

# **BACKGROUND ANALYSIS** **on the Spread and Trends of the** **Hidden Economy in Macedonia**



**“Background Analysis on the Spread and Trends of the Hidden Economy in Macedonia”**  
**Project name: Promoting Good Governance and Economic Rights through Empowering Macedonian Civil Society**  
**to Monitor and Tackle the Hidden Economy in the FYR of Macedonia**

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# **BACKGROUND ANALYSIS**

## **on the Spread and Trends of the Hidden Economy in Macedonia**

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“Background Analysis on the Spread and Trends of the Hidden Economy in Macedonia”

Authors: Ana Mickovska-Raleva Ph.D, Emil Shurkov M.Sc

Editors: Ruslan Stefanov M.Sc, Daniela Mineva M.Sc

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## I. Introduction

Blamed for many of the country's problems, but at the same time under-researched and ineptly understood, the hidden economy phenomenon has, for many years, been insufficiently tackled by Macedonian academic and political elites. During the past few years, a renewed interest in the topic has led towards its more systematic treatment by institutions, but still largely based on approximations, lack of coordination between institutions and under-evaluation of policy measures. This treatment of the problem opens the floor to many speculations regarding the effectiveness of policies and their actual impact on reducing the size of hidden economy.

Trying to maintain the fragile social peace, but at the same time implementing stricter demands from businesses, the government frequently finds itself in the position of making 'two steps forward and one backward' when it comes to effectively reducing the hidden economy and especially tackling its root causes. The largely implemented repressive measures fall on the back of micro and small businesses, which are often faced with the dilemma of whether to adhere or close down, thus reducing their potential to become drivers of new employments. Citizens, on the other hand, while in principle aware of the negative effects, in practice rarely confront many of the hidden economy practices and accept them as normal. This opens the floor for discussions on the effectiveness of the implemented policy measures, their resonance within specific target groups and the potential for better targeted policies.

This analysis aims to address some of these issues through representing cross-section of existing data on the hidden economy in Macedonia and relevant policies, with the intention to review and summarize the knowledge-base on the issue and provide recommendations for better tackling the problem. At the same time, it aims to expand the issue from the economic to the social sphere through emphasizing the impact of the hidden economy on the vulnerable groups in the society and the relevant policies for tackling the negative effects.

Initially, the part entitled – 'economic overview' provides a brief summary of the most important economic indicators for the country as a background for later framing the issue of hidden economy. Then, the report continues with a chapter on defining the concept of hidden economy, as well as its measurement methods, with a focus on the measures and data used by the Macedonian Statistical Office.

The analysis follows with a section on placing the hidden economy in Macedonia in a comparative context, through reviewing data from studies which have employed different estimations of the scope of hidden economy. This is continued by a literature review of academic studies focused specifically on assessing the hidden economy and its related manifestations for Macedonia.

Consequently, the analysis contains a part on the legal and institutional framework for tackling the hidden economy, centering on the main institutions responsible for dealing with this phenomenon and the most relevant legislative documents tackling the issue. This is followed by an analysis of the media reporting on the topic during the past three years, which is included as a reference on the manner in which the hidden economy is treated by different media outlets and presented to the public.

Finally, the last part of the report frames the policies implemented by Macedonian authorities for directly or indirectly tackling the hidden economy by placing them within a matrix of types of policy measures; and makes assessments of their effectiveness based on available quantitative and qualitative indicators. On the basis of these data, conclusions are drawn and recommendations provided for the final part of the report.

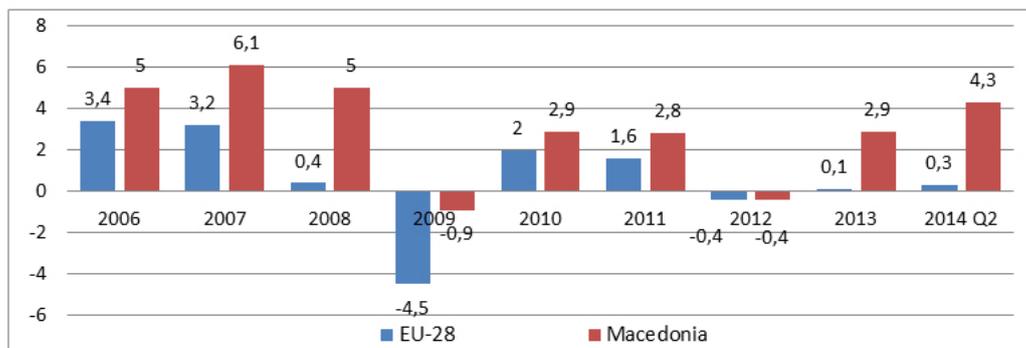
## II. Economic Overview

The following part of the analysis presents and overview of the macroeconomic situation in the country, through several main economic indicators: GDP and consumption, loans and deposits, trade balance and FDIs, labour market, and barriers to doing business. The presented indicators are aimed to provide a wider picture of the state and current trends of the Macedonian economy, as a background for later framing the issue of hidden economy in the country.

### GDP and Consumption

According to the National Bank of Macedonia's (NBRM) latest estimates, the GDP in Q1 of 2014 has increased by 3.9 %. NBRM's forecasts are that GDP growth for 2014 will be maintained at 3.7% with a potential of further growth of 4.4% in 2015. NBRM forecasts inflation for 2014 to be held at 1%, thus encouraging consumer spending. On the other hand, SSO registered a deflation of 0.2% in Q3 2014, which might negatively affect government revenues in the long run. On one

Figure 1 - Real GDP Growth of EU vs. Macedonia (% annual change),  
Sources: Eurostat, SSO, NBRM



hand, the inflation in Q1 2014 was 0.6% and the uncertainties enveloping the conflicts in Iraq and Ukraine, as well as the recent regional floods, will put inflationary pressure on food and energy prices and keep the inflation rate at a stable and acceptable level. On the other hand, EU and USA imposed sanctions against Russia and the related dramatic drop in oil prices will put deflationary pressures on the economy, especially EU's, with which Macedonia has the biggest trade volume.

Government deficit is forecasted at 3.5% in 2014 (decrease from 4.1% in 2013). This fiscal stimulus will be most notably used in construction and large

infrastructural projects that generate secondary effects in the economy by impacting dozens of economic branches and increasing employment. This stimulus is visible and has led to increase in gross capital formation mainly attributed to construction works (62.4%) and machinery and equipment (31.5%)<sup>1</sup>. Industrial output in October 2014 has also soared by 7.5% compared to October 2013 which corresponds with increased employment in industry by 9.5%<sup>2</sup> or 7.9 % for the whole period (Jan. - Oct.). However public debt, while among the lowest in the region, shows an increasing trend (39.3%, Q3 2014)<sup>3</sup>, which is expected to continue in the following years.

<sup>1</sup> State Statistical Office, press release 30.09.2014. Retrieved from <http://www.stat.gov.mk/PrikaziSoopstenie.aspx?id=34&rbr=1496>

<sup>2</sup> State Statistical Office, press release 04.07.2014. Retrieved from: <http://www.stat.gov.mk/pdf/2014/6.1.14.93.pdf>

<sup>3</sup> Ministry of Finance of Macedonia, Public Debt as of 31.12.2014. Retrieved from: <http://www.finance.gov.mk/mk/node/57>

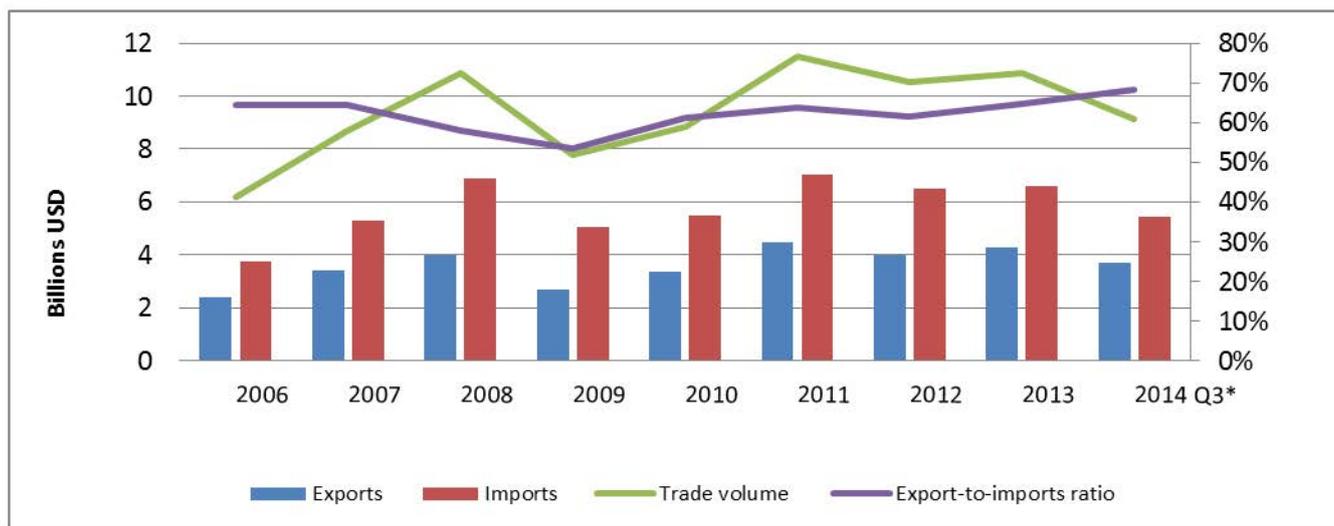
## Loans and Deposits

Furthermore, as of July 2014<sup>4</sup>, the deposits from households and enterprises increased by 8.1% on an annual basis which sum up to 4.35 billion EUR. Accordingly, in July 2014 there was an increase in total credit growth of 8.4% on an annual basis and sums up to 3.97 billion EUR. This is an indication that savings have finally encouraged additional lending by banks which in turn is reflected in the upward figures for final consumption expenditure, which could have a positive impact on crossover from the informal to the formal economy. However risks to the economy are still present. The bad loans portfolio shows an increasing trend and represents 12.2% (Q3 2014) of the total credit portfolio while in 2007 stood at 7.5% of the total credit portfolio<sup>5</sup>.

## Trade Balance and FDIs

Moreover, while Macedonia continues to have a fiscally stable and increasingly export-oriented economy due partly to the drastic annual increase in exports especially from the Foreign Direct Investment (FDI) companies, the FDI as a whole remains modest since the onset of the crisis, ending up with EUR 252 mln. in 2013 and 201 mln. in Q3 2014<sup>6</sup>. In order for Macedonia to be able to change its exports structure towards larger added value goods, a significant increase in FDI is needed in the following period. According to the Directorate for Technological Industrial Development Zones (TIDZ), **the exports coming from these zones have amounted to 25% of total exports in 2013 and are expected to surpass 30% of total exports by the end of 2014.**<sup>7</sup> Total exports coming from the TIDZ,

Figure 2 - Trade Volume of Macedonia. Left axis (billions USD) for exports, imports and trade volume. Right axis % for exports-to-imports ratio.



as of August 2014, amounted to 750 mln. EUR which is equivalent to the total exports from TIDZ in fiscal year 2013.

Additionally, exports-to-imports ratio (Figure 2) shows an increasing trend with coverage of imports by exports of 68.2% on an annual basis, which represents the largest ratio since 2001. Total trade volume over the past 3 years is maintained around the 6.5 billion USD mark which trend is

expected to continue by the end of 2014 (Figure 2). Clustering FDI is important for speeding up structural transformation and so is technological spillover from one company to the broader sector or even across sectors.<sup>8</sup> Enabling technology to spread from TIDZ to the rest of the economy will play an instrumental role in the structural transformation of the economy.

<sup>4</sup> National Bank of the Republic of Macedonia (NBRM), Statistical Annex, October 2014.

Retrieved from: [http://www.nbrm.mk/WBStorage/Files/Istrazuvanje\\_statisticki\\_prilog\\_10\\_2014.xlsx](http://www.nbrm.mk/WBStorage/Files/Istrazuvanje_statisticki_prilog_10_2014.xlsx)

<sup>5</sup> National Bank of the Republic of Macedonia (NBRM), Financial Stability Indicators.

Retrieved from: <http://www.nbrm.mk/?ItemID=14491983563ACC458FCCA1F743335F6D>

<sup>6</sup> National Bank of the Republic of Macedonia (NBRM), Inward Direct Investment – Flows, Sep. 2014.

Retrieved from: <http://www.nbrm.mk/?ItemID=9A0F5F9FE76D1A4F9F957C1BEACAD1ED>

<sup>7</sup> "The foreign Investors increase the exports" Kurir, 22.07.2014.

