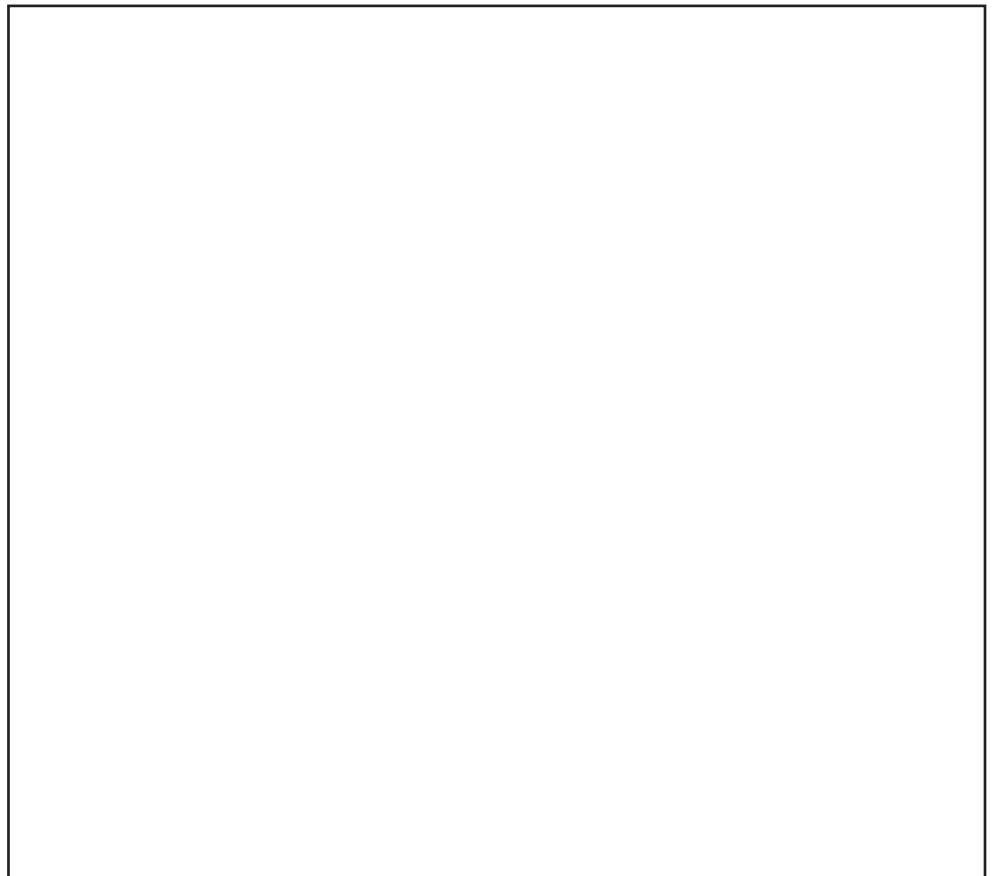




Eurofound

Tackling undeclared work in the former Yugoslav Republic of Macedonia



Contents

Executive summary	1
Introduction	3
Research background	5
Extent and nature of undeclared work	7
Organisation of efforts against undeclared work	13
Policy approaches to undeclared work	17
Conclusions	23
References	25

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 the former Yugoslav Republic of Macedonia. The country has been classified by the World Bank as an ‘upper middle income’ country, having a GNI per capita of USD 11,159 in 2012. The objectives of the report are to analyse the prevalence and character of undeclared work in the former Yugoslav Republic of Macedonia, 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 the former Yugoslav Republic of Macedonia 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

The former Yugoslav Republic of Macedonia has a large undeclared economy relative to the EU27. Using the Multiple Indicators Multiple Causes (MIMIC) method, Schneider (2011) finds that this country’s undeclared economy is equivalent to 34.9% of GDP, which is larger than that found in all of the EU27 Member States. In the World Bank Enterprise Survey 2009, 73.9% of firms reported that they compete against unregistered or informal firms, and 54.9% reported that the practices of informal sector competitors represent a major constraint on the growth of their business.

Few contemporary assessments have been conducted on the nature of the undeclared economy in the former Yugoslav Republic of Macedonia, exploring issues such as the sectors in which it is prevalent, who undertakes this work and why it is conducted. One of the few studies available, the 2009 World Bank Enterprise Survey, revealed that businesses in the retail sector were almost as likely as businesses in manufacturing and other services to have witnessed competition from unregistered or informal firms. It also found that the activities of unregistered businesses were most commonly identified as posing a major constraint in retail and other services. Large firms, and exporting and foreign-owned businesses, are less affected by informal businesses, and less likely to view them as a major constraint, than are small and medium-sized businesses, and non-exporting and domestically owned businesses. Regional variations also exist. Businesses are more likely to state that they compete against unregistered businesses within major and more developed cities and towns. Businesses in such places are also more likely to state that unregistered businesses represent a major constraint.

The 2010 International Labour Organization (ILO) Labour Force Survey in the former Yugoslav Republic of Macedonia found that 8% of all jobs in manufacturing involve informal employment, as do 43.1% of jobs in construction, 13% in trade, 16.5% in transportation and 8.3% in other services. By consequence, 17.9% of all informal employment is in manufacturing, 27.4% is in construction, 19.5% is in trade, 9.2% is in transportation and 25.8% is in services other than trade and transportation.

