61 |
| Introducing supply chain responsibility | | 17 |
| Restricting free movement of (foreign) workers | | 43 |
| <i>Curative measures</i> | | 64 |
| Stimulate purchasers to buy declared | | |
| Service vouchers | | 26 |
| Targeted direct tax incentives | | 61 |
| Targeted indirect taxes | ✓ | 17 |
| Stimulate suppliers to formalise | | |
| Society-wide amnesties | | 9 |
| Individual-level amnesties for voluntary disclosure | | 17 |
| Formalisation advice to business | | 30 |
| Formalisation support services to businesses | | 30 |
| Targeted VAT reductions | | 17 |
| Free record-keeping software to businesses | | 13 |
| Fact sheets on record-keeping | | 22 |
| Free advice/training on record-keeping | | 22 |
| Gradual formalisation schemes | | 13 |
| <i>Fostering commitment to declared work</i> | | 69 |
| Campaigns to inform undeclared workers of risks and costs of working undeclared | ✓ | 61 |
| Campaigns to inform undeclared workers of benefits of formalising their work | ✓ | 57 |
| Campaigns to inform users of undeclared work of the risks and costs | | 61 |
| Campaigns to inform users of undeclared work of the benefits of declared work | ✓ | 52 |
| Use of normative appeals to people to declare their activities | | 52 |
| Measures to change perceived fairness of the system | ✓ | 26 |
| 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 |
| Measures to improve knowledge of tax, social security and labour law | | 65 |
| Adoption of commitment rather than compliance approach (e.g. 'responsive regulation') | | 30 |
| Campaigns to encourage a culture of commitment to declaration | ✓ | 39 |

In Montenegro, efforts against undeclared work are in their infancy. While emphasis is placed on deterrence measures, with only 27 labour inspectors in place, this approach is far from effective. It is important to realise that in Montenegro, the institutions and structures being employed to tackle undeclared work are young and developing, as is the organisation of tripartite social dialogue. Alongside this, the number of formal companies there has rapidly expanded rapidly, making it difficult to develop an adequate institutional framework. It is also important to understand that undeclared work in Montenegro is heavily concentrated in the under-developed northern region of the country where poverty is rife compared with the rest of Montenegro.

Progress is being made in efforts to improve the institutional infrastructure to address undeclared work. In order to reduce undeclared work in the Montenegrin economy, an economic reform programme for the period 2001–2005 was introduced. This includes enforcement measures, including harsher penalties for undeclared work and increased inspection; legislative changes, including a new and more comprehensive tax system, a tax amnesty law and a law on general profits; measures for enterprise creation such as more comprehensive rules for business creation; and enterprise restructuring and labour transformation initiatives, targeting mainly previously state-owned enterprises and micro credit schemes for start-up businesses and new employment (Miheš et al, 2010). The Central Bank of Montenegro estimated that at the end of the programme, undeclared work decreased from 40% in 2001 to around 30% in 2002 (Sisević, 2008, p. 39).

In 2007, the National Strategy for Employment and Human Resources Development was introduced to operate until 2011, with the aim of raising the level and quality of employment. Its focus was to increase employment and counteract unemployment, improve productivity and the quality of work and strengthen social cohesion. Lowering undeclared work is among its main targets. To reach that target, the policy has two major focal points: to reduce the costs of doing business through the reduction of administration and tax burdens; and the more effective implementation of labour legislation (Miheš et al, 2010).

Alongside deterrence measures, enabling measures are being introduced with the aim of striking a more balanced approach, as the following examples show.

A supply-side preventative measure

A programme offering incentives in the form of exemption from social security contributions for the first year of a newly registered employee and a range of sanctions for employers has helped to reduce undeclared labour and to encourage the formalisation of jobs (Petkova et al, 2010). Sisević et al (2005) argue that in 2003, as part of its efforts to tackle undeclared work, the government introduced a temporary cut in social contributions for new employees in their first year, resulting in a total contributions rate of 20% for these individuals. This resulted in 54,700 more people being registered with the Pension Fund and paying their social contributions. This was a short-term measure (nobody knows how long these people will stay as active contributors), however, and some employers feel that it only served to reward companies that had previously hired staff without paying the mandatory contributions.

The government introduced a variety of measures as a part of its economic reform programme that aimed to shift the focus to longer and better sustained measures of tackling undeclared work. Training schemes were set up that enable unemployed young people to gain the necessary qualifications for the formal labour market. To further aid integration into the labour market, job-search assistance was introduced for all those registered as unemployed. Taking into consideration unforeseen economic shocks, a temporary wage subsidy scheme was employed to ensure that employers can keep their employees employed on a formal basis rather than allowing them to move into informal employment.