Retrieved from: <http://kurir.mk/makedonija/ekonomija/166096-Stranskite-investitori-go-zgolemuvaaat-izvozot>

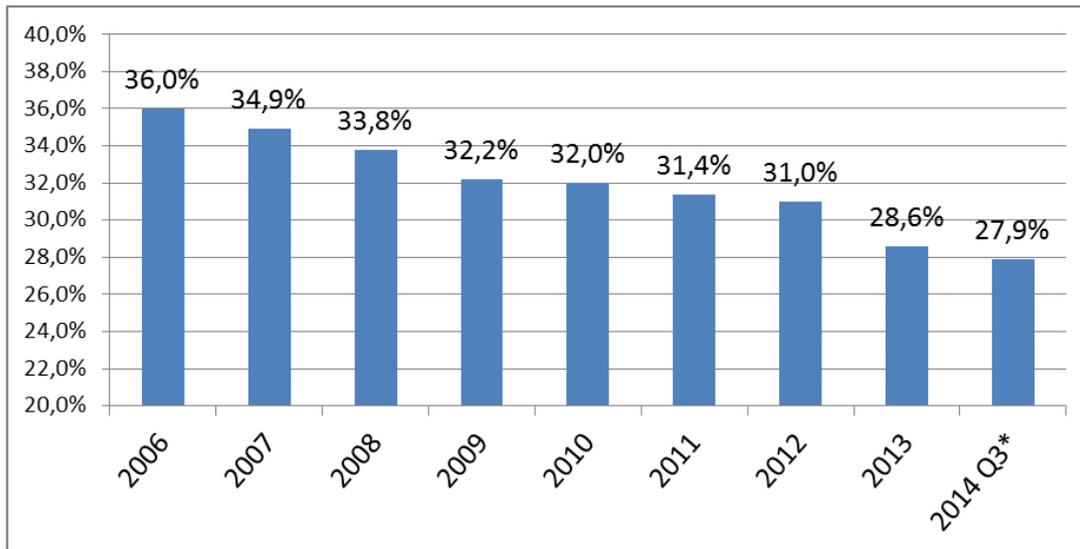
<sup>8</sup> IMF Country Report No. 13/179 (p. 12-15). Retrieved from: <http://www.imf.org/external/pubs/ft/scr/2013/cr13179.pdf>

## Labour Market

Furthermore, the labour market continues to be affected by its inherited structural unemployment from the early 1990s. **As of Q3 2014, the unemployment rate has decreased to 27.9% (267,428 people), with a tendency to decrease**

**further.** Despite a significant decline (**from 37.2% in 2004 – Figure 3**), unemployment, especially at this scale, represents one of the most significant factors in generating hidden economic activities. Even within the context of the economic crisis of 2008, the unemployment rate has decreased

Figure 3 - Unemployment Rate in Macedonia (in %)  
Source: SSO

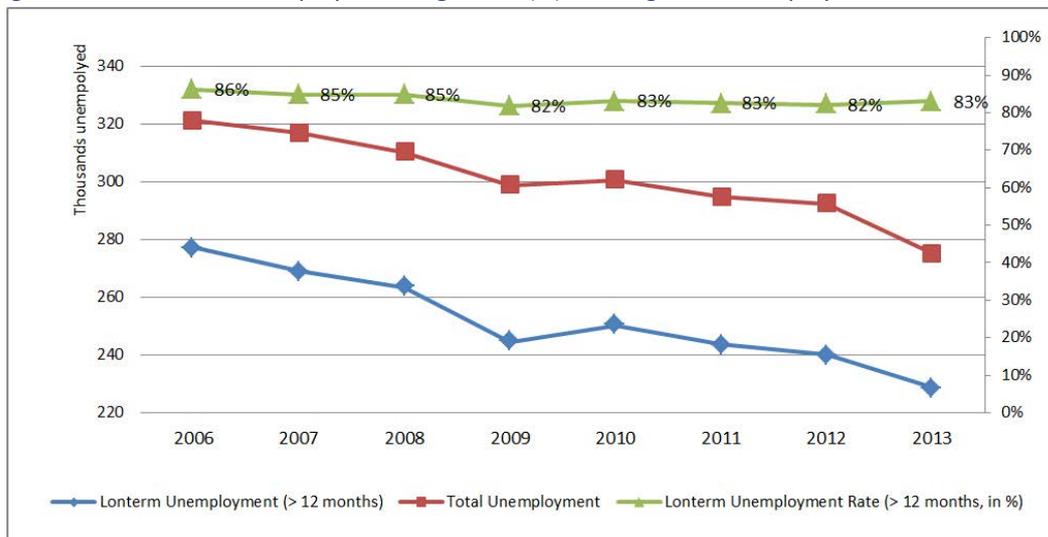


by 5.9% in the years since, showing an increased capacity of the Macedonian economy to absorb new workers and consequently offer better conditions for crossing over from the informal to the formal economy.

Despite the numerous strategies of lowering the unemployment rate, the total long-term unemployment each year since 1996 remains

above 80% (83%, 2013 est. – Figure 4). Similarly youth unemployment remains high, at 52.0% of total unemployment in Q3 2014, with a tendency to decrease further. In contrast, total seasonally adjusted unemployment rate, long-term unemployment (as % of total unemployment) and youth unemployment in EU28 countries in 2014 was 11.5% (Q3), 48.7% (Q1), and 21.6% (Q3) respectively.<sup>9</sup>

Figure 4 - Structure of unemployment. Right Axis (%) for Long-term unemployment rate. Source: SSO



<sup>9</sup> Eurostat News Release, 01.07.2014, Euro Indicators October 2014. Retrieved from:

<http://ec.europa.eu/eurostat/documents/2995521/6033691/3-31102014-BP-EN.PDF/fb5a7034-d11b-498c-b997-43a691c85c8f>

Since the officially unemployed are more prone to undertaking jobs in the undeclared economy, analysing the unemployment structure might provide hints as to where policies and measures

should be targeted or better adjusted in order to achieve optimal efficiency. The unemployment historical data (Figure 5 & Figure 6) from the Employment Agency (EA) show an abrupt change

Figure 6 - Unemployment by Nationality of Active Job Seekers (% of total active job seekers)

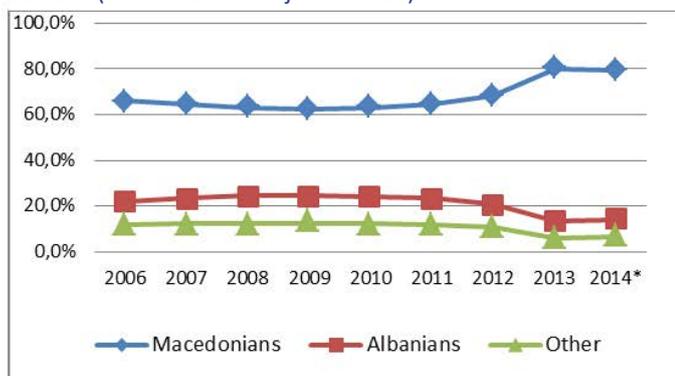
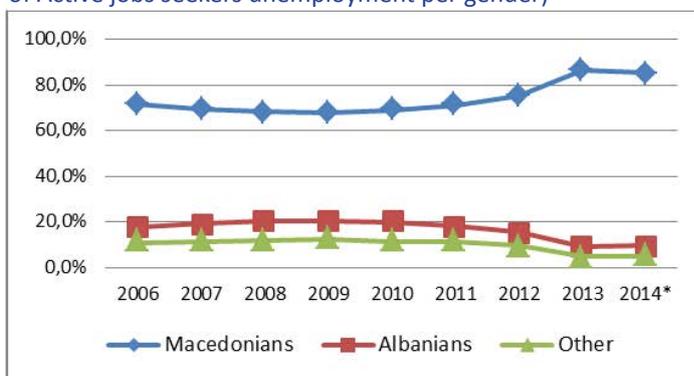


Figure 5 - Women's Unemployment by Nationality (% of Active jobs seekers unemployment per gender)



Source: Employment Agency (EA) data, 2006-2014 July.

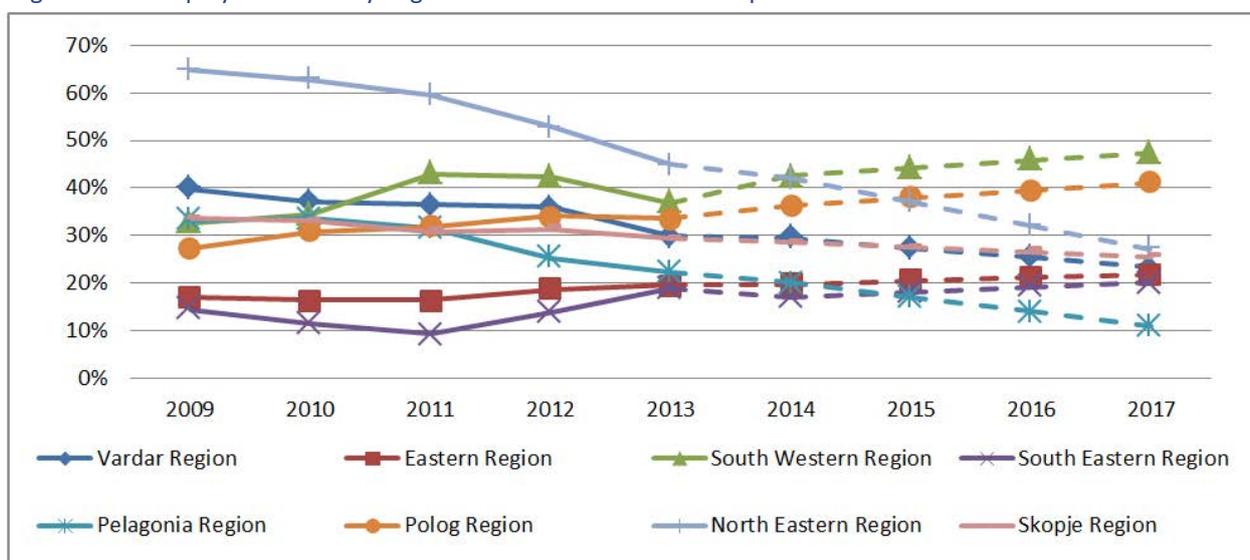
Available at: <http://avrm.gov.mk/pregled-na-evidentirani-nevraboteni-lica-spored-nacionalna-pripadnost.nspix>

in 2012-2013, which is attributed to the change in the way the EA started registering the unemployed since 2012 i.e. as active jobs seekers (obliged to go to job interviews, trainings and regularly register at the EA offices once every 3 months), and the rest designated as passive job seekers.

comprehensive since, as some studies show, 17.4% of the inactive population aged 25-40 were not registered as unemployed nor were employed,<sup>10</sup> thus skewing the data towards underestimation. In addition, the decline in the number of active job seekers among Albanians and other ethnicities (Roma in particular) might be explained with the fact that many are not adequately informed therefore are unaware of the need to register more frequently in the Employment Agency in order to be considered as active job seekers, as some field data indicates.<sup>11</sup>

An in-depth look at the data can offer some insight into the scope of undeclared labor in Macedonia since the latter category of unemployed, the passive job seekers, are considered as more likely to be involved in undeclared activities. It has to be noted that the data is not substantially

Figure 7 - Unemployment Rate by Region. Period 2014-2017 is a simple linear forecast. Source: SSO



<sup>10</sup> Janeska, V. (2013) Labor market and labor migration in the Republic of Macedonia – changes and current situation. Paper presented at the 6th IZA/ASE Workshop on EU Enlargement and the Labor Markets. Available from: [http://www.iza.org/conference\\_files/EUEnlargement\\_2013/viewProgram?conf\\_id=2594](http://www.iza.org/conference_files/EUEnlargement_2013/viewProgram?conf_id=2594) (Accessed 10.10. 2014).

<sup>11</sup> Analysis: Between Implementation and Reliety of the National Strategy for roma Inclusion – Roma Decade 2005-2015, Helsinki Committee of RM, 2014

Looking at the unemployment rate data by region there is a noticeable trend of convergence among the different regions in Macedonia. All other factors being constant, the linear data forecast suggests that even though there are still significant regional inequalities most regions show a tendency to converge below the 30% mark with the Pelagonia region showing best results at 10% unemployment rate. However, the Polog and South Western regions forecasts in 2017 show very high unemployment rates of 41.% and 47% respectively (Figure 7). These figures are likely to be much lower, especially for the South Western region, as new FDI companies have already announced their investments in the years following 2013, but nevertheless it is an important indicator of unequal regional development.

**Barriers to doing business**

A valuable source of information about the business climate in Macedonia, which is the backbone of economic development, is World Economic Forum (WEF) annual competitiveness reports. The survey explores the effectiveness of legislation through the evaluation of 16 key

factors: Inefficient government bureaucracy, access to financing, policy instability, corruption, inadequate supply of infrastructure, inadequately educated workforce, poor work ethic in national labour force, tax regulations, restrictive labour regulations, tax rates, government instability/ coups, crime and theft, poor public health, inflation, foreign currency regulations and insufficient capacity to innovate.

In the Macedonian case, the top 5 barriers to doing business commonly represent around 60% of all barriers. When the top 5 barriers are compared for years 2010 and 2014, several crucial indications emerge. Access to financing remains to be the top barrier for doing business since 2011 onwards, and the inefficiency of the government bureaucracy remains to be significant and be among the top 5 barriers throughout 2010-2014 (Figure 8). Inadequate supply of infrastructure keeps dropping in and out of the top 5 barriers signifying that the present efforts to improve infrastructure, which is crucial to business operations, need to be further enhanced.

Figure 8 - Top 5 barriers to doing business in Macedonia, in %. World Economic Forum – World Competitiveness Reports 2010 - 2015

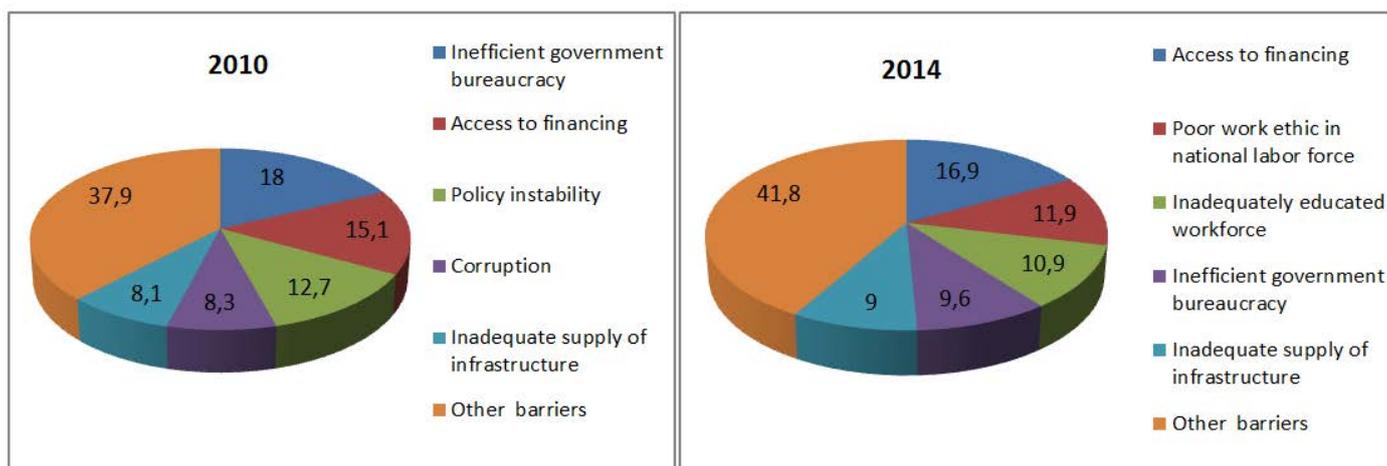


Table 1- World Competitiveness Report, 16 barriers to doing business in Macedonia, (%).  
Source: World Economic Forum (WEF), Global Competitiveness Reports 2010-2015.