The annual World Bank Doing Business surveys compared 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 across 183 countries. The former Yugoslav Republic of Macedonia was ranked 22nd in 2012 in terms of the ease of doing business and 34th in 2011, compared with the EU27 as a composite, which was ranked 38th in 2012. Doing business is therefore easier in the former

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

Yugoslav Republic of Macedonia than it is in the EU27 as a whole. In terms of ease of starting a business, the former Yugoslav Republic of Macedonia was ranked 6th out of 183 countries, compared with 66th for the EU27 as a composite; it is one of the easiest countries in the world in which to start a business. Starting a business requires three procedures, takes three days and costs 2.4% of income per capita. In relation to ease of paying taxes, the former Yugoslav Republic of Macedonia was ranked 26th out of 183 countries, compared with 71st for the EU27 as a composite. On average, firms in the former Yugoslav Republic of Macedonia make 28 tax payments a year, spend 119 hours a year filing, preparing and paying taxes, and the total tax rate amounts to 9.7% of profit; paying taxes there is easier than it is in the EU27 as a whole.

Key findings

Organisation of efforts against undeclared work

A study of 31 European countries revealed that only 8 countries (26%) had either a single agency responsible for the drive against undeclared work or a central coordinating committee responsible for ensuring coordinated action by the multifarious departments involved in tackling undeclared work. In the former Yugoslav Republic of Macedonia, no one single compliance body is responsible for tackling undeclared work. However, the State Labour Inspectorate, within the Ministry of Labour and Social Policy, is the main department responsible in this field. Numerous other departments are responsible for different facets of efforts to combat undeclared work, including the Market Surveillance Inspectorate, the Health and Sanitary Inspectorate, the Public Revenue Office, the Employment Service Agency, the Centres for Social Work, the State Statistical Office, the Central Register, as well as agencies including customs, border police and immigration bodies. Cooperation between these agencies on the whole is weak.

Tripartite social dialogue takes place between the government, employers and trade unions in tackling undeclared work, especially through the Ministry of Labour and Social Policy. Some 35 trade unions and 6 employers' associations are involved. The voices of social partners are not perhaps as strong as in many other European countries. The trade unions, once the major player and partner in the tripartite social dialogue, have lost much of their influence, a situation that is not helped by their fragmentation, unstable finances, and lack of management capacity and active membership.

Policy approaches

As in the EU27 as a whole, policies on undeclared work in the former Yugoslav Republic of Macedonia have a repressive focus, seeking to stamp it out. As indicated in interviews with government officials and social partners, however, policymakers are beginning to introduce enabling measures, albeit mostly preventative ones. Indeed, initiatives to make starting a business easy in this country possibly represent best practice measures whose transferability to other EU27 countries could be fruitfully explored.

Policy pointers

Areas for improvement include giving greater prominence to 'harder' enabling measures to help suppliers transform their undeclared work into the declared economy, and introducing a wider array of 'softer' measures that foster commitment to tax morality. Besides such direct policy interventions, this report also 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 have 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 the former Yugoslav Republic of Macedonia. The objectives are 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 adopted. Throughout this report, the intention is to compare the extent and nature of undeclared work and how it is being tackled in this EU candidate country with the situation in the EU27. The main questions being addressed are:

- What is the extent and nature of undeclared work in the former Yugoslav Republic of Macedonia and how does this compare with the rest of Europe?
- What institutional structures and policy approaches are used 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 the rest of Europe in terms of policy measures when tackling undeclared work in this country?
- What lessons can the EU27 learn from practices in this country?

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 the former Yugoslav Republic of Macedonia:** As with other EU27 and EU candidate countries, the former Yugoslav Republic of Macedonia is included in cross-national databases such as the World Bank Enterprise Surveys and the World Bank Doing Business surveys, as well as in many cross-national surveys using indirect measurement methods (see Schneider, 2011; European Commission, 2009). 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 Europe more widely.
- **A desk-based review of the institutional approach to fighting undeclared work in the former Yugoslav Republic of Macedonia:** This includes both published and grey literature on the organisation of the drive against undeclared work in this country. 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 the former Yugoslav Republic of Macedonia, including those undertaken by social partners and sector-specific organisations, are reported and compared with other European countries.

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 the former Yugoslav Republic of Macedonia, the organisation of the efforts against it and policy approaches and measures used, along with their perceived effectiveness. A survey tool recently applied across the EU27 by Dekker et al (2010) was used, enabling comparative data to be collected. Third, a validation workshop took place in November 2012 with experts and representatives of key stakeholders in the four candidate countries and Croatia. The outcome is a wide-ranging review of the extent and nature of undeclared work in the former Yugoslav Republic of Macedonia and how undeclared work is being tackled there 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 the former Yugoslav Republic of Macedonia 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 the former Yugoslav Republic of Macedonia, and various strategies for tackling it, can be compared.

This country emerged in 1945 as one of six constitutive republics of the Socialist Federal Republic of Yugoslavia. When Yugoslavia disintegrated in the second half of 1991, the former Yugoslav Republic of Macedonia declared independence on 8 September 1991. In 2001, it signed the Stabilisation and Association Agreement with the European Union, which envisaged the successive liberalisation of trade and established an institutional framework for cooperation. Since December 2005, the former Yugoslav Republic of Macedonia has been an official candidate for EU membership. With a population of 2,060,563, the World Bank defines the former Yugoslav Republic of Macedonia as an ‘upper middle income’ country with a GNI per capita of USD 11,159 (World Bank, 2012). The country has had double-digit unemployment rates since it was part of the former Yugoslavia. Registered unemployment in the former Yugoslav Republic of Macedonia was 12.8% in 1960, almost 20% in 1970, 22.4% in 1980s and around 24% at the time of independence in 1991. Registered unemployment has continued to rise during transition and accelerated since the mid-1990s, leaving the country an apparent outlier in the region. According to data from the International Labour Organization (ILO) Labour Force Survey, the unemployment rate for 2007 was 34.9% (Novkovska, 2008).