Further supply-side measures were established by the National Strategy for Employment and Human Resource Development 2007–2011. This involved greater assistance for job-seekers as a way of ensuring an adequate supply of

labour in the formal economy. Reductions of fiscal burdens on employees' wages through reductions of the individual contributions for health insurance and non-wage labour costs were also introduced.

The Economic Reform Programme 2001–2005 combined deterrence measures with enabling measures. Increased penalties for non-registered businesses were introduced along with the previously mentioned intensified labour inspection activities. Various tax measures to restrict undeclared work were also introduced and the tax system was simplified, with various specific taxes reduced, thus incentivising employers and employees to formalise. With regards to labour inspections, Montenegro has increasingly widened its labour inspection activities. New laws for overseeing new activities included laws on tourism inspection, financial inspection and labour inspection. In recent years, labour inspection has been used as a tool to make improvements with regards to strengthening the enforcement of employment rights and the development of occupational health and safety.

Seasonal work

Seasonal employment is very topical in Montenegro and is the focus of many current policies. In May 2012 the Labour Inspectorate publicly announced that measures to tackle the seasonal undeclared economy would be intensified during the forthcoming season. To this end, the government formed a coordination team to monitor the measures being undertaken to combat undeclared work during the summer months, focusing on both domestic and foreign workers. Chief Inspector Angelina Međedović stated that the inspections are rigorous and severe on those operating informally. Penalties for irregular employment start at a minimum mandatory €500 fine issued instantly and range up to €20,000. The intensified controls were foremost aimed at large employers, hotels and restaurants, although small employers were also inspected. Inspectors temporarily went to the coast where seasonal work is concentrated, and the chances of undeclared work taking place are therefore higher. Minister Numanovic added that inspectors from the continental and northern parts of Montenegro engaged in specific, targeted inspection visits of larger businesses. This information, and the severity of the situation, was publicised through the use of media (Pobjeda, 2012).

To make the monitoring of undeclared work in the summer months more effective, plans were made to introduce a central monitoring system for tourist traffic. At time of writing, it was planned that this would be operated in conjunction with the police, customs administration and the Ministry of Sustainable Development and Tourism. With this new system, tourists will be registered electronically upon arrival in the country, thereby making identification of undeclared work easier and more efficient.

Increases in the demand for labour during the summer months cause the dynamics of Montenegro's labour market to vary substantially; the summer months see a large influx of foreign workers. Recognising this, a significant section of the inspection system controls the employment of foreign workers in the manner prescribed by the Law on Employment and Work of Aliens. Therefore, a foreign worker can only be employed in Montenegro under a special regime, as they must initially obtain a work permit and a permanent or temporary residence permit, followed by a contract of employment from an employer who must report them for compulsory social contributions.

Awareness campaigns

In April 2012, the Federation of Free Trade Unions in Montenegro (USSCG) launched a 40-day campaign against undeclared work of all forms. The aim was to draw attention to the fact that such activity damages not only the country and the wider community but also the employees active within the undeclared economy. They emphasised that work without a contract is not the only side-effect of undeclared work. Consequences also include unfair overtime work, work without any days off, work consisting of more than 40 hours per week and a lack of social contributions, amongst others. The campaign consisted of stands, leaflets and informing the unemployed of their rights, emphasising the meaning of declared work and the disadvantages of working on an undeclared basis. Recognising workers' fears of being fired, the union activists allowed for anonymous reporting of those working on an undeclared basis.

The numerous national and regional level awareness-raising campaigns on the negative effects of undeclared work have targeted the general public as well as workers and employers. The involvement of social partners is emphasised in these awareness campaigns, which represent a critical component of the tripartite action plans. Within these actions, the importance of educating and changing attitudes towards undeclared work is brought to the fore. However, such examples are scarce, and it is crucial that Montenegro carries on with improving its social dialogue and with further integrating social partners as well as working on policies that positively change the attitudes of tax payers.