2010		2011		2012		2013		2014	
Inefficient government bureaucracy	18	Access to financing	19,7	Access to financing	17,1	Access to financing	17,4	Access to financing	16,9
Access to financing	15,1	Inefficient government bureaucracy	13,2	Inadequately educated workforce	12,5	Inadequate supply of infrastructure	15,2	Poor work ethic in national labor force	11,9
Policy instability	12,7	Inadequately educated	10	Corruption	11,5	Inadequately educated workforce	11,9	Inadequately educated workforce	10,9
Corruption	8,3	Poor work ethic in national labor force	9,8	Inefficient government bureaucracy	11,4	Poor work ethic in national labor force	11,6	Inefficient government bureaucracy	9,6
Inadequate supply of infrastructure	8,1	Corruption	8,8	Inadequate supply of infrastructure	9,3	Inefficient government	10,6	Inadequate supply of infrastructure	9
Inadequately educated workforce	7,7	Policy instability	8,1	Poor work ethic in national labor force	7,5	Corruption	8,7	Policy instability	8,4
Poor work ethic in national labor force	6,4	Tax regulations	7,3	Policy instability	5,7	Insufficient capacity to innovate	5,7	Insufficient capacity to innovate	7,6
Tax regulations	6,4	Inadequate supply of infrastructure	5,2	Insufficient capacity to innovate	5,4	Tax rates	3,6	Corruption	5
Restrictive labor regulations	6	Tax rates	4,6	Tax regulations	3,7	Policy instability	3,3	Tax rates	4,6
Tax rates	4,2	Government instability/coups	3,4	Restrictive labor regulations	3,4	Poor public health	3,2	Tax regulations	4,2
Government instability/coups	2,4	Restrictive labor regulations	3,1	Crime and theft	3	Tax regulations	3,1	Restrictive labor regulations	3,8
Crime and theft	1,9	Inflation	3,1	Government instability/coups	2,9	Restrictive labor regulations	1,8	Poor public health	2,8
Poor public health	1,4	Poor public health	2	Tax rates	2,7	Crime and theft	1,7	Crime and theft	1,6
Inflation	1,2	Crime and theft	1,2	Inflation	2,2	Government instability/coups	1,4	Foreign currency regulations	1,5
Foreign currency regulations	0,3	Foreign currency regulations	0,5	Poor public health	1,4	Inflation	0,4	Government instability/coups	1,3
Insufficient capacity to innovate		Insufficient capacity to innovate		Foreign currency regulations	0,2	Foreign currency regulations	0,4	Inflation	1

The most important trend witnessed in the past 2-3 years is a steady movement toward the top 5 barriers for doing business of 2 factors, poor work ethic in national labor force and inadequately educated workforce. In 2014, as mentioned above, they are the second and third biggest barrier to

doing business in Macedonia. Various business associations have also indicated repeatedly that there is a significant gap between the business needs in terms of particular labor skills and the actual supply of labor necessary for optimal business operations.

Table 2 - Government Revenue vs. Main Macro Indicators and other data

Indicator (MKD million unless otherwise stated)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	Q1-Q3 2014*
GDP (Current Prices Mln MKD)	320.059	364.989	411.728	410.735	434.112	459.789	458.621	473.019	385.793
Export Total (Mln USD)	2.415	3.398	3.991	2.708	3.351	4.478	4.015	4.267	3.694
Import Total (Mln USD)	3.752	5.281	6.883	5.073	5.474	7.027	6.522	6.600	5.419
Final Consumption Expenditure	308.328	342.361	405.487	392.912	407.052	429.450	427.573	447.578	340.396
Household Final Consumption Expenditure	250.309	279.880	330.399	314.376	324.096	345.262	342.809	364.665	276.048
Public Final Consumption Expenditure	58.019	62.481	75.088	78.536	82.957	84.188	84.764	82.912	64.348
Gross Fixed Capital Formation	56.485	71.557	86.403	81.872	82.968	94.698	105.443		
FDI Total (mln MKD)	21.207	31.117	24.593	8.916	9.842	20.713	4.431	15.466	12.337
FDI Total (mln EUR)	344,8	506,0	399,9	145,0	160,0	336,8	72,0	251,5	200,6
Profit Tax	4.710	5.896	8.579	4.435	3.691	3.888	3.655	4.419	3.590
Income Tax	8.414	8.891	8.696	8.707	8.872	9.513	9.553	10.255	8.603
VAT (The PRO)	27.240	32.962	36.174	35.178	37.694	42.223	38.468	39.835	31.422

VAT (Customs)	26.400	34.500	43.400	32.511	34.814	41.322	41.041	37.741	28.172
Excises	680	890	1.000	14.730	14.670	15.559	16.630	18.064	14.363
Customs Tax	5.600	6.400	6.400	5.409	4.760	3.779	4.066	4.255	3.100
Credit Growth Rate (%)					7,1	8,5	5,4	6,4	8,7*
Household Credit Growth Rate (%)					5,1	8,1	6,5	10,2	12*
Enterprises Credit Growth Rate (%)					8,4	8,6	4,5	3,8	6,4*
Bad Loans Rate (%)	11,2	7,5	6,8	9,1	9,3	9,9	10,5	11,5	12,2
Deposit Growth Rate (%)					13,7	9,2	4,9	6,1	8*
Household deposits					17,4	12,0	7,2	6,7	7,9*
Enterprises deposits					6,4	6,1	-2,0	4,1	12,3*
Public Debt	30,6	23,5	20,5	23,6	24,1	27,7	33,7	34,2	39,3
Public Debt (incl other debt)	33,2	25,8	23	26,2	27,2	32,0	38,3	40,5	46,6
Budget Deficit (%)	-0,5	0,6	-0,9	-2,7	-2,4	-2,5	-3,9	-4,1	
Inflation Rate (%)	3,2	2,3	8,3	-0,8	1,6	3,9	3,3	2,8	-0,2
NBRM FX reserves (mln EUR)	1.416,7	1.524,4	1.494,9	1.597,5	1.714,5	2.068,9	2.193,3	1.993,0	2.435,0
Non-Observed Economy NOE (as % adjustment of GDP)			20,1	21,0	19,6	20,0	19,2		

\* To be confirmed with official data, available only until Q4 2013.

Source: Ministry of Finance, National Bank of RM, State Statistical office

### III. Hidden economy: concept and measurement

The concept of 'hidden economy' is not new in the Macedonian public and academic sphere, although the term itself has not been used so far. The most widely used term is 'grey' or 'informal' economy, utilized by the state institutions in the strategic documents (Action plans), the media and most of the academics. It is defined as 'economic activities which are legal, but are (intentionally) unregistered and not recorded for tax purposes.

Overall, a wide variety of terms and definitions have been put forward by economists and policy makers throughout the relevant literature. The socio-economic phenomenon has been given a wide array of labels, including informal, shadow, hidden, or underground economy, with an even

wider reference within each language. While all terms and definitions touch upon the same general matter of un-recorded economic activities, they each differ slightly depending on their purpose. For example the European Commission focuses more on undeclared work which defines it as "any paid activities that are lawful as regards their nature but not declared to public authorities, taking into account differences in the regulatory system of Member States." This definition covers diverse activities while excluding criminal activities. The World Bank's model of informality identifies the causes and composition of the hidden economy. Some of the field's main authors, such as Schneider and Williams (2013), state that the shadow economy: "includes all market-based production of legal goods and services that are deliberately concealed from public authorities for the following reasons:

<sup>12</sup> Grey economy action plan 2014, MLSP, 2013

<sup>13</sup> European Commission Communication COM(2007) 628 final.

Retrieved from: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0628:FIN:EN:PDF>

<sup>14</sup> Chen, M., A., The Informal Economy: Definitions, Theories and Policies (2012).

Retrieved online on 07.03.13 from: [http://wiego.org/sites/wiego.org/files/publications/files/Chen\\_WIEGO\\_WP1.pdf](http://wiego.org/sites/wiego.org/files/publications/files/Chen_WIEGO_WP1.pdf)

- to avoid payment of income, VAT or other taxes;
- to avoid payment of social security contributions;
- to avoid having to meet certain legal labor market standards, such as minimum wages, maximum working hours, safety standards, etc.; and
- to avoid complying with certain administrative obligations”<sup>15</sup>

There are several different methods (direct and indirect) for measuring the hidden economy. The most prominently used are listed in Table 2.

In the case of estimating the hidden economy in Macedonia, there is a prevalence of **indirect methods**. Most researchers and institutions have been focusing their attention to the two-sector dynamic general equilibrium model<sup>16</sup>, Electricity Consumption Method (ECM)<sup>17</sup>, Multiple Indicators

Table 3 - A list of most used methods for measuring hidden economic activity

Direct approaches	Indirect approaches
<ul style="list-style-type: none"> <li>• Representative studies of hidden economic activity</li> <li>• Studies of time budgeting</li> <li>• Tax audits</li> </ul>	<ul style="list-style-type: none"> <li>• Monetary methods</li> <li>• Income-expenditure discrepancy methods</li> <li>• Labour supply-demand discrepancy methods</li> <li>• Physical input (vs. official product) methods (electricity consumption)</li> <li>• Multiple indicators – multiple causes</li> </ul>

– Multiple Causes (MIMIC)<sup>18</sup><sup>19</sup>, and the supply-demand method of using adjustments of national GDP for non-exhaustiveness as a measure of estimating the non-observed economy (NOE)<sup>20</sup>. **Direct methods**, on the other hand, have been represented by intermittent country-level direct population surveys<sup>21</sup>, enterprise surveys<sup>22</sup>, and the Labor force Survey<sup>23</sup>.

The part that follows elaborates on the methods employed by the Macedonian Statistical Office for measuring the scope of hidden economy and offers some suggestions for improvement.

### Hidden economy in the State Statistical Office

As the only public institution with an annual mandate to measure different forms of hidden economic activities, the State Statistical Office employs two measures to assess the scope of hidden economy: detecting the share of informal employments as part of the overall employment rate; and adjusting the GDP through calculating the non-observed economy. The first data is collected through the Labour Force Survey (LFS) and the second through the calculations/estimations of exhaustiveness of GDP.

<sup>15</sup> Schneider, Friedrich; Williams, Colin “The Shadow Economy,” The institute of Economic Affairs 2013, pp 23-27, Retrieved on 01.06.2014 from: <http://www.iea.org.uk/sites/default/files/publications/files/IEA%20Shadow%20Economy%20web%20rev%207.6.13.pdf>

<sup>16</sup> Elgin, C. and Öztunali, O. (2012) Shadow Economies around the World: Model Based Estimates. Istanbul: Bogazici University, Department of Economics.

<sup>17</sup> Garvanlieva, V., Andonov, V., Nikolov, M. (2012) Shadow Economy in Macedonia. Skopje: Center for Economic Analyses

<sup>18</sup> Ibid,

<sup>19</sup> Schneider, F., Buehn, A. and Montenegro, C. (2010) Shadow Economies All over the World. New Estimates for 162 Countries from 1999 to 2007. Policy Research Working Paper 5356. Washington D.C.: World Bank Group.

<sup>20</sup> SSO

<sup>21</sup> Stankovic, M. and Stankovic, B. (2012). Social and economic aspects of the shadow economy in the Republic of Macedonia: A study. Social Science Research Network [Online]. Available from: <http://ssrn.com/abstract=2162922> (Accessed 30 June 2014).

<sup>22</sup> World Bank. (2014) Enterprise Survey 2013. Country Profile Macedonia. Washington D.C.: World Bank Group.

<sup>23</sup> State Statistical Office (SSO)

In 2008, the State Statistical Office (SSO) initiated a process of specifying the LFS questions on informal sector and the nonstandard/informal employment, with the assistance of external experts. The process resulted in identifying measures for nonstandard/informal employment, as well as for the informal sector.<sup>24</sup> Currently, SSO uses the measure of 'observed informal employment' to encompass all undeclared employees (those without social and legal protection coverage), regardless if they work in: regular firms, un-registered or un-incorporated entities, own-account enterprises or in the household sector.

Specifically, the survey initially detects the employed persons, i.e. all persons who have worked at least one hour during the reporting week. Then, the survey asks whether the person has been registered in the Employment Agency and/or paid benefits in the Pension Insurance Fund<sup>25</sup>. The SSO defines informal sector units as 'enterprises that are not registered' and informal sector employment refers to the population

employed in: (1) own-account enterprises which are not registered; (2) enterprises of informal employers which are not registered and (3) enterprises of informal employers whose employees are not registered. The information is collected only for the main/primary job, meaning that the employment in the informal sector refers only to persons whose main job is in the informal sector. In line with this, *'the informal employment includes the employed persons who are not registered (in their main job) in the Pension Fund, the Health Fund and/or an Employment Agency.'*<sup>26</sup> Specifically, the following types of employees are regarded as informal: (1) own-account workers employed in their own informal sector enterprises; (2) employers employed in their own informal sector enterprises; (3) contributing family workers working in formal sector enterprises; (4) contributing family workers working in informal sector enterprises; (5) employees holding informal jobs in formal sector enterprises; (6) employees holding informal jobs in informal sector enterprises.

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<sup>24</sup> Novkovska, B., (2008), Measuring Non-standard and Informal Employment in the Republic of Macedonia, paper prepared for the workshop on, Measurement Informal Employment in Developed Countries WIEGO, Kennedy School of Government, Harvard University, October 31-November 1, 2008

<sup>25</sup> Ibid.

<sup>26</sup> ILO-LFS Methodology for Macedonia, available at: [http://www.ilo.org/dyn/lfsurvey/lfsurvey.list?p\\_lang=en&p\\_country=MK](http://www.ilo.org/dyn/lfsurvey/lfsurvey.list?p_lang=en&p_country=MK)

The following questions (Box 1) are used by the SSO to detect informal employment through the LFS:

Box 1 - Questions used by the SSO for detecting informal employments

“Are you registered in some of the institutions in your work?” (more answers possible)

1. Pension Insurance Fund of the RM
2. Private pension insurance funds
3. Fund for the health and social insurance of the RM
4. Do not know
5. Not registered
6. Other (specify)

“Is the business subjects where you work registered in the Central Registry?”