Extent and nature of undeclared work

Several cross-national databases enable the comparison of the extent and nature of undeclared work in the former Yugoslav Republic of Macedonia with the situation in the rest of Europe and beyond, including the World Bank Enterprise Survey and Doing Business surveys. Numerous other studies measure undeclared work in the former Yugoslav Republic of Macedonia; some use indirect measurement methods that employ various proxy indicators and/or seek statistical traces of undeclared work in data collected for other purposes (for example, Schneider, 2011) and some are national surveys (see Bogov, 1997; Micevska et al, 2002; Nikolov, 2005; Novkovska, 2008).

Extent of undeclared work

In the former Yugoslav Republic of Macedonia, as in other countries, estimates of the size of the undeclared economy vary according to the measurement methodology employed. It is important, therefore, to be aware of the measurement methods that underpin any estimate. Table 1 reports the findings of the World Bank Enterprise Survey 2009, which involved interviews with 366 firm owners, using the same questions across many countries (World Bank, 2009). One finding was that 73.9% of firms reported that they compete against unregistered firms, and 54.9% reported that the practices of informal sector competitors represented a major constraint on the growth of their business. Some 99.2% of the firms surveyed reported that they were formally registered when they started operations; those who were not (0.8%) operated on average for less than a year without formal registration.

Table 1: *Prevalence of the undeclared economy in the former Yugoslav Republic of Macedonia*

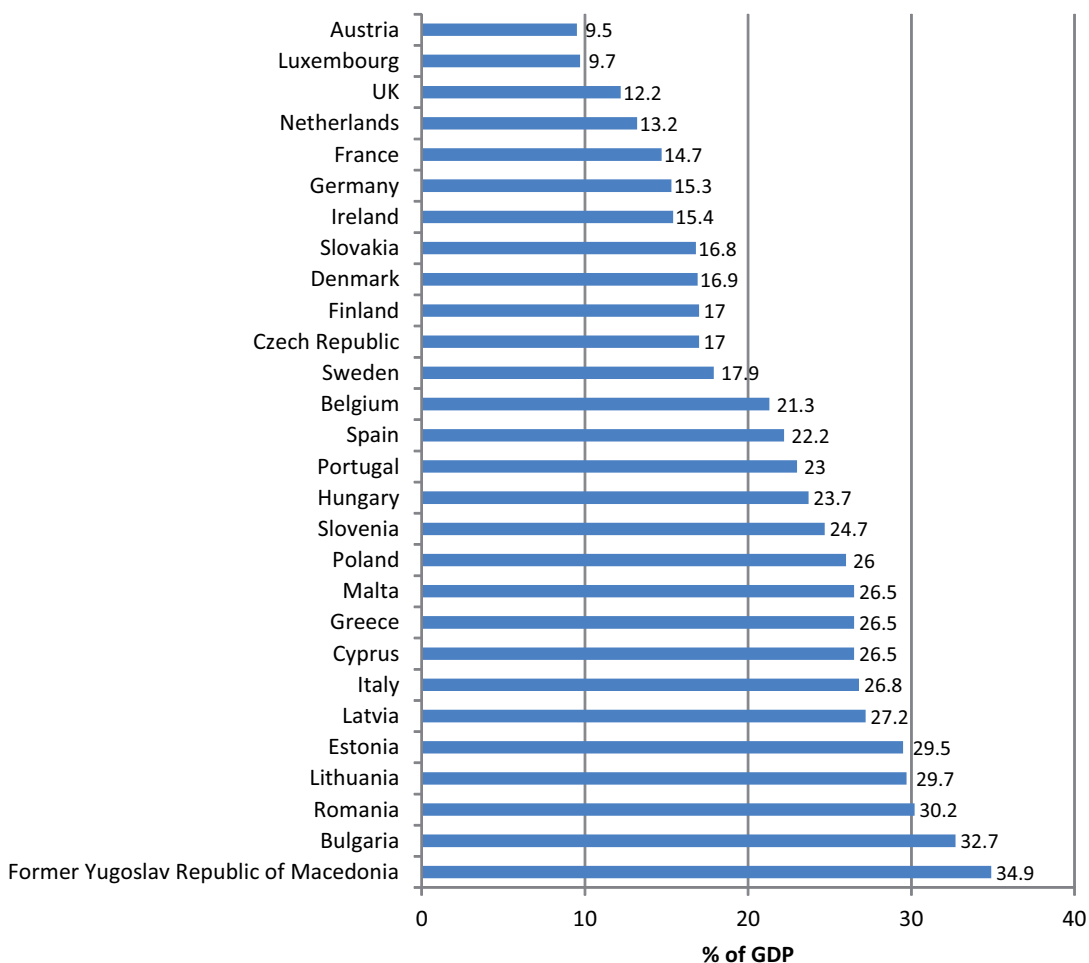
	Former Yugoslav Republic of Macedonia	Eastern Europe and Central Asia	World
Firms competing against unregistered firms (%)	73.9	45.2	56.3
Firms identifying practices of competitors in informal sector as a major constraint (%)	54.9	28.7	31.6
Firms formally registered when they began operating (%)	99.2	96.3	87.7
Years operated without formal registration (no.)	0.0	1.1	0.9

Note: N = 366.