On 22 July of 2011, the Tax Administration of Montenegro and the Ministry of Finance organised a ‘VAT is your money’ (PDV je tvoj novac) campaign, focusing on changing attitudes towards formalisation of business activities. The campaign was designed with the aim of informing the public about the importance of the fiscal system and tax revenue to build a better society and better way of life of all citizens. At the launch conference, Minister for Finance Milorad Katnić spoke about the priority of building a favourable business environment in Montenegro and the importance of improving the citizens’ tax morality for reducing the undeclared economy in Montenegro. The campaign included the broadcasting of videos and radio spots, the distribution of brochures, leaflets at border crossings and labels for retail facilities. The campaign’s success is reflected in the fact that, during the first 26 days, 212 irregularities were filed, almost five times more than were filed in the previous month. Even after the end of the campaign, citizens were (and continue to be) invited to report all observed irregularities by calling the tax office’s call centre at a toll-free number, writing or directly visiting the headquarters and regional units of the tax administration. As in previous practice, the tax administration states that they will act on all submitted applications by taking measures of inspection. The results of the campaign are expected to contribute to the achievement of objectives of general interest and build confidence in the country’s tax system.

Relationship between undeclared economies and work and welfare regimes

Evidence shows that the broader work and welfare regimes influence the size of the undeclared economy in a country. Until now, in simple terms, two contrasting perspectives have prevailed regarding the relationship between the size of an undeclared economy and a work and welfare regime. According to the neo-liberal viewpoint, undeclared economies are the direct result of high taxes, over-regulation and state interference in the free market and the remedy is therefore for countries to pursue tax reductions, deregulation and minimal state intervention. According to the social democratic viewpoint, undeclared economies are the product of under-regulation; the remedy involves intervention in the economy and higher levels of social protection.

Five indicators can be used to evaluate these competing perspectives. These are the level of implicit tax rates on labour income (Eurostat, 2007, 2011); state expenditure on interventions in the labour market as a proportion of GDP (Eurostat, 2011); the level of state social protection expenditure (excluding old age benefits) as a proportion of GDP (European Commission, 2011); the effectiveness of state redistribution via social transfers (European Commission, 2011); and the level of intra-national equality in the society, as measured by the Gini coefficient (European Commission, 2011). For fuller details of the datasets and methodology used in the studies cited here, see Williams (2012a, 2012b) and Vorley and Williams (2012).

As Table 6 shows, there is no statistically significant correlation between the implicit tax rates on labour (the average effective tax burden on labour income) and the size of undeclared economies. Using Spearman’s rank correlation coefficient (r_s) due to the non-parametric nature of the data, no statistically significant correlation is found between the size of the undeclared economy across the EU27 and the implicit tax rates on labour ($r_s=-0.266$). Merely 10.2% of the variance in the size of the underground economy is correlated with the variance in implicit tax rates ($R^2=0.1019$). However, a statistically significant correlation does exist between the size of undeclared economies and the level of state expenditure on labour market interventions, expenditure levels on social protection, the level of state redistribution via

social transfers, as well as the degree to which societies are equal. Welfare regimes where there is greater labour market intervention, higher levels of social protection expenditure and redistribution via social transfers, and greater equality tend to have smaller undeclared economies. Put another way, the existence of larger undeclared economies seems to be a result of under-regulation. This has clear implications for Montenegro. It suggests that to reduce its undeclared economy, not only will the institutions directly involved in the fight against undeclared work need to be modernised, its work and welfare regime will need to be addressed as well through higher levels of expenditure on state intervention in the labour market and social protection, alongside redistribution via social transfers so as to construct a more equal society. Indeed, the fact that 27% of undeclared workers are pensioners (UNDP, 2002) provides a clear signal that pensions are too low to cover basic needs.

Table 6: *Relationship between size of undeclared economy and work and welfare regimes*

| | Undeclared work as % of GDP | |
|---|-----------------------------|-------|
| | r_s | R^2 |
| Implicit tax rate | -0.266 | 0.102 |
| Labour market expenditure | -0.599** | 0.235 |
| Social protection expenditure | -0.700** | 0.467 |
| State redistribution via social transfers | -0.642** | 0.457 |
| Inequalities (Gini coefficient) | 0.448** | 0.227 |

Note: This table shows the bivariate regressions on the relationship between the size of an undeclared economy and different work and welfare regimes.

Source: Eurostat and European Commission publications, based on the analysis of the situation in the EU27

Conclusions

This report has provided a systematic overview of the extent and nature of undeclared work, and how it is being tackled, in the EU candidate country of Montenegro, an ‘upper middle income’ country with a GNI per capita of USD 6,690. The objectives were to analyse the prevalence and character of undeclared work in this country, to examine how the fight against undeclared work is organised, and to review the relevant policy approaches and measures being adopted. Throughout the report, the situation in this Montenegro has been compared with the EU27 wherever feasible.