1. Registered
2. Not registered
3. Don't know
4. Other

“Do you have?”

1. Written contract
2. Oral contract

ILO-LFS Methodology for Macedonia, available at:

[http://www.ilo.org/dyn/lfsurvey/lfsurvey.list?p\\_lang=en&p\\_country=MK](http://www.ilo.org/dyn/lfsurvey/lfsurvey.list?p_lang=en&p_country=MK)

While detecting the basic forms of informality, the mentioned method does not include the more specific forms of informality, for example: employees who are registered on a smaller wage (usually the minimum wage for the sector), but receive higher net wage, through ‘envelope payments’ or additional service contracts; employees registered as part-time workers, but actually working full time; etc. In addition, it does not include the employees who are paid a certain remuneration on their banking account (for which taxes are being calculated), but are required to return part of the money to the employer. As accounts of the existence of such practices are widespread<sup>27</sup>, they indicate that the

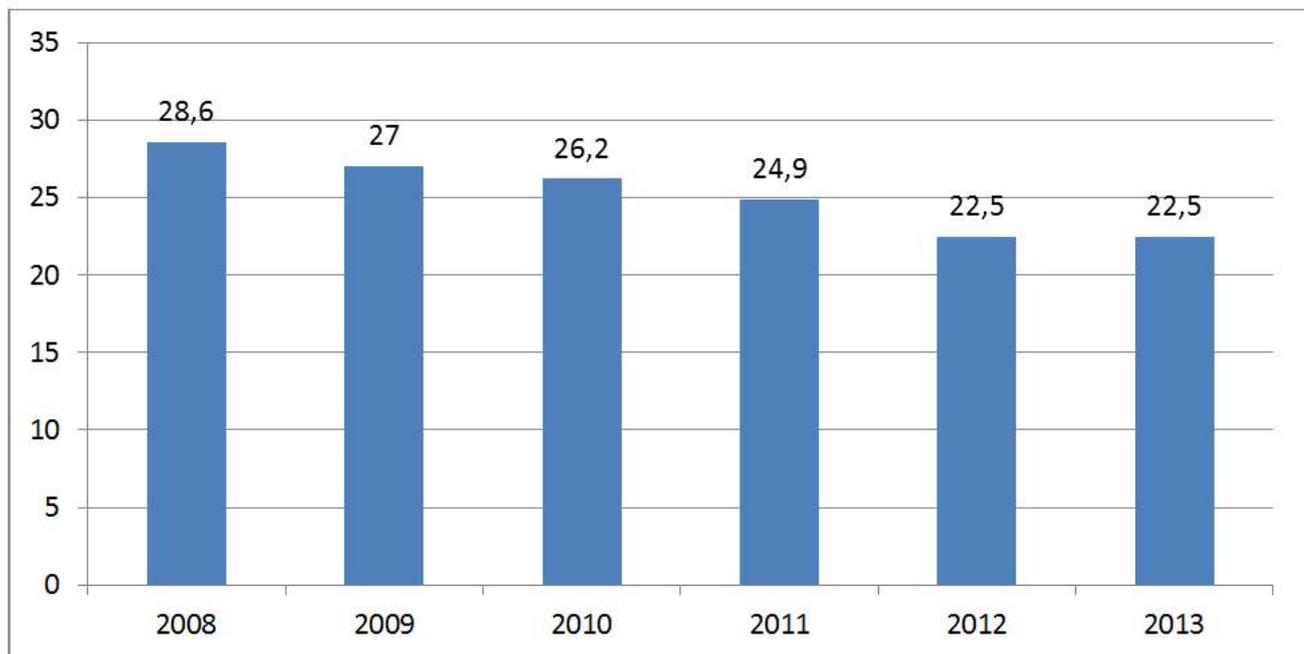
current method for measuring informality is not completely exhaustive. Still, however limiting, they provide valuable information to policymakers on the scope and structure of informal employment, part of which is elaborated below.

### Share and structure of informal employment

According to the Labour Force Survey 2013 conducted by the SSO, the observed informal employment as a percentage of the total employment as of 2013 stands at 22.5% (Figure 9). What is noticeable is the decreasing trend of the observed informal employment over the past few years, an indication of labor crossover towards formalization of employment.

<sup>27</sup> <http://lider.mk/2014/07/22/pogolemi-kazni-za-nepocituvacite-na-zakonot-za-minimalna-plata/>;  
<http://faktor.mk/archives/102624#>;  
<http://www.time.mk/cluster/8035d735bd/ohrid-sky-vo-mtv-za-odbranite-se-deli-plata-vo-pliko.html>

Figure 9 - Share of informally employed, as percentage of the total number of employed persons (2008-2013)



Source: SSO, LFS 2008, 2009, 2010, 2011, 2012, 2013

With regards to demographic specifics, the latest data from the LFS indicate that **informal employment is the dominant type of employment within the group of employees over 65 years, followed by the 15-24 age group** (Table 3). Among other age groups, the informal employment ranges at around 20%. While the high level of informality among the population over 65 years

should not be concerning, since it usually refers to retired persons who have their social insurance covered with their status, but continue working informally for additional income; the high share of informality among the young population is a condition that should be seriously tackled. In terms of gender, men comprise a larger share of the informal employees compared to women.<sup>28</sup>

Table 4 - Share of informal employments as % of total employments within the age-group

Age-group	15-24	24-44	45-64	65+
%	43	20	20	90

Source: Authors' calculations on the basis of LFS data

Novkovska (2008) notes that **informal employments are strongly linked to the form of employment, i.e. they tend to be characteristic for the temporary and nonstandard<sup>29</sup> employments** (see Table 4 below), with the former accounting for 77.7% and the latter for 70%

of all informal wage employment. The author concludes that since temporary employment agencies in Macedonia are required to formally register their employees, it can be implied that all informal temporary employment occurs outside of the agencies.

Table 5 - Formal and informal employments and form of employment (LFS, 2007)

	male	female	total
Temporary as % of formal	4.8%	4.8%	4.8%
Temporary as % of informal	78.4%	74.2%	77.0%
Nonstandard <sup>30</sup> as % of formal	5.9%	6.8%	6.3%
Nonstandard as % of informal	79.1%	74.8%	77.7%

Source: [http://wiego.org/sites/wiego.org/files/publications/files/Novkovska\\_Measuring\\_informal\\_empl\\_Macedonia.pdf](http://wiego.org/sites/wiego.org/files/publications/files/Novkovska_Measuring_informal_empl_Macedonia.pdf) (Novkovska, 2008)

<sup>28</sup> SSO, LFS, 2014

<sup>29</sup> Defined by Novkovska (2008) as: temporary employees who are working through temporary employment agency, temporary employees (other than agency) and part-time employees.

<sup>30</sup> temporary employees who are working through temporary employment agency, temporary employees (other than agency) and part-time employees.

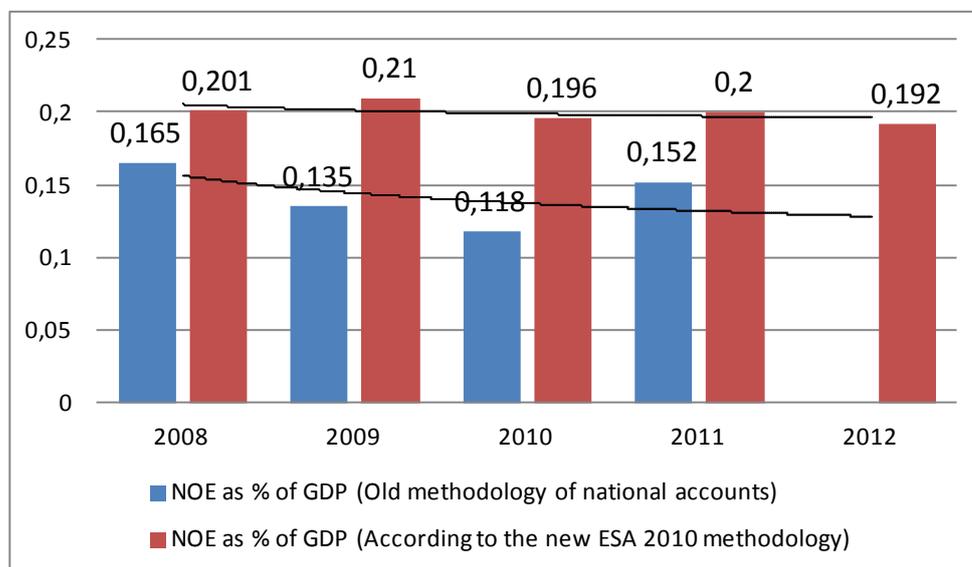
Since another typical feature of informal employments is the place of work, Novkovska (2008) also explored the share of informal employees and employers who work from home, and found that this percentage is very low. In fact, 95.5% of non-agricultural and 97.8% of agricultural informal employees do not work from home; whereas 93% of non-agricultural and 89% of agricultural employers do not work from home.

From the data presented, it is evident that the **most vulnerable groups for hidden economic activities are: young people, men, employees in temporary and non-standard employment.**<sup>31</sup> Although typically related to people with low qualifications and seasonal workers, untraditional forms of informal employment also include professions such as: interpreters, programmers, tutors etc.<sup>32</sup>. Hence, these groups should be (and some are) exposed to specific policy measures in order to tackle the issue effectively. More on the characteristics of vulnerable groups is presented in Chapter 6, and on the policies directed towards them - in Chapter 8 of this report.

### Measuring non-observed economy

Additional method of measuring hidden economy used by the SSO comprises measurements of the exhaustiveness of GDP. In particular, the SSO defines "non-observed economy" as 'activities that are within the production boundary defined by the ESA 95<sup>33</sup> but which are omitted, either partially or completely, from the estimates of GDP because they are under-reported or not covered by the statistical surveys or administrative records from which the national accounts are constructed.'<sup>34</sup> Hence, exhaustiveness adjustments are made when calculating GDP by production method. The SSO identifies and quantifies the various types or causes of non-exhaustiveness on the basis of OECD Handbook for measuring the non-observed economy and Eurostat's tabular approach to exhaustiveness. In particular, adjustments are made for the following types of non-observed economy: (1) producer deliberately not registering - underground; (2) producer not required to register; (3) registered entrepreneurs not surveyed; (4) producers deliberately misreporting; and (5) other statistical deficiencies.<sup>35</sup>

Figure 10 - Non Observed Economy (NOE) in Macedonia (2008-2012), as % adjustment of annual GDP



Source: SSO, GDP Reports

<sup>31</sup> It is expected that these groups are not exhaustive, but the available data is limited to further estimations.

<sup>32</sup> Tevdovski, D., & Tosevska, K. (2006). The Main Characteristics of the Unemployment in Macedonia . *Proceedings from the International Scientific Conference - ECOTREND-2006* . Targu-Jiu: Constantin Brancusi University.

<sup>33</sup> European System of Accounts

<sup>34</sup> SSO, GDP Reports, 2011

<sup>35</sup> Ibid.

The non-observed economy from 2008-2012 has ranged at about 20% of GDP, experiencing its lowest level (19.2%) in 2012. (Figure 10). The largest share of non-observed economic activities were detected with the indicator – ‘producer not required to register’ (11-12%) and ‘producers deliberately misreporting’ (5-6%). (SSO, 2014)<sup>36</sup>

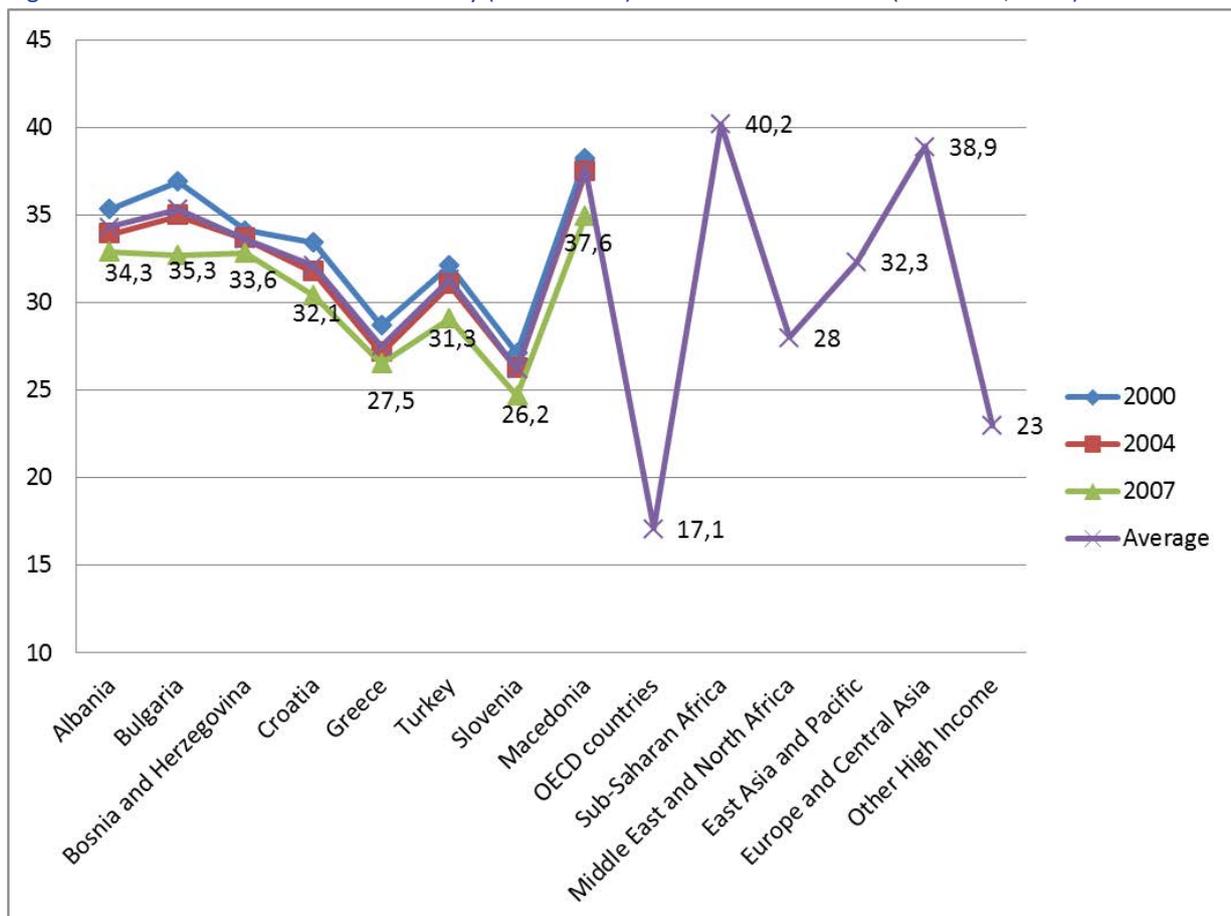
## IV. The Hidden Economy in Macedonia in a Comparative Context

The level of hidden/grey economy in the Republic of Macedonia has been assessed by several foreign authors, in a comparative context with other countries, as well as individually by domestic authors. The following chapter presents the estimations of different authors and aims

to provide a picture of where Macedonia stands compared to other countries from the region and outside the region.