Source: *World Bank Enterprise Survey 2009 (World Bank, 2009)*

Schneider (2011) measures the size of the undeclared economy as a proportion of GDP using his Multiple Indicators Multiple Causes (MIMIC) method. This method provides only relative values, with the help of the currency demand approach for a few countries (Austria, Germany, Poland and Switzerland). These values have been calibrated into absolute ones. Drawing on these data, Figure 1 compares the size of the undeclared economy in the former Yugoslav Republic of Macedonia with its EU27 counterparts. It reveals that the former Yugoslav Republic of Macedonia, with an undeclared economy equivalent to 34.9% of GDP, has a larger undeclared economy than all EU27 Member States.

Figure 1: Size of undeclared economy as % of GDP, by country



Source: *Schneider (2011)*

Bogov (1997) examined discrepancies in the national accounts and found that the undeclared economy is equivalent to 6.3% of GDP. Micevska et al (2002), using the electricity consumption method, argued that electricity consumption in the former Yugoslav Republic of Macedonia rose between 1990 and 2000 by 18%, while in the same period official GDP decreased by 14%. These authors argued that the real GDP could be about 30% higher than currently estimated, which highlights the size of the undeclared economy. Nikolov (2005), also using electricity consumption, calculated that in 2004, the undeclared economy in the former Yugoslav Republic of Macedonia was equivalent to 35.3% of GDP; this is somewhat lower than in 1996 when it was 40.3%. Analysing the discrepancies in data from the Labour Force Surveys and the Bureau of Payments Operations (BPO) statistics, Micevska et al (2002) found that according to the BPO statistics, there were 418,000 registered salary recipients in 2001, while the Labour Force Survey reports 599,300 employees. This means that 181,300 employees (30%) did not receive official salaries or received salaries that were not cleared through the BPO.

Nature of undeclared work

Sector variations

The World Bank Enterprise Surveys can be used to provide cross-nationally comparative data on sectoral variations in the undeclared economy in the former Yugoslav Republic of Macedonia. In 2009, and as Table 2 shows, businesses in the retail sector were almost as likely as those in manufacturing and other services to have had competition from unregistered firms. Businesses in retail and other services were most likely to cite the activities of unregistered businesses to be a major constraint; this was less of an issue for manufacturing companies (World Bank, 2009).

Table 2: Prevalence of the undeclared economy in the former Yugoslav Republic of Macedonia

	Firms competing against unregistered or informal firms (%)	Firms identifying practices of competitors in informal sector as a major constraint (%)	Firms formally registered when operations started in country (%)	Years operated without formal registration (no.)
	73.9	54.9	99.2	0.0
By sector:				
Manufacturing	72.0	50.4	99.9	0.0
Retail	70.1	58.7	98.0	0.0
Other services	77.8	57.4	99.3	0.0
By firm size:				
Small (5-19 employees)	77.8	59.3	99.2	0.0
Medium (20-99 employees)	67.8	49.7	99.6	0.0
Large (100+ employees)	57.8	30.5	98.1	0.1
By location:				
Skopje	71.9	44.2	95.2	0
Eastern Macedonia	72.7	43.4	100.0	0
South Macedonia	73.1	63.3	100.0	0
North-west and west Macedonia	79.5	80.8	100.0	0
By exporting status:				
Direct exports 10%+ of sales	61.3	42.8	99.7	0
Non-exporter	77.9	58.8	99.1	0
By ownership:				
Domestically owned	75.4	55.8	99.2	0
Foreign owned	57.0	44.5	99.6	0

Note: N = 366.

Source: World Bank Enterprise Survey 2009 (World Bank, 2009)

The ILO (2011), meanwhile, examines informal employment, which refers to those jobs that generally lack basic social or legal protections or employment benefits. The 2010 ILO Labour Force Survey in the former Yugoslav Republic of Macedonia found that 8% of all jobs in manufacturing were informal employment, 43.1% of jobs in construction, 13% in trade, 16.5% in transportation and 8.3% in other services. The consequent finding was that 17.9% of all informal employment was in manufacturing, 27.4% in construction, 19.5% in trade, 9.2% in transportation and 25.8% in other services than trade and transportation (Mojsoska-Blazevski, 2011).

Socioeconomic, business and geographical variations

Men working undeclared are concentrated in construction and transportation, while women are concentrated in manufacturing and services other than trade or transportation (Mojsoska-Blazevski, 2011).

Table 2 above shows that smaller firms appear to be more affected than larger businesses by the existence of unregistered businesses. While over three-quarters of small businesses assert that they compete against informal or unregistered firms, just over half of large firms assert that this is the case. Indeed, smaller businesses are far more likely than larger businesses to assert that unregistered businesses are a major constraint. Non-exporting businesses and domestically owned businesses are more likely than exporting and foreign-owned businesses to face competition from unregistered businesses and to state that the undeclared economy constrains their business.

Significant regional variations exist in the former Yugoslav Republic of Macedonia in relation to the prevalence of the undeclared economy. Business in major and more developed cities and towns are more likely to state that they compete against unregistered businesses and that those businesses are a major constraint.

Types of undeclared work

The 2010 ILO Labour Force Survey provides an insight into the types of undeclared work in the former Yugoslav Republic of Macedonia (Mojsoska-Blazevski, 2011). Although 25.8% of people in employment are in the undeclared economy, Table 3 shows that they engage in different kinds of work. The ILO (2011) defines the informal sector as consisting of unregistered and/or small unincorporated private enterprises engaged in the production of goods or services for sale or barter. Employment in the informal sector refers to the total number of jobs in informal sector enterprises, which amounts to 7.6% of all persons in employment in the former Yugoslav Republic of Macedonia. For practical reasons, the concept is measured as the number of persons employed in informal sector enterprises as their main job. The term informal employment refers to those jobs that generally lack basic social or legal protections or employment benefits, which may be found in the formal sector, informal sector or in households. In the former Yugoslav Republic of Macedonia, 12.6% of all employment is in the informal sector, and a further 5.2% of people in employment are in informal employment outside of the informal sector. Interestingly, 0.4% of people are in formal employment in informal sector enterprises.