There are varying estimates regarding the size of the undeclared economy in Montenegro. Although comparative data is not available on the size of its undeclared economy relative to the EU27, it has been estimated that 22.6% of employment is in informal sector companies or is informal employment in formal sector companies, of which 77% are employed in formal sector enterprises and 23% work for informal sector enterprises (ISSP, 2007, 2010). Moreover, 17.5% of declared employees receive an unofficial undeclared ‘envelope wage’ in addition to their declared official salary, and their overall net wage is some 30% higher than their declared salary (ISSP, 2010). Much undeclared work in Montenegro is therefore waged employment, as is commonly the case in southern European countries.

According to research conducted by the Institute for Strategic Studies and Prognoses (ISSP), undeclared work mostly takes place in the retail (38.1%), agriculture (18.2%), catering (19.1%), construction (10.8%) and transport (9.6%) sectors (ISSP, 2010). This profile is confirmed by the findings of the World Bank Enterprise Survey 2009, which found that businesses in the retail sector were most likely to witness competition from unregistered or informal firms, and to view such work as a major constraint on their business, followed by manufacturing and then other service industries. Large firms, exporting businesses and foreign-owned businesses are less affected by informal businesses, and less likely to view them as a major constraint, than are smaller and medium-sized businesses, non-exporting businesses and domestically-owned businesses. However, significant regional variations occur. While 77.5% of businesses in the northern region state that they compete against unregistered or informal businesses, this figure is just 28.6% in the central and southern regions and 21.4% in the coastal region. A greater proportion of businesses in the northern region view unregistered or informal businesses as a major constraint.

Turning to the barriers to formalisation, the annual World Bank Doing Business surveys analyse how easy or difficult it is for a local entrepreneur to open and run a small-to-medium-sized business when complying with relevant regulations. In 2012, Montenegro was ranked 56th out of 183 countries in terms of the ease of doing business, compared with 38th for the EU27 as a composite. Doing business is therefore more difficult in Montenegro than it is in the EU27 as a whole. In relation to ease of starting a business, Montenegro was ranked 47th out of 183 countries compared with 66th for the EU27 as a composite. Starting a business requires six procedures in Montenegro, takes 10 days and costs 1.8% of income per capita. In relation to ease of paying taxes, Montenegro stands at 108th in the ranking of 183 economies compared with 71st for the EU27. On average, firms in Montenegro make 42 tax payments a year, spend 372 hours a year filing, preparing and paying taxes, and pay total taxes amounting to 7.1% of profit. Compared with the EU27, starting a business is easier in Montenegro, while paying taxes is more difficult.

No single compliance unit or coordinating committee is responsible for tackling undeclared work in Montenegro. Neither is there a lead department. Instead, the approach is fragmented, with different governmental organisations responsible for different aspects. The labour relations department of the Ministry of Health, Labour and Social Welfare deals with the preparation, monitoring and improvement of labour legislation. The implementation of these laws is mainly undertaken by the Labour Inspectorate and the Safety at Work Inspection. Furthermore, the Employment Agency, the National Pension Fund, the Health Care Fund and others are included in both the drafting and implementation of labour market policies. Involvement of social partners occurs through the Social Council of Montenegro, which includes the Confederation of Trade Unions (CITUM) and the Association of Employers of Montenegro. An action plan for the suppression of undeclared work (developed with ILO assistance) has been adopted by the Social Council, with a focus on awareness-raising and information campaigns.

In Montenegro, the fight against undeclared work is in its infancy. Although deterrence measures have been given primary importance, there are only 27 labour inspectors, so this approach is far from being effective. The institutions and structures employed to tackle undeclared work are young and developing, as is the organisation of tripartite social dialogue. In recent years, the number of formal companies has rapidly expanded. All of these factors have made it difficult to develop an adequate institutional framework for dealing with undeclared work. Although deterrence measures have been created, as have a range of mostly preventative curative measures, further development of the institutional framework in Montenegro is necessary before it can become more effective in tackling undeclared work.

Montenegro needs to develop a greater deterrence capability; to introduce a wider range of enabling policy measures, especially to transform undeclared work into declared work; to pursue 'softer' measures to engender a commitment to tax morality; and to better coordinate the campaign against undeclared work either by establishing a single agency responsible, a coordinating committee or a lead government department. This report also provides evidence of a strong correlation between countries with greater labour market intervention, social protection, redistribution and equality, and smaller undeclared economies.

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