Schneider et al. (2010)<sup>37</sup> used the MIMIC approach to estimate the grey economy, as percentage of GDP in 162 countries, including Macedonia. The authors used somewhat different cause variables for countries with different characteristics. Specifically, for the Eastern European and Central Asian (mostly former transition) countries, these include ‘the size of government, the fiscal freedom index, for state regulation the business freedom index, and for the state of the economy the unemployment rate, inflation rate and openness (sum of export and imports of goods and services, in percentage of GDP)’. As indicators, they used the growth rate of GDP per capita, the growth rate of total labour force, and the ratio M0 over M1<sup>38</sup>.

Figure 11 - Estimations of shadow economy (as % of GDP) with the MIMIC model (Schneider, 2010)



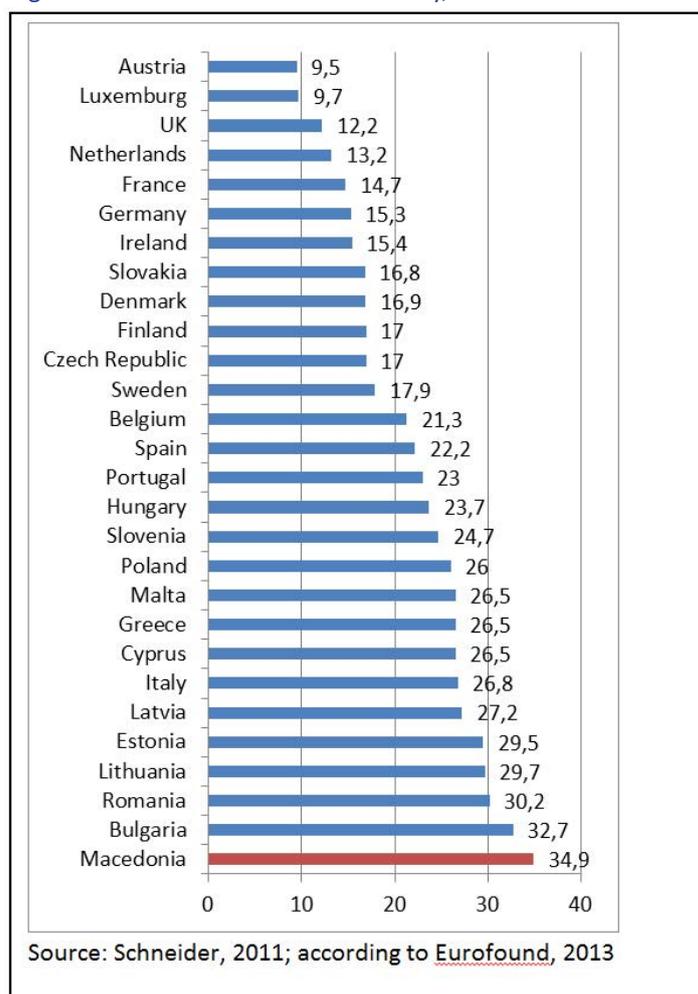
<sup>36</sup> GROSS DOMESTIC PRODUCT, 2000 - 2012 revised data, SSO, 2014

<sup>38</sup> M0/M1:M0 corresponds to the currency outside the banks; the usual definition for M1 is M0 plus deposits (Schneider et al. (2010)

Estimations indicate that the shadow economy in Macedonia is the highest in the region (Figure 11), composing on average (from 1999 to 2007) 37.6% of the GDP. Schneider et al (2010) argue that with regards to Eastern European and Central Asian (mostly former transition) countries 'the size of government and the fiscal freedom variable (both capturing the overall state burden), are highly statistically significant causes' for the shadow economy rate, as well as the inflation rate, the

growth rate of the total labour force and the growth of GDP per capita. However, the economic freedom was found to be negatively correlated with the shadow economy rate in these countries. Finally, analysis indicates that 'a reduction of the regulatory burden and improvement of business/economic freedom in transition and OECD countries leads to a much higher reduction of the shadow economy than it would in developing countries'.<sup>39</sup>

Figure 12 - Size of Undeclared Economy, as a % of GDP



The Eurofound (2013) analysis notes that Schneider's method provides only 'relative values, with the help of the currency demand approach for a few countries (Austria, Germany, Poland and Switzerland)', who have been then calibrated into absolute ones.<sup>40</sup> However, they use Schneider's

data to present the following figure (Figure 12) which compares the undeclared economy for Macedonia in with its EU 27 counterparts. Data indicate that Macedonia lags behind all EU 27 countries, although Bulgaria and Romania are close.

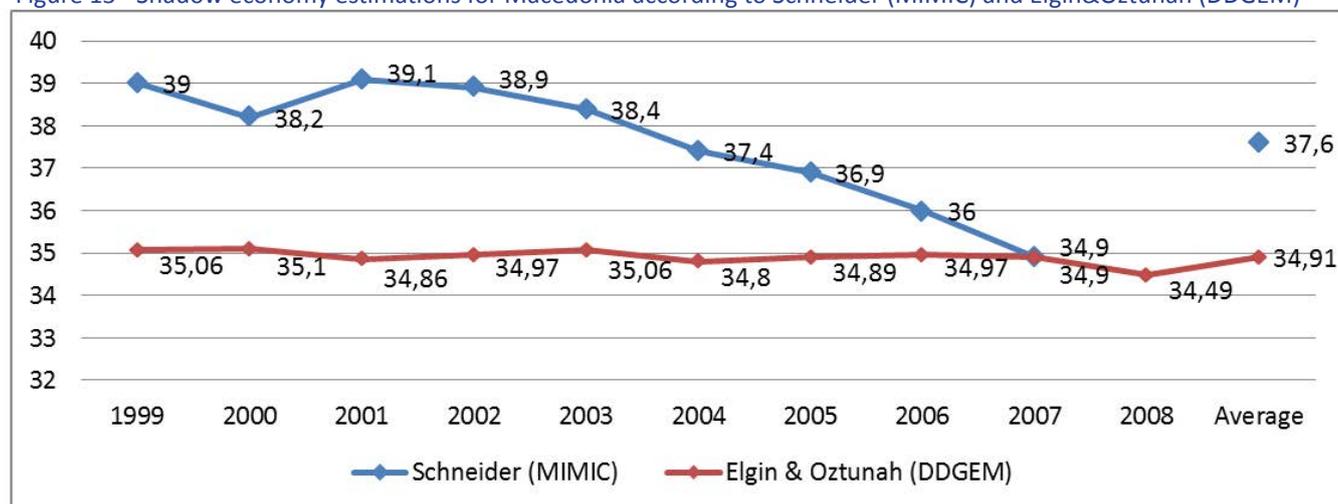
<sup>39</sup> Schneider, F., Buehn, A. and Montenegro, C. (2010) Shadow Economies All over the World. New Estimates for 162 Countries from 1999 to 2007. Policy Research Working Paper 5356. Washington D.C.: World Bank Group.

<sup>40</sup> Eurofound (2013) Tackling Undeclared Work in FYR Macedonia

Evidently, Schneider's estimations indicate a slow, but steady decline in the shadow economy for Macedonia, as a percentage of GDP from 39% in 2001 to 34.9% in 2007. Elgin and Öztunali (2012), on the other hand, using a novel Deterministic

Dynamic General Equilibrium (DDGE) model did not detect larger fluctuations from 1999 until 2008 and mostly found the percentage of shadow economy to be ranging between 34 and 35 percent of GDP (Figure 13).<sup>41</sup>

Figure 13 - Shadow economy estimations for Macedonia according to Schneider (MIMIC) and Elgin&Oztunah (DDGEM)



The approach employed by Elgin and Öztunali treats the size of the shadow economy as an unobserved latent variable and essentially consists of two steps: In the first step, the causes and the indicators of the shadow economy are determined. Then in the second step, given the causes and the indicators and the specified relationship among them through the unobserved latent variable, a structural equation model is run to estimate the coefficients of the causes and the indicators.<sup>42</sup>

Estimations from this model also place Macedonia as a leader in the region with regards to the share of shadow economy, as percentage of GDP, and as country with the least progress for reducing the shadow economy from year 1999 to year 2008 (see Table 5). However, since estimations for Macedonia are only made until 2008, it prevents us to assess whether the policies implemented since this year (flat tax, reduction of social insurance tax, etc.) have resulted in changing these numbers.

Table 6 - Shadow economy estimations for Western Balkan countries. Elgin & Öztunali (deterministic dynamic general equilibrium model)

Year/country	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Albania	36.04	36.97	35.78	35.44	35.16	34.75	34.27	33.64	32.9	32.06	
Bulgaria	34.98	35.05	35.02	34.9	34.63	34.45	33.92	33.43	32.7	31.91	
Bosnia and Herzegovina	35.49	34.54	34.11	33.89	33.83	33.81	33.43	33.05	32.8	32.03	
Croatia	33.14	32.99	32.96	32.75	32.39	32.04	31.57	30.96	30.4	29.77	
Greece	28.79	28.5	28.13	27.9	27.72	27.39	26.92	26.76	26.5	26.16	25.85
Turkey	32.53	31.96	31.56	31.61	31.36	31.2	30.82	30.26	29.1	28.63	27.68
Slovenia	27.72	27.17	26.74	26.45	26.01	25.86	25.45	25.08	24.7	24.11	
Macedonia	35.06	35.1	34.86	34.97	35.06	34.8	34.89	34.97	34.9	34.49	

The high level of shadow economy determined through the above methods is also supported through the findings of the enterprise survey (World Bank and IFC, 2013). In the latest survey, 30% of companies in Macedonia (especially small

and medium-sized firms) assessed the 'practices of competitors in the informal sector' as the biggest obstacle for doing business. Compared to other indicators, this was the leading obstacle, followed by the 'access to finance' selected by 22%

<sup>41</sup> Elgin, C., Öztunali, O., Shadow Economies around the World: Model Based Estimates, p.42

<sup>42</sup> Ibid.

of companies and ‘political instability’ selected by 10% of companies. In comparison, out of the countries from the region, the informal sector practices were selected as the leading obstacle by the majority of companies in Kosovo (25%), Bulgaria (28%) and Albania (18%). The informality was the third most selected obstacle by companies

in Serbia (11%) and Croatia (10%) and was not among the top three obstacles in Bosnia and Herzegovina. The data once again emphasise the large size of the informal economy in Macedonia, separately and in comparison to countries from the region, and the extent at which it limits the development of the formal economy.

Table 7 - Persons in informal employment in Macedonia and other ECA countries

Country (Year)	Persons in informal employment	Persons employed in the informal sector	Labour force participation rate	Unemployment rate	Gross Domestic Product per capita	Poverty
	% of non-agricultural employment	% of non-agricultural employment	% of Working age population	% of Economically active population	In current US\$ (year 2010)	% of population living below national poverty line
Macedonia (2010)	12.6	7.6	55.7	32	4,431	19
Serbia (2009)	6.1	3.5	43.3	13.6	5,233	6.6
Moldova (2009)	15.9	7.3	41.9	7.4	1,630	29.0
Ukraine (2009)	na	9.4	65.9	8.1	3,000	7.9
Turkey (2009)	30.6	na	48.8	11.9	10,399	20.5
Russian Federation (2010)	na	12.1	67.7	7.5	10,437	11.1

Source: ILO Department of Statistics (2012),

[http://laborsta.ilo.org/applv8/data/INFORMAL\\_ECONOMY/2012-06-Statistical%20update%20-%20v2.pdf](http://laborsta.ilo.org/applv8/data/INFORMAL_ECONOMY/2012-06-Statistical%20update%20-%20v2.pdf)

An analysis on the employment in the (non-agricultural) informal sector and informal employment conducted by the ILO Department of Statistics<sup>43</sup> drawing on data from 47 medium and low-income countries, including Macedonia, led to the following findings.

- From the countries analyzed, the lowest percentages of informal employment were observed in Central and Eastern European countries;
- The cross country data suggested that informal employment is paired with low income per capita and high poverty rates. In a comparative context with the ECA countries (Table 6), Macedonia can be found in the middle with regards to the share of persons in informal employment and employed in the informal sector.

## V. Legal and Institutional Framework

The following chapter gives an overview of the most important institutions in charge of tackling different aspects of the hidden economy in Macedonia. In addition, it summarizes the most important legal documents which regulate the work of the institutions and/or set the foundations for the main policies aimed to address the issue of hidden economy and its various facets.