Table 3: *Formal and informal employment in non-agricultural sectors in the former Yugoslav Republic of Macedonia*

	Total (000s)	Women (000s)	Men (000s)	Urban (000s)	Rural (000s)
Persons in informal employment	65	16	49	34	31
Persons employed in the informal sector	39	5	33	18	20
Persons in formal employment in the informal sector	2	1	1	1	0
Persons in informal employment outside the informal sector	27	11	16	17	11
<i>As % of non-agricultural employment:</i>					
Persons in informal employment	12.6	8.1	15.4	9.5	19.4
Persons employed in the informal sector	7.6	2.5	10.3	5.0	12.5
Persons in formal employment in the informal sector	0.4	0.5	0.3	0.3	0.2
Persons in informal employment outside the informal sector	5.2	5.6	5.0	4.8	6.6

Source: ILO Labour Force Survey 2010

The 2010 ILO Labour Force Survey found that 34.7% of the self-employed are working in the undeclared economy, with 6% of employers and 48.6% of all sole traders doing so. This tendency of the self-employed to operate on an undeclared basis varies geographically. Comparing urban and rural areas, 28.3% of the self-employed in urban areas (4.8% of

employers and 43.5% of own-account workers) operate in the undeclared economy, but this figure is much higher in rural areas, where 44.8% of the self-employed (9.1% of employers and 57.1% of own-account workers) operate in the undeclared economy.

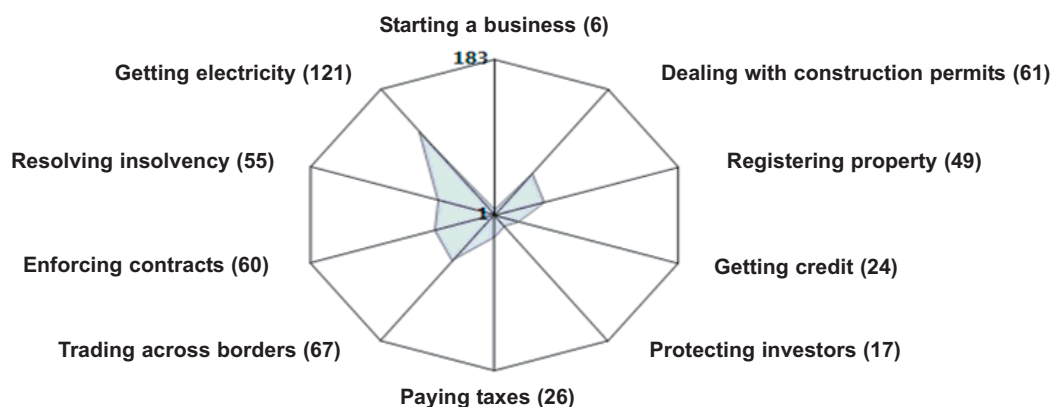
The 2010 ILO Labour Force Survey also revealed that 9.2% of all employees operate in the informal sector (21.4% of agricultural employees and 8.8% of non-agricultural employees). Again, undeclared waged employment was found to be higher in rural than urban areas. In rural areas, 14.5% of all employees are in the informal sector compared with 6.9% in urban areas. The undeclared economy is more prevalent in rural areas in the former Yugoslav Republic of Macedonia.

Barriers to formalisation

The annual World Bank Doing Business surveys comprise one of the few data sources on the barriers to formalisation in the former Yugoslav Republic of Macedonia. 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.

In 2012, the former Yugoslav Republic of Macedonia was ranked 22nd out of 183 (the EU27 as a composite was ranked 38th) and 34th in 2011, although it performs better in some aspects of the ease of doing business than others (see Figure 2). It was ranked 6th in terms of ease of starting a business, while the EU27 as a composite was ranked 66th. The former Yugoslav Republic of Macedonia is one of the easiest countries in the world in which to start a business. Starting a business requires three procedures, takes three days and costs 2.4% of income per capita. To improve the ease of starting a business, in 2009 the country's one-stop shop system was updated to encompass the full range of business start-up processes, reducing both the number of procedures and the time required. In 2010 and 2011, further improvements were made.

Figure 2: Former Yugoslav Republic of Macedonia's ranking on aspects of doing business



Source: World Bank Doing Business database

In terms of ease of paying taxes, the former Yugoslav Republic of Macedonia was ranked 26th out of 183 countries while the EU27 as a composite was ranked 71st, meaning that it is easier to pay taxes in the country than it is in the EU27 as a whole. On average, firms make 28 tax payments a year, spend 119 hours a year filing, preparing and paying taxes, and the total tax rate amounts to 9.7% of profit. To improve the ease of paying taxes, in 2009 the corporate income tax was reduced to 10%, in 2010 social security payments were classified into five groups and social security contribution rates were reduced, and in 2011 the country lowered tax costs for business by requiring that corporate income tax be paid only on distributed profits.

Organisation of efforts against undeclared work

Cross-government cooperation

Analysing how the drive against undeclared work is organised in 31 European countries, Dekker et al (2010) found that 8 countries (26%) had established one body dedicated to combating undeclared work. This was either a single agency responsible for the tackling undeclared work or a central coordinating committee responsible for ensuring coordinated action by the multifarious departments that have a stake in tackling undeclared work.