<sup>43</sup> ILO, Department of Statistics (2012). Retrieved from:

[http://laborsta.ilo.org/applv8/data/INFORMAL\\_ECONOMY/2012-06-Statistical%20update%20-%20v2.pdf](http://laborsta.ilo.org/applv8/data/INFORMAL_ECONOMY/2012-06-Statistical%20update%20-%20v2.pdf)

# 1. Institutional Framework

## 1.1 Ministry of Labour and Social Policy (MLSP)

On a national and regional level, the Ministry of Labour and Social Policy (MLSP) is the main body that regulates the activity of all labour market institutions as well as constructing the main pillars around the social security contributions. The MLSP drafts legislation, programs and measures within the field of labour market regulation (including undeclared labour) and implements and enforces policies through the Employment Agency (EA), Pension and Disability Insurance Fund, Social Assistance Agency<sup>44</sup> and State Labour Inspectorate (SLI)<sup>45</sup>. Additionally a range of specialized associations, agencies, boards and commissions assist the ministry in its work. These specialized units further cooperate with the Inspection Surveillance Council (ISC), State Market Inspectorate (SMI), Public Revenue Office (PRO) etc. MLSP is included in the process of designing the policy system around social security benefits and contributions thus being actively involved in the creation of the particular Macedonian network of incentives, benefits and duties.

The MLSP is currently the main institution in charge of drafting and implementing the Action Plan for the reduction of the grey economy (Ministry of Economy, 2013; MLSP, 2014), which represents a consultative effort to coordinate and monitor the activities of several institutions and regulatory bodies into the field of tackling undeclared labour, tax evasion and their different facets while at the same time clearly delineating responsibilities among them. The plan is consisted of repressive and preventative measures as well as measures that boost commitment and tax morale (for examples see The policy approaches framework used in Table 15 (established initially by Williams and Rennoy, 2009) shows clearly some of the more prominent measures undertaken by the Government of Macedonia (GoM) in order to deter

and prevent undeclared work. Illustrating the key features of the measures aimed at the undeclared economy is a good starting point for evaluation and modification of implemented measures and a cornerstone for future measures.

However, deficiencies are present within areas such as:

- despite some recent measures towards fostering commitment and tax morale the focus is predominantly on detection and control
- “in order for the fight against undeclared work to become a joint effort of the public administration as a whole, the plan would need to go beyond simply reinforcing the main tasks of each body separately, and provide a more substantial basis for cooperation and coordination of measures through shared strategies and targets, as well as mechanisms for information sharing and joint reporting.”<sup>46</sup>

### 1.1.1 Employment Agency (EA)

Working under the auspices of the Ministry of Labour and Social Policy, the EA is responsible for managing active employment measures, as well as employment programs, such as the self-employment program and development of SME's, through its 30 local branches. Through these programs it also plays an important role in enabling formalization of businesses and labour in general. According to the EA, since the inception of the self-employment program (2007-2014), 5,835 micro and small enterprises were initiated with 72% of them being sustainable and still functioning successfully. The EA also works towards enhancing its capacities by implementing the following projects:

- EU project “Supporting Youth Employment, Long-term Unemployed Women (II)”

<sup>44</sup> Social Assistance Agency. Retrieved from: [http://www.mtsp.gov.mk/institucii-ns\\_article-zavod-za-socijalni-dejnosti.nsp](http://www.mtsp.gov.mk/institucii-ns_article-zavod-za-socijalni-dejnosti.nsp)

<sup>45</sup> While traditionally a body under the auspices of the MLSP, after forming the Inspection Council, the SLI is administratively part of this institution.

<sup>46</sup> Dzhekova, Franic, Mishkov, C. Williams (2014), “Tackling the Undeclared Economy in FYR Macedonia” GREY Working Paper No. 3, University of Sheffield. Retrieved from: [http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM\\_10072014.pdf](http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf) p.34

- EU project "Supporting the Employment Agency for Implementing Active Measures and Services in the Labor Market"
- EU project "Strengthening Relevant Stakeholders Towards Social Inclusion on the Local Level"
- USAID project "Youth Network for Acquiring Skills for Employment"<sup>47</sup>

Apart from these programs, focused on certain types of users, the EA's everyday tasks include registration of employed and unemployed persons, provision of trainings for employment skills and re-qualification, and acting as a mediator between the job seekers and job providers. Through these and similar activities, they have the opportunity to provisionally estimate the scope of informally employed job seekers. However, they are in need of further developing the detection methods.<sup>48</sup>

### 1.1.2 State Labour Inspectorate (SLI)

The State Labour Inspectorate (SLI) is the main enforcement body of the labour legislation and thus is responsible for exercising control over undeclared work through its four departments:

- The Labour Relations Department,
- Safety and Health at Work Department, c) Department for Legal Matters in the field of
- Safety and Health at Work, and
- Department for Coordination, Training and Administrative Enforcement.<sup>49</sup>

Additionally, the SLI has 30 local offices which are organized into three regional departments where they are equipped with a total of 107 inspectors (72 labour relations inspectors and 35 Occupational Safety and Health OSH inspectors).

The SLI is authorized for conducting controls only in registered companies, while the State Market Inspection (below) is in charge of detecting unregistered/informal companies. In conducting

its work, the SLI is guided by the Law on Labour Inspection<sup>50</sup> and the provisions from the Law on Labour Relations (articles 256-263) referring to the SLI. According to the former law (article 10), the inspector is authorized to enter the company/institution in every time of the day and night, without prior announcement and regardless of the working hours of the employer. The employer is obliged to provide the inspector all information and documents requested.

The Inspectorate is obliged once a year to inspect the adherence to laws within employers from the areas of: industry, trade, construction, agriculture, forestry, transport, communal services, artistry, catering and school and faculty laboratories; whereas other employers are to be submitted to inspection at least once in three years.<sup>51</sup> In case irregularities are determined, the inspector can: (1) point out the irregularities to the subject and determine a deadline for their removal; (2) force the implementation of appropriate measures and activities within a given deadline; (3) prohibit the work in one part or the complete company.<sup>52</sup> The decision of the inspection can be appealed in front of a committee within the Ministry of Labour and Social Policy.<sup>53</sup>

### 1.2 State Market Inspectorate (SMI)

The State Market Inspectorate (SMI), a legal entity, functions as a part of the Ministry of Economy. It supervises the adherence to laws, regulations and other legal acts by commercial companies, other private and individual entities as well as all citizens who perform commercial activities on the territory of the Republic of Macedonia. The jurisdiction of the SMI commonly encompasses areas such as product safety, consumer protection, trade activities, hospitality, tourism, handicraft economy, protection of industrial ownership rights, and other activities within the domain of the law on State Market Inspectorate (O. Gazette of RM, Nr. 35/97, 23/99, 7/02, 20/02, 24/2007, 81/2007) that regulates its activities.

<sup>47</sup> Employment Agency, 2014. *Operational Plan for Active Policies and Measures for Employment* <http://avrm.gov.mk/content/Programaza2014.pdf>

<sup>48</sup> Interview with Vlatko Popovski, Director of the EA. 22.12.2014

<sup>49</sup> State Labour Inspectorate (SLI). Retrieved from: <http://www.mtsp.gov.mk/drzaven-inspektorat-za-trud.nsp>

<sup>50</sup> Law on Labour Inspection, Official Gazette of RM, 29/02

<sup>51</sup> Ibid.

<sup>52</sup> Law on Amending the Law on Labour Inspection, Official Gazette of RM, 36/11 (article 4)

<sup>53</sup> Ibid (article 5)

The SMI functions through 2 specific departments, the department for product safety and the risk assessment department as well as its 10 regional inspection surveillance departments across different cities in Macedonia. In 2014 SMI's activities are being executed through its 98 inspectors<sup>54</sup> the use of regular, control and on-the-spot inspections against private entities and individuals performed on grounds of its annual work plan or after complaints filed by citizens or institutions.

### 1.3 Inspection Surveillance Council

The Inspection Surveillance Council<sup>55</sup> is to oversee the work and coordinate activities among the 29 different state inspectorates. According to the law establishing this body, the function of the new council, consisted of members/directors of the inspectorates, is oversight over the work of the inspectorates and coordination of their work, reviewing the work of inspectorates where irregularities have been reported or detected, putting in place training programs, inspector certification, and in general will work towards increasing the efficiency of the inspectorates while decreasing costs.

## 1.4 Ministry of Finance

### 1.4.1 Public Revenue Office (PRO)

The Public Revenue Office function as part of the Ministry of Finance and is responsible for tax collection and other receivables while at the same time being tasked with tackling tax evasion and fraud as well as other violations of the tax code by using its General Tax Inspectorate (GTI). The progress reports of the European Commission (EC) (2010 - 2013) consistently point out to deficiencies in the operational capacity of the Macedonian tax administration and specifically refer to:

- Limited tax investigation and intelligence capacity
- Weak auditing and enforced collection capacity
- The IT infrastructure requiring further improvement

In the past few years the country has undertaken several administrative and legislative improvements in order to address these shortcomings.

“The PRO's specialization and enforcement capacity were further improved by the establishment of a 'Centre for debt collection', a 'Centre for seized goods' and a 'Tax Academy for training' (EC, 2011b). In addition, a forensic (not yet operational) laboratory has been established for tackling high-risk tax fraud (EC, 2013).”<sup>56</sup> By the end of 2014 the crossover to GSM fiscal cash registers, which gathers transactions data in real time from the point-of-sale to the PRO, should enhance the investigative powers of the PRO and other interconnected agencies and registers. “In 2012, administrative cooperation between the PRO and key investigative bodies was extended through signing of a memorandum for electronic data exchange with the Financial Police and the Financial Intelligence Unit (EC, 2012).”<sup>57</sup>

### 1.4.2 Financial Police

The Financial Police (FP) became operational for the first time on 26.06.2013 as part of the Ministry of Finance (O. Gazette, 55/02 and 55/07) and its jurisdiction was set within uncovering financial criminal offences such as tax evasion and fraud, money laundering, smuggling, unlawful trade and other criminal offences that produce significant amount of unlawful income. With the latest changes (O. Gazette 150/10 and 100/12) the FP together with the Ministry of Internal Affairs (MIA) and the Customs have become part of the Judicial

<sup>54</sup> State Market Inspectorate Q3 2014 report.

Retrieved from: [http://dpi.gov.mk/index.php?option=com\\_content&view=article&id=117&Itemid=162&Name=Value](http://dpi.gov.mk/index.php?option=com_content&view=article&id=117&Itemid=162&Name=Value)

<sup>55</sup> Official Gazette of the Republic of Macedonia Nr. 50/2010, 147/2013, 41/2014

<sup>56</sup> Dzhekova, Franic, Mishkov, C. Williams (2014), “Tackling the Undeclared Economy in FYR Macedonia” GREY Working Paper No. 3, University of Sheffield. P.17. Retrieved from: [http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM\\_10072014.pdf](http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf)

<sup>57</sup> Ibid

Police which in turn is managed by the responsible Public Prosecutor of Macedonia.

### 1.4.3 Customs Administration

The Customs Administration carries out the activities that are under its competence in accordance with the Law on Customs Administration, the Customs Law, the Customs Tariff Law and other laws governing the importation, exportation and transit of goods, as well as for the performance of all other activities that are vested under its competence with other laws.<sup>58</sup>

The Customs Administration seems as an unlikely Government body to deal with tackling the hidden economy but it does have an important role. Moreover in the past than today, the informal economic activities were present in the foreign-trading relations of the country. The main manifestation was within the activities involving the import of goods and services where the deliverance of the necessary documentation is either avoided, or double invoices are issued during which only the one with the lower amount is presented to the authorities in-charge, in order to avoid paying higher customs and tax duties.<sup>59</sup>

### 1.5 Social Partners

Trade unions take part in bipartite and tripartite social dialogue which is regulated by the stipulations in the Law on Labour Relations. The register of the Ministry of Labour and Social Policy (MLSP) in 2014 contains 40 trade unions<sup>60</sup>

where in 2013 there were 34, which indicates an increased fragmentation of the union's body as well as membership.

Employers' associations (EOM) also take part in bipartite and tripartite social dialogue regulated by the stipulations in the Law on Labour Relations. The register of the MLSP contains 9 employers' associations out of which most prominent are the Organization of Employers and the Confederation of Employers established in 2001 and 2004 respectively.

Bipartite and tripartite social dialogues are performed through the Economic and Social Council (ESC). Another form of institutionalized private-public-civil dialogue was enhanced in 2012 through the reinforcement of the National Entrepreneurship and Competitiveness Council (NECC). Membership comprises of representatives of business associations, chambers of commerce, civil society organizations and public sector representatives.<sup>61</sup>

According to Ancheva (2014), since 2011 the Economic-Social Council 'is approaching its required position, with sporadic omissions'. Nevertheless, occasionally 'important issues are not on the agenda of the ESC', especially when the government aims to amend the labour legislation through shortened means, meaning that amendments are directly sent to the Parliament for approval, bypassing the ESC.<sup>62</sup>

<sup>58</sup> Law on Customs Administration. Retrieved from: <http://www.customs.gov.mk/en/Uploads/LawonCustomsAdministrationFINAL.pdf>

<sup>59</sup> Nenovski, Tome; (2012) "The Grey Economy in Macedonia: Macroeconomic Aspects, Implications and Possible Problem Solutions", (20 Journal of Sustainable Development, Vol. 5, Issue 10, March 2014. Retrieved from: <http://www.fbe.edu.mk/JoSDv10.pdf>

<sup>60</sup> Ministry of Labor and Social Policy (MLSP) registers (2014) retrieved from: <http://mtsp.gov.mk/registri.nspix>

<sup>61</sup> Dzhokova, Franic, Mishkov, C. Williams (2014), "Tackling the Undeclared Economy in FYR Macedonia" GREY Working Paper No. 3, University of Sheffield. Retrieved from: [http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM\\_10072014.pdf](http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf) p.36

<sup>62</sup> Ancheva, M., (2014) Annual Review of Labour Relations and Social Dialogue in South East Europe: Macedonia, 2013, FES

## 2. Legal Framework

### Law on Labour Relations

The main document regulating labour relations in Macedonia is the Law on Labour Relations.<sup>63</sup> In the article 13, the law provisions the requirements from the employer for establishing the employment relations in the company. For example, (1) the labour relation is established through signing a contract with the employer, (2) the rights and responsibilities include mandatory social insurance from the day the employer begins his/her employment; (3) the employer is responsible for submitting application for the employer in the social insurance institutions and the Employment Agency; (4) the rights, obligations and responsibilities from employment begin to be valid from the day the employment starts.