As Table 4 shows, tax offices, social security administrations and labour inspectorates can take this central role, depending on the country concerned. In Nordic countries, tax offices tend to be responsible, 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 4: *Main authority for tackling undeclared work in 31 countries*

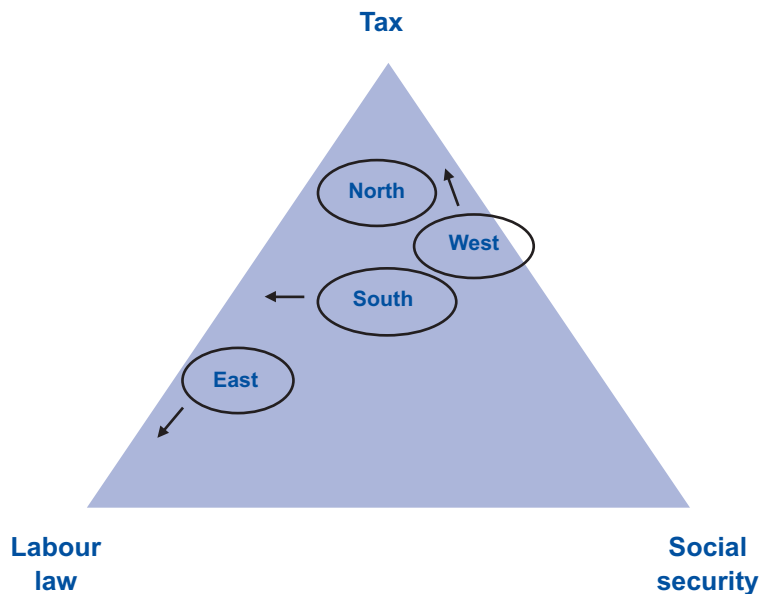
Labour inspectorate	Social security administration	Tax administration
Bulgaria, Cyprus, Czech Republic, Greece, Hungary, Italy, Iceland, Latvia, Lithuania, Malta, Luxembourg, Poland, Portugal, Romania, Slovakia, Slovenia, Spain	Belgium, France, Switzerland, Liechtenstein	Austria, Denmark, Estonia, Germany,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

Source: Dekker et al (2010)

Figure 3 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 take the leading role, there are greater contributions by the social security authorities. In southern European countries, a more equal contribution is made by all three bodies while in east-central Europe, responsibility lies much more with the labour inspectorates and less with the tax and social security authorities.

Figure 3 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 3: Responsibility for undeclared work in the regions of Europe



In the former Yugoslav Republic of Macedonia, although no single agency or coordinating committee exists for this purpose, the State Labour Inspectorate is the main department responsible for combating undeclared work. Located within the Ministry of Labour and Social Policy, the State Labour Inspectorate supervises the enforcement of laws and other regulations in relation to labour relations, employment, occupational safety and health, collective agreements and employment agreements that regulate the rights and obligations of employees and employers. The Labour Inspectorate's central office has four departments:

- Labour Relations Department;
- Safety and Health at Work Department;
- Department for Legal Matters in the field of Safety and Health at Work;
- Department for Coordination, Training and Administrative Enforcement.

There are 30 local offices of the Labour Inspectorate, across three regional departments. Table 5 presents some basic facts about the Labour Inspectorate.

Table 5: *Facts about the former Yugoslav Republic of Macedonia Labour Inspectorate*

	Data
Total number of staff in labour inspection services	109
Number of inspectors	101
Proportion of staff based in headquarters	8%
Ratio of occupational safety and health (OSH) versus employment inspections	34:67
Proportion of economically active population covered by labour inspection services	65%
Inspectors per 1,000 enterprises	0.7
Inspectors per 1,000 employees	0.19
Inspections per 1,000 workers per year	57.36
Visits by one inspector per year	297

Source: *Macedonian National Occupational Safety and Health profile report, 2007 (cited in Mojsoska-Blazevski, 2008)*

Many other departments are responsible for different facets of tackling undeclared work, including the Market Surveillance Inspectorate, the Health and Sanitary Inspectorate, the Public Revenue Office, the Employment Service Agency, the Centres for Social Work, the State Statistical Office, the Central Register, as well as some agencies, including customs, border police and immigration bodies.

The coordination between the State Labour Inspectorate and other agencies involved in combating undeclared work is weak; no common coordination procedure exists, joined-up strategies are lacking and the various departments do not share targets. A limited number of joint inspections take place in the realm of safety at work. Currently, software is being designed, which will connect the inspectorate through a network with all areas and institutions from which useful data can be obtained, such as the Central Register, the Public Revenue Office and the Employment Agency.

Role of social partners

A total of 35 trade unions and 6 employers' associations are listed in the register of the Ministry of Labour and Social Policy. In the former Yugoslav Republic of Macedonia, social partners are involved in combating undeclared work in the following ways.

- Trade unions are involved in bipartite and tripartite social dialogue regulated by the Law on Labour Relations. Officials at national, branch and company levels are involved in the Association of Trade Unions established in 1946 and re-registered in 1991, the Union of Independent and Autonomous Trade Unions and the Confederation of Free Trade Unions established in 2005.
- Employers' associations are involved in bipartite and tripartite social dialogue regulated by the Law on Labour Relations, including the Organisation of Employers established in 2004 and the Confederation of Employers established in 2001.
- Representatives of social partners are involved in the Economic and Social Council.
- Representatives of social partners are involved in steering committees (for example, in the Employment Service Agency, the Pension and Disability Fund, the Health Insurance Fund and the VET Council).
- Representatives of social partners cooperate with the Ministry of Labour and Social Policy on a regular and ad hoc basis.