The Law also partially regulates the work of the State Labour Inspection. In this regard, the article 258-a states that if during the inspection, the inspector determines irregularity, the procedure regulates pointing out the irregularity to the employer and inviting him/her to education regarding the anomaly detected. However, even if the employer or other relevant representative does not come to the educative session, the law provisions that the session will be regarded as conducted. During the control inspection, if the irregularity is found to be still present, the inspector files a request for misdemeanour procedure.

Detecting up to two undeclared employees in the employer's workplaces, according to article 259, requires from the employer to pay a fine of 1000 EUR for every person found to be working undeclared, as well as obligation for their registration and signing an employment contract on indefinite

period within eight days, as well as not reducing the number of employees within the following three months. In contrary, the inspector files a ban for working in duration of 15 days (or a fee of 5000 EUR) and submits a request for misdemeanour procedure. Detecting more than two undeclared persons, the ban of work is in duration of 30 days (or a fee of 8000 EUR). In the period when the company is closed, the employer is obliged to pay to the employees at least 70% of their salary, as well as contributions. These parts of the law went through several changes since 2005 in order to improve the effectiveness of provisions and attain better compliance on behalf of employers.

### Minimum Wage Law (2012)

The minimum wage law (MWL) was adopted in 2012 and later adjusted in 2014 (O. Gazette, nr. 11/12 and 30/14) where minimum wage was set at 39.6% of the annual gross wage for the previous year as calculated by the State Statistical Office (SSO). Minimum wage is defined as the "lowest monthly amount of the basic wage which the employer is liable to pay for the employee's full time work and fulfilled norms."<sup>64</sup> In 2014 the minimum national gross wage was set at 13.140 MKD. The latest changes in 2014 (O. Gazette, nr. 30/14) have made a progressive 3 year commitment to increase the minimum wage (each March per annum) till 2016 (see Table 7).

However the enterprises with activity in the manufacturing of clothing, textiles and leathers were excluded from the initial law till 1st of January 2015 which presents a problem in terms of adherence to the law and enabling workers' rights especially having in mind that 80% of the workers employed in these sectors have wages that are well below the wage stated in the Minimum Wage Law.<sup>65</sup> Actually, the latest adjustments of the

Table 8 - Minimum net wage for sectors manufacturing textiles, clothing, and leather products (2014-2018)

	2014	2015	2016	2017	2018
Net Min. wage (MKD)	7.500	8.050	9.000	9.590	10.080
% annual increase		6,8%	10,6%	6,2%	4,9%

<sup>63</sup> Law on Labour Relations, Official Gazette of RM, 145/14

<sup>64</sup> Official Gazette of RM, nr. 11/12. Retrieved from: [http://mtsp.gov.mk/WBStorage/Files/Zakon\\_minimalna.pdf](http://mtsp.gov.mk/WBStorage/Files/Zakon_minimalna.pdf)

<sup>65</sup> Tevdoski, D. (2011), Decent Work in the Republic of Macedonia. Progress Institute, Palme Center and SOLIDAR Retrieved from: <http://www.palmecenter.org/PageFiles/62765/Decent%20Work%20in%20the%20Republic%20of%20Macedonia.pdf>

Table 9 - Minimum net wage (2012-2016)

	2012	2013	2014	2015	2016
Net Min. wage (MKD)	8.050	8.050	8.800	9.590	10.080
% annual increase		0,0%	8,5%	8,2%	4,9%

Minimum Wage Law<sup>66</sup> (consolidated text) stipulate a separate progressive increase of the minimum wage specifically for sectors in the manufacturing of textiles, clothing and leather products (2014-2018) that show a lag of 2 years compared to the minimum net wage matrix that concerns all other sectors (see Table 8).

The MWL stipulates that in case of failure to pay out the minimum wage salary to the employee a penalty of 6.000 to 7.000 EUR has to be paid by the employer or/and 3.000 to 4.000 EUR by the responsible manager of the enterprise. The benefits of the Minimum Wage are articulated in Tonin (2011) who “examines the interaction between minimum wage legislation and tax evasion upon employment, and based on a theoretical model shows that the introduction of a minimum wage creates a spike in the distribution of declared earnings and induces higher compliance by some actors, however, leading to a reduction in their disposable income.”<sup>67</sup>

### National Collective Agreements

The basic Law that regulates collective bargaining in Macedonia is stipulated in the Law on Labour Relations in the form of bipartite and tripartite social dialogue which are organized on 3 levels of collective bargaining:

- **national** (for private and public sector, respectively); collective agreements are signed by representative confederations of unions and employers associations (for private sector) and by representative confederations of unions and minister of labour (for public sector)
- **sectorial (branch)** - collective agreements are signed by adequate and

representative unions and employers organizations

- **single (for single employers)** - agreements are signed between the (representative) union organization in the company and the employer.

The tripartite social dialogue is organized mainly through the Economic and Social Committee (ESC) which was established as a consultative body in 1996. In addition, social partners are involved in steering committees in the Employment Agency, Health Insurance Fund, Pension and Disability Fund, the VET Council) and cooperate with the MLSP on regular or ad-hoc basis.

The Government in ESC is represented by the ministers of labour, finances, economy and the deputy prime minister. The trade unions who are eligible to participate are the Confederation of Free Trade Unions of Macedonia and the Federation of Trade Unions of Macedonia. The only employers’ organization that meets national representativeness criteria and participates in the ESC is the Organization of Employers of Macedonia (OEM) which envelopes 23% of the private sector employees. Each social partner has 4 members.

- No rotation principle within the presidency of the ECM as the minister of labour is acting as president.
- Limited activity of the ECM between May 2008 and September 2011 due to lack of interest or conflicts between ECM members.
- ECM importance is challenged by Government changing laws without consultation with social partners which is mandatory (eg. Law on Employment and Unemployment Insurance<sup>68</sup>).

<sup>66</sup> Law on Minimum Wage in the Republic of Macedonia (Consolidated text), Official Gazette of RM <http://www.mtsp.gov.mk/content/pdf/zakoni/Zakon%20za%20minimalna%20plata%20precisten.pdf>

<sup>67</sup> Dzhokova, Franic, Mishkov, C. Williams (2014), “Tackling the Undeclared Economy in FYR Macedonia” GREY Working Paper No. 3, University of Sheffield. P.44. Retrieved from: [http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM\\_10072014.pdf](http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf)

<sup>68</sup> Anceva, M. (2012) Annual Review 2011 on Labour Relations and Social Dialogue in South East Europe: Macedonia. Belgrade: Friedrich-Ebert-Stiftung Regional Project for Labour Relations and Social Dialogue in South East Europe. Retrieved from: <http://library.fes.de/pdf-files/bueros/belgrad/08912.pdf>

- Sporadically important issues are not on the ESC's agenda and it is bypassed by forwarding the labour related laws directly to the parliament.

The present status of the collective bargaining agreements is as follows: "the General Collective Agreement for the private sector is on power, as well as few branch collective agreements and more single collective agreements. However, since by law the general agreements are mandatory and are applied directly to all employers, both in the private and public sector, the coverage of employees appears to be 100%."<sup>69</sup>

### Law on Inspection Surveillance Council

Following the best practices from other countries in tackling the hidden economy, Macedonia has put in place the new Inspection Surveillance Council (O. Gazette of RM, Nr. 50/2010, 147/2013, 41/2014<sup>70</sup>). The Council is to oversee the work and coordinate activities among the 29 different state inspectorates, also working towards increasing the efficiency of the inspectorates while decreasing overall costs. Within these

29 inspectorates are also the State Labour Inspectorate and State Market Inspectorate which are instrumental in tackling the hidden economy. Thus a wider collaboration among them and wider oversight on top of them by the Inspection Surveillance Council should increase overall efficiency. Additional to its oversight over the work of the inspectorates, the Council will put in place training programs, inspector certification, and in general will fight towards increasing the efficiency of the inspectorates while decreasing costs

### Law on Mandatory Social Security Insurance Contributions (LMSSC)

The current law on mandatory and social security contributions (LMSSC) was adopted in 2008, but amended in 2011 with the establishment of progressive decrease in the social contributions in the following years<sup>71</sup>. Since the tax burden is one of the most important factors that incentivize hidden economic activities the progressive reductions made within the LMSSC is a step in a good direction.

Table 10 - Social security contributions

	2006	2007	2008	2009	2010/2013	2014	2015*
<b>Pension and disability contributions</b>	21,2	21,2	21,2	19%	18%	17,6%	17,5
<b>Health Insurance contributions</b>	9,2	9,2	9,2	7,5%	7,3%	7,3%	7,3%
<b>Unemployment Insurance Contributions</b>	1,6	1,6	1,6	1,4%	1,2%	1,2%	1,1%
<b>Additional Health Insurance contributions in case of accidents at work and work related injuries</b>				0,5%	0,5%	0,5%	0,5%
<b>Total</b>	<b>32%</b>	<b>32%</b>	<b>32%</b>	<b>28,4%</b>	<b>27,0%</b>	<b>26,6%</b>	<b>26,4%</b>

Source: KPMG (2012), the PRO (2014) and Trpeski, Tashevska (2012)  
<http://www.oeconomica.uab.ro/upload/lucrari/1420122/24.pdf>

However, despite the lower personal income tax rate, the overall tax burden remained relatively high, in particular for low skilled labour, "caused by the minimum base for payment of social

insurance contributions, which was prescribed at 65% of the national average wage rather than on the individual wage and at around 50% for health insurance on average (differentiated by branches,

<sup>69</sup> Anceva, M. (2013) Annual review of labour relations and social dialogue in South East Europe: Macedonia: - Belgrade : Friedrich-Ebert-Stiftung, Labour Relations and Social Dialogue in South East Europe, 2014. – 15.

Retrieved from: <http://library.fes.de/pdf-files/bueros/belgrad/10544.pdf>

<sup>70</sup> Law for Inspection Surveillance Council, (consolidated text)

[http://www.mio.gov.mk/files/pdf/dokumenti/zakoni/Zakon\\_za\\_inspekckiski\\_nadzor\\_konsolidiran\\_tekst.pdf](http://www.mio.gov.mk/files/pdf/dokumenti/zakoni/Zakon_za_inspekckiski_nadzor_konsolidiran_tekst.pdf)

<sup>71</sup> Law on mandatory social security insurance contributions (LMSSC), Official Gazette No.42/08, 64/09, 156/09, 166/10, 53/11 and 185/11)

with higher relative burden on branches with lower average wages) (World Bank, 2008, p.11, Betcherman and Arandarenko 2008, Lopez-Murphy, 2008, Mojsoska-Blazevski et al., 2009, p.101)<sup>72</sup>

### Temporary service contracts reform

In July 2014 the GoM proposed a set of amendments to the several Laws including the Law on Labour Relations, Law on Mandatory Fully Funded Pension Insurance, on Mandatory Social Security Insurance Contributions, Law on Healthcare Insurance, Law on Pension and Disability Insurance (Official Gazette of the Republic of Macedonia, No 113/2014.)<sup>73</sup>. These Amendments were passed by the Parliament, among other changes, amending the nature of temporary service contracts.<sup>74</sup> The amendments of the laws stipulated that employers that employ workers with temporary service contracts and whose gross wage exceeds the minimum wage in 2015 (9.590 MKD) have the duty, by law, to pay healthcare, social and employment contributions. Before 2014 temporary service contract workers were only obliged to pay the personal income tax (10%). This new measure is supposed to affect about 100.000 people<sup>75</sup> who have temporary service contracts or copyright contracts, and whose earnings amount to about 190 mln EUR per year.

It would be premature to discuss the policy impacts of the new law, however the expectations of the GoM are that through its implementation a significant impact will be achieved in decreasing the grey economy and undeclared labour, and increasing the social security contributions. The divergent opinion is that this measure will have no effect at best, and opposite effect at worst in tackling the hidden economy in Macedonia, as

the measure is mainly focused at increasing the total sum of the social security contributions by encasing most types of labour contracts within the tax system.<sup>76</sup>

By running the numbers one can approximate how many annual pensions can be paid out by using the social security contributions that would come in from the taxation of these contracts, given that these contributions will flow only towards the first pension pillar which is still a PAYG system (Pay-As-You-Go). The pension contributions rate in 2013 was set at 18% which means that this measure, all other factors being equal, will generate an additional 34.2 mln. EUR pension contributions annually (18% of 190 mln. EUR). Given that the annual payment for pensions by the Pension and Disability Fund of Macedonia (PIOM) in 2013<sup>77</sup> was around 827 mln. EUR, this new measure will be responsible for 4.1% of total pensions paid per annum which otherwise would have been covered by the general budget of Macedonia. Or in terms of number of pensioners (291,821 in 2013<sup>78</sup>), if the average pension (192 EUR in 2013) was applied equally to all, the new measure would satisfy the annual pensions of 14,854 pensioners or 5.1 % of all pensioners in 2013.

While this new measure will likely make the pension system in Macedonia more sustainable, lack of transparency during the formulation of the law as well as imprecise stipulations concerning the basis for payment of the social security contributions and categories of workers and contracts which are exempted from the law are likely to give rise to public dissatisfaction and fuel negative perceptions about equal treatment and discriminatory nature of the law if stipulations remain the same.

<sup>72</sup> Trpeski P., Tashevskaa B. (2012) Labour Tax Wedge in the Republic of Macedonia – Trends and International Comparison. *Annales Universitatis Apulensis Series Oeconomica*, 14(2), 2012, p.575. Retrieved from: <http://www.oeconomica.uab.ro/upload/lucrari/1420122/24.pdf>

<sup>73</sup> <http://www.mts.gov.mk/zakoni.nsp>

<sup>74</sup> "Social and Health contributions of temporary service contracted workers will be paid by themselves or the employers," *Ekonomija, Dnevnik*, 24.07.2014. Retrieved from: <http://www.dnevnik.mk/?ItemID=DF568DAA03CAA64C94F86366E42ECA51>

<sup>75</sup> Janev Aleksandar, *Kapital*, 14.11.2014 "They slaughter 1 cow to retrieve only one stake! 100.000 temporary service contract employees in out, only for 65 million EUR" [Translated from Macedonian] - Unofficial estimations.