The voices of social partners in this policy realm are perhaps not as strong as in many other European countries. The trade unions, once major players and partners in the tripartite social dialogue, have lost much of their influence; their recent fragmentation has not helped their cause. They lack stable finances, management capacity and an active membership.

Policy approaches to undeclared work

Typology of policy approaches

In the EU27, tackling undeclared work has been dominated traditionally 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). 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, p. 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. 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 (Eurofound, 2009).

Policy approach: Comparison with 31 other European countries

As Table 6 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, with just 43% deeming 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 6: *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 four candidate countries (Iceland, Montenegro, 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. The former Yugoslav Republic of Macedonia is no exception. The findings of interviews with government officials and social partners strongly confirm that deterrence remains the dominant policy approach, although it is recognised that a much wider range of measures are being introduced, even if they are not yet given the same importance as deterrence in combating undeclared work.

As Table 7 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 and/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 at least one 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 engender a commitment to tax morality; 69% of the 31 countries have adopted some commitment measure.

Table 7: Policy measures used in the former Yugoslav Republic of Macedonia and 31 other European countries to tackle undeclared work

Measures	Used in the former Yugoslav Republic of Macedonia	% of 31 other European countries using measure
Repressive measures		
Penalties		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		100
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		
Preventative measures		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

Tackling undeclared work in the former Yugoslav Republic of Macedonia

Measures	Used in the former Yugoslav Republic of Macedonia	% of 31 EEA countries using measure
Measures enabling compliance		
<i>Preventative measures</i>		<i>90</i>
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>		<i>64</i>
Stimulate purchasers to buy declared goods and services		
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>		<i>69</i>
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

Source: *Williams et al, 2013 (Table 3)*

Comparing the range of measures used in the former Yugoslav Republic of Macedonia with the EEA and Switzerland, Table 7 shows that both use a full range of deterrence measures. Although enabling measures are beginning to be used, up to now, it is largely preventative measures that have been adopted. Curative measures that seek to transform undeclared work into declared work are particularly scarce in this candidate country, compared with the other 31 European countries, as are policies aimed at fostering commitment to declared work.

Up until recently, inspectors were detecting many cases, but most of the lodged requests for initiation of misdemeanour procedures were not dealt with in due time by the court, which resulted in discontinuance of the procedure due to the statute of limitations. The fines pronounced by the court were also too low, so employers were encouraged to further violate the provisions of the law. To overcome this, in December 2008, amendments and consolidations to the Labour Relations Law were made, which introduced more severe measures. Now, when a labour inspector finds a person working without established employment relations, they can prohibit the working operations of the employer for a period of 30 days. Higher fines have also been introduced for such employers, of €5,000 and €11,000. The misdemeanour procedure is no longer managed by the court, but by the Ministry of Labour and Social Policy; in June 2009, a misdemeanour body was established within this ministry, consisting of one commission for labour relations misdemeanours, and one for occupational safety and health misdemeanours. Lutovska (2012) reported that inspectors conducted 24,000 inspections in 2011. These inspections resulted in nearly 1,000 orders being issued to employers to sign contracts with unregistered workers and give them three months' salary. According to official data from the State Statistical Office, despite the economic crisis, the number of employed people increased by 4.8% between the second quarter of 2008 and the second quarter of 2009. In the same period, the number of unemployed persons declined by 4.1%.

Despite this continuing emphasis on strengthening deterrence measures, a gradual increase has also occurred in the range of enabling measures in the former Yugoslav Republic of Macedonia. For example, a law on business registration has been adopted that reduces the time, procedural steps and financial costs required to start a business; this might explain why the former Yugoslav Republic of Macedonia is ranked 6th out of 183 countries in terms of ease of starting a business. In 2010, the second phase of the 'one-stop shop' system was initiated, consisting of three components: an online application for the registration of companies; an electronic system for the classification and listing of companies under the court procedures for insolvency; and an electronic system for the registration of collateral and leasing (Bertelsmann Stiftung, 2012). Given the high global position of the former Yugoslav Republic of Macedonia with regard to ease of starting a business, this initiative might well be a best practice policy measure for other EU Member States to follow, if it is deemed transferable to other contexts.

The introduction of awareness-raising campaigns represents another enabling measure, which was supported by the ILO Decent Work Technical Support Team and Country Office for Central and Eastern Europe, for the agricultural and construction sectors. Trade unions, employers and government institutions were involved in selecting campaign themes and sectors involved. The target audiences were employers and workers, particularly those in small and medium-sized enterprises (SMEs). Use was made of visual resources such as posters and information materials like leaflets to convey the disadvantages of working on an undeclared basis and the benefits of being fully declared. Inspection visits took place during the campaigns to maximise their success.

Another campaign in the former Yugoslav Republic of Macedonia was specifically aimed at students. The centre of focus was vocational schools because students from these schools were considered most likely to work undeclared. Young people were taught to recognise the pitfalls of undeclared work. This initiative is currently being expanded, with additional presentations and brochures being developed, to prepare students for finding declared work and to recognise the risks of entering undeclared work. These students will also be taught soft skills for finding employment and will receive further training.

The undeclared economy in the former Yugoslav Republic of Macedonia is larger than that of the four EU candidate countries and Croatia and all the EU27 Member States. Until now, this has been tackled largely by repressive measures, alongside enabling measures that seek to prevent people entering the undeclared economy. Initiatives to make it easier to start a business in this candidate country may represent best practice; their transferability to other EU27 countries could be fruitfully explored. In addition, campaigns have taken place to promote a culture of commitment to tax morality. Despite these measures, many areas for improvement remain, including giving greater prominence to ‘harder’ enabling measures to help suppliers transform their undeclared work into the declared economy, and also introducing a wider array of ‘softer’ measures that foster commitment to tax morality. This, however, is not the only change that is required if the former Yugoslav Republic of Macedonia is to tackle undeclared work more effectively.