Retrieved from: <http://kapital.mk/pridonesite-na-honorarite-ne-gi-krpat-golemite-dupki-vo-sotsijalnite-fondovi/>

<sup>76</sup> Ruslan Stefanov, director of the economic program at the Center for the Study of Democracy (CSD), Statement at the conference on Undeclared Labour, 27.11.2014, Skopje

<sup>77</sup> Pension and Disability Fund of Macedonia, Annual Report (2013).

Retrieved from: <http://www.piom.com.mk/informacii/statistika/266.html>

<sup>78</sup> Ibid p.9

The imprecise stipulations concerning payment of social security contributions gave rise to some unanswered questions such as:

- If the worker has temporary service contracts with several employers, which employer will pay the social security contributions?
- How will the law be implemented concerning workers who pay their social security contributions through a fulltime job but additionally have one or more temporary service contract from another employer?
- How will it be determined if an individuals' pay is over or under the minimum wage if the temporary service contract are shorter than 12 months?

Additionally the following categories of workers have been exempted from paying social security contributions on their temporary service contracts: members of parliament, counsellors, judges, professional sportsmen, individuals on jury duty, pensioners, and members of management and supervisory boards in companies with state capital.

It is very likely that the law will not be adopted in its present form and will experience changes and clarification in the law and its bylaws that define the specifics as well as changes within the exemptions to the law.

## VI. Research and analysis on the hidden economy in Macedonia

The hidden economy and its related manifestations in Macedonia have not been given much focus in the academic circles, as a separate research topic. While widely mentioned when talking about economic trends in the country, overall, relatively few researchers have made attempts to look into the issue in more depth and offer recommendations for tackling the phenomenon. This chapter will provide a short review of the available studies on the issue, presented through the main topics analyzed by researchers.

In general, the following topics related to the hidden economy have been explored more thoroughly.

### Estimating the size of the grey economy

Depending on the used method, for Macedonia the hidden economy estimates range from 24% of GDP by using the ECM method (Electricity Consumption Method) (CEA, 2012), 30% of GDP according to the Ministry of Economy (using LFS estimates presented by Novkovska, 2013), to a staggering hidden economy estimate of 46.9% (CEA, 2011) as a share of GDP by using the MIMIC method (Multiple Indicator Multiple Causes).

The Eurofound (2013) report makes a review of several older studies which estimated the level of undeclared economy using different methods. For example, Bogov's (1997) estimations were based on the discrepancies in the national accounts and lead to an estimation of undeclared economy as 6.3% of GDP. Micevska et al (2002), using the electricity consumption method, came to a much

higher percentage of about 30% of GDP. They noted that electricity consumption in Macedonia rose by 18% between 1990 and 2000, while in the same period official GDP decreased by 14%. Nikolov (2005), also using electricity consumption, came to a similar assumption that in 2004, the undeclared economy in the Macedonia was equivalent to 35.3% of GDP. In addition, through analysis of 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, concluding that 181,300 employees (30%) either did not receive official salaries or received salaries that were not cleared through the BPO.<sup>79</sup>

Nenovski (2012) concludes on the importance of precise measurement of the grey economy as an essential factor for managing the macroeconomic policy. Otherwise, its improper estimation may lead to 'over - or underestimation of the (anti) inflation effects of the monetary and fiscal policy and the effects from the measures for reduction of the unemployment rate in the country.' He also argues on the best possible methods for measuring the grey economy and concludes that '*the most simple, and at the same time, most unsafe way to measure the size of the grey economy is performing survey research among the economic subjects where that phenomenon is supposed to be present*'.<sup>80</sup> Garvanlieva et al. (2012) also dispute the reliability of the direct method approach, as the results are highly dependent on the '*willingness of the interviewees to reveal truthful answers, as well as the structure and form of the questionnaire*'.<sup>81</sup>

<sup>79</sup> Williams, C.C., Baric, M. and Renooy, P. (2013) Tackling Undeclared Work in FYR Macedonia. Dublin: Eurofound.

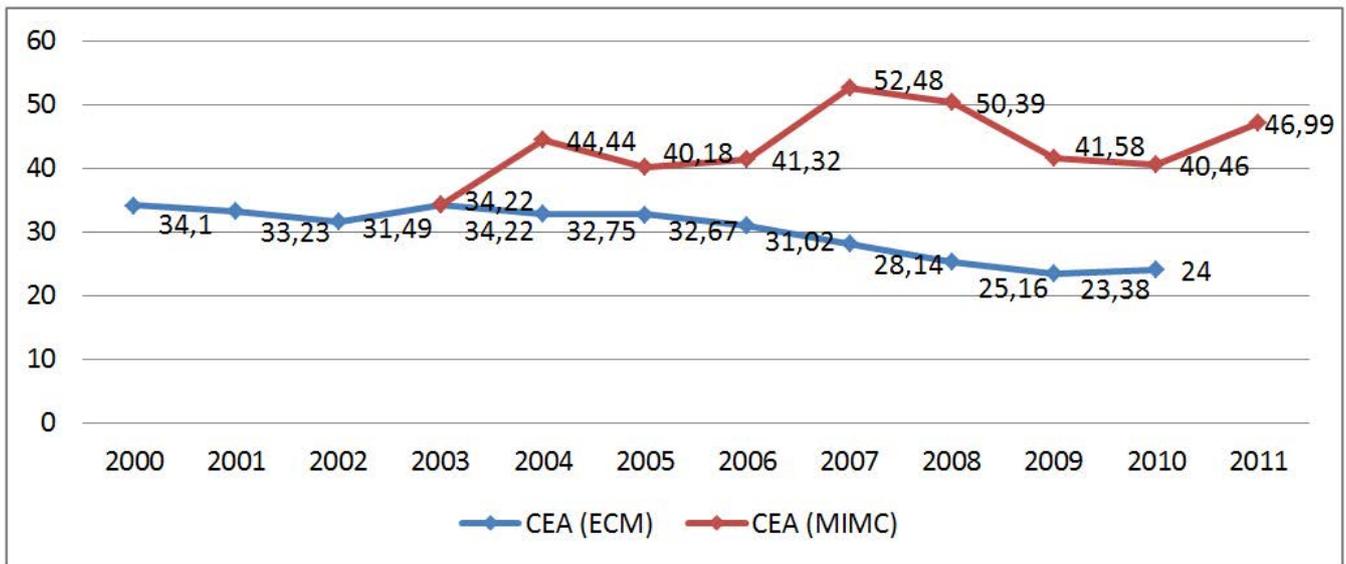
<sup>80</sup> Nenovski, T. (2014) The Grey Economy in Macedonia: Macroeconomic Aspects, Implications and Possible Problem Solutions, Journal of Sustainable Development

<sup>81</sup> Garvanlieva, V., Andonov, V., Nikolov, M. (2012) Shadow Economy in Macedonia. Skopje: Center for Economic Analyses

Hence, it is no surprise that direct methods have rarely been used to assess the level of hidden economy in Macedonia and researchers have mostly used indirect ones. Garvanlieva et al. (2012) used the ‘electricity consumption method’ (hereinafter ECM) and the Multiple Indicator Multiple Causes (hereinafter MIMIC) approach to assess the relative size of the shadow economy in Macedonia.

The electricity consumption model estimations indicate a sharper decline in the share of shadow economy from 2003 to 2009, followed by a small rise in 2010, probably as a result of the delayed effects of the economic crisis. Authors stipulate that the steeper decline from 2006 onwards can be due to the flat taxation model implemented in 2006, which caused increase in the tax base and made tax evasion more difficult.

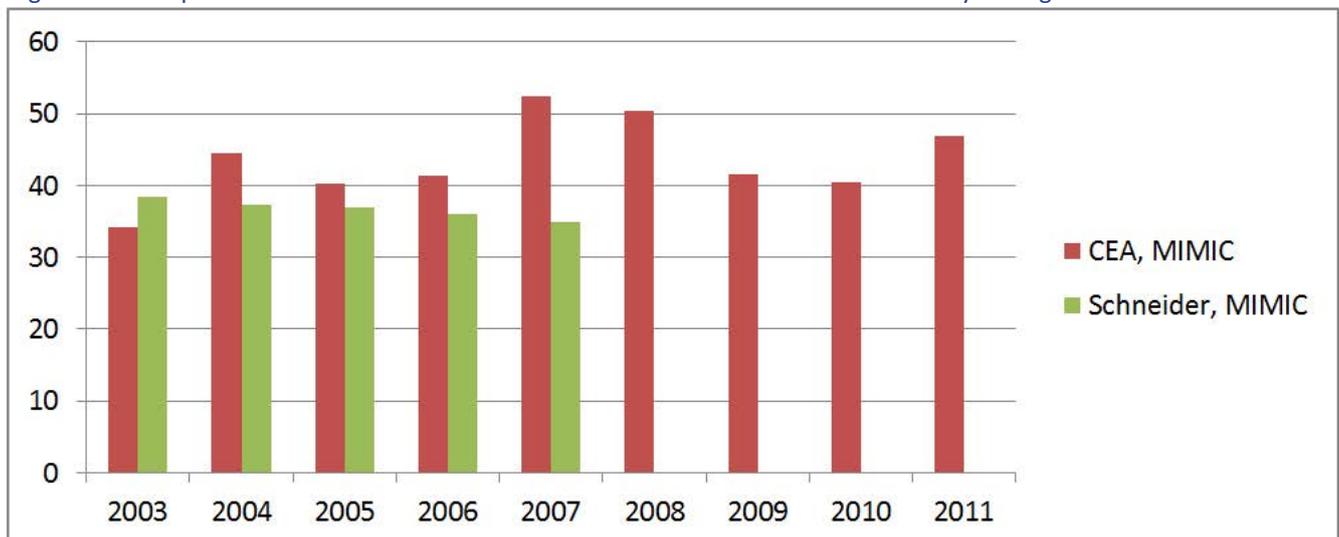
Figure 14 - Shadow economy estimations for Macedonia according to EC model and MIMIC model (Garvanlieva, Andonov, Nikolov, 2012)



However, results from the use of the MIMIC model do not follow the same trend of reduction in the share of grey economy, as a percentage of GDP. While findings indicate a decrease from 34% of GDP in 2000 to 24% of GDP in 2010 if the ECM

method is used, they point to an increase of the shadow economy to 52% in 2007 and then reduction to 47% in 2011 if the MIMIC approach is applied (Figure 14).

Figure 15 - Comparisons between Schneider’s and CEA’s estimations of shadow economy through the MIMIC model



<sup>82</sup> Ibid

The differences in values can be attributed to the different models used. However, even with the same model used, different authors came across different estimations and even trends. For example, using the MIMIC model, Schneider (2010) and Garvanlieva et al. (2012) arrived at different estimations, especially concerning the year 2007 (Figure 15). This indicates the variability of these models since they are based on estimations.

### Potential causes of shadow economy

Speaking about the instigators of the grey economy in Macedonia, Nenovski (2014)<sup>83</sup> emphasizes the **overburdening with taxes and contributions**, especially until 2007 when the progressive calculation of the personal income tax was in force. In response to this, the Macedonian Government introduced the flat profit tax and flat personal tax and reduced their rates at 10% in 2008. This policy, according to Nenovski resulted in improved tax ethics of the taxpayers, increased national budget and reduction of the grey economy. Garvanlieva et al agree that the **reduction of the tax burden** leads to lowered incentives to avoid taxes and hence reduces the shadow economy.<sup>84</sup> However, other studies, elaborated below (e.g. Mojsovska-Blazeski, 2012) only partially support this claim.

In addition, Nenovski (2014) considers the **administrative burdens for businesses** to be an additional factor for the grey economy with their effect of discouraging registration of businesses.

Therefore, the one-stop-shop system, the decrease in time for registration of businesses and the ‘regulatory guillotine’ are noted as effective policies for transferring informal businesses into the formal sphere. Likewise, Stankovic and Stankovic (2012) note that according to the World Bank’s Doing Business report (2012), it requires 3 procedures, takes 3 days, and costs 2.24% GNI per capita to start a business in Macedonia, facts which are expected to influence the decrease of the shadow economy.<sup>85</sup>

Hence, both Garvanlieva et al. (2012) and Nenovski (2014) assess that the **business regulation reduction contributes towards reduction of SE through** ‘motivating the businesses to work in the official economy’<sup>86</sup>. In this regard, the project “regulatory guillotine” (initiated in 2006) is assessed as which effective if related with the shadow economy. Specifically, ‘the Business Freedom Index<sup>87</sup> (Heritage Foundation) based on the WB Doing Business Study indicated significant improvement in the area in the concerning period following the regulatory guillotine (55 points in 2002 to 65 in 2008 and 80,9 in 2012) which can be correlated with the reduction of the SE in the same period as well.’<sup>88</sup>

Garvanlieva et al.’s assessment indicates that the **amount of social transfers (paid by the Government to citizens, and by employers) co-varies with the size of the shadow economy.**

<sup>83</sup> Nenovski, T. (2014) The Grey Economy in Macedonia: Macroeconomic Aspects, Implications and Possible Problem Solutions, Journal of Sustainable Development

<sup>84</sup> Garvanlieva, V., Andonov, V., Nikolov, M. (2012) Shadow Economy in Macedonia. Skopje: Center for Economic Analyses

<sup>85</sup> Stankovic, Mirjana and Stankovic, Bratislav, Social and Economic Aspects of the Shadow Economy in the Republic of Macedonia: A Study (2012). Available at SSRN: <http://ssrn.com/abstract=2162922> or <http://dx.doi.org/10.2139/ssrn.2162922>

<sup>86</sup> Garvanlieva, V., Andonov, V., Nikolov, M. (2012) Shadow Economy in Macedonia. Skopje: Center for Economic Analyses

<sup>87</sup> Quantitative measure of the ability to start, operate, and close a business that represents the overall burden of regulation as well as the efficiency of government in the regulatory process

<sup>88</sup> Garvanlieva, V., Andonov, V., Nikolov, M. (2012) Shadow Economy in Macedonia. Skopje: Center for Economic Analyses

Specifically, the total amount of paid social transfers was increasing until 2008, when they stagnated at 38 million MKD. In parallel, the SE index had also decreased from 28.14% in 2007 to 24.01% in 2010, implying that the former influenced the latter. The authors argue that such dynamics could also be explained as a result of the process of ‘cleaning up’ the registry of unemployed