Relationship between undeclared economies and work and welfare regimes

If the undeclared economy is to be tackled effectively, changes are not only required in the realm of direct policy measures. Evidence suggests that the broader work and welfare regimes also 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 on the datasets and methodology used in the studies cited here, see Williams (2012a, 2012b) and Vorley and Williams (2012).

As Table 8 shows, no statistically significant correlation exists 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 with greater labour market intervention, higher levels of social protection, redistribution via social transfers and greater equality tend to have smaller undeclared economies. This has clear implications for the former Yugoslav Republic of Macedonia. It tentatively suggests that the undeclared economy will be reduced not only by pursuing targeted policy measures but also by modernising its work and welfare regime through higher levels of expenditure on state intervention in the labour market and social protection, coupled with redistribution via social transfers so as to improve social equality.

Table 8: *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 the former Yugoslav Republic of Macedonia, an 'upper middle income' country with a GNI per capita of USD 11,159. The objectives were to analyse the prevalence and character of undeclared work in this country, to examine how the drive against undeclared work is organised and to review the policy approaches and measures being adopted.

The undeclared economy in the former Yugoslav Republic of Macedonia is equivalent to 34.9% of GDP, which is larger than that found in all other EU27 Member States and EU candidate countries. The result is that 73.9% of firms report that they compete against unregistered firms and 54.9% report that the practices of informal sector competitors represent a major constraint on the growth of their business (World Bank, 2009). This is high compared with the EU27 Member States.

In the same study, businesses in the retail sector were almost as likely as those in manufacturing and other services to have witnessed competition from unregistered firms, and the activities of unregistered businesses were most commonly cited as a major constraint in retailing and other services (World Bank, 2009). 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 small and medium-sized businesses, non-exporting businesses and domestically-owned businesses. There are, however, significant regional variations. Companies in major and more developed cities and towns are more likely to state that they compete against unregistered or informal businesses. These businesses are also more likely to state that unregistered businesses pose a major constraint. The 2010 ILO Labour Force Survey in the former Yugoslav Republic of Macedonia found that 8% of all jobs in manufacturing involve informal employment, as do 43.1% of jobs in construction, 13% in trade, 16.5% in transportation and 8.3% in other services. As a consequence, 17.9% of all informal employment occurs in the manufacturing sector, 27.4% occurs in construction, 19.5% in trade, 9.2% in transportation and 25.8% in other services.

The annual World Bank Doing Business surveys compare 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 across 183 other countries. In 2012, the former Yugoslav Republic of Macedonia was ranked 22nd in terms of the ease of doing business, while the EU27 as a composite was ranked 38th. Doing business is therefore easier in the former Yugoslav Republic of Macedonia than it is in the EU27 as a whole. In terms of ease of starting a business, the former Yugoslav Republic of Macedonia was ranked sixth out of 183 countries, compared to the EU27, which was ranked 66th; this candidate country is one of the easiest countries in the world in which to start a business. Doing so requires three procedures, takes three days and costs 2.4% of income per capita. In relation to ease of paying taxes, the former Yugoslav Republic of Macedonia was ranked 26th out of 183 countries, compared with 71st for the EU27. On average, firms in the former Yugoslav Republic of Macedonia make 28 tax payments a year, spend 119 hours a year filing, preparing and paying taxes and the total tax rate amounts to 9.7% of profit.

Dekker et al (2010) found that only 8 out of 31 European countries (26%) had established one body dedicated to tackling undeclared work. This was either a single agency responsible for combating undeclared work or central coordinating committee responsible for ensuring coordinated action by the multifarious departments involved in tackling undeclared work. In the former Yugoslav Republic of Macedonia, no one single compliance body is responsible for tackling undeclared work. However, the State Labour Inspectorate in the Ministry of Labour and Social Policy is the main department in this field. Many other departments are also responsible for different facets of combating undeclared work, including the Market Surveillance Inspectorate, the Health and Sanitary Inspectorate, the Public Revenue Office, the Employment Service Agency, Centres for Social Work, the State Statistical Office, the Central Register, as well as agencies including customs, border police and immigration bodies. Cooperation between these agencies is, however, weak.

Tripartite social dialogue takes place between the government, employers and trade unions in the fight against undeclared work, particularly through the Ministry of Labour and Social Policy. A total of 35 trade unions and 6 employers' associations are involved. The voice of social partners is perhaps not as strong as in many other European countries. The trade unions, once the major player and partner in the tripartite social dialogue, have lost much of their influence; this has not been helped by their fragmentation, unstable finances, lack of management capacity and active membership.

As with the EU27 as a whole, efforts to address undeclared work in the former Yugoslav Republic of Macedonia focus on repressive measures. Recently, however, some enabling measures have been introduced; most of these seek to prevent people from entering the undeclared economy from the outset. Initiatives aiming to make it easier to start a business might represent best practice; their transferability to other EU27 countries could also be fruitfully explored.

Despite these developments, many areas for improvement remain. These include better coordination of efforts against undeclared work across government agencies through the use of shared strategies, operations and targets; creating a more formal institutional framework for tripartite social dialogue; developing an array of 'harder' enabling measures to help suppliers transform their undeclared work into the declared economy; and introducing a wider array of 'softer' measures that foster commitment to tax morality. 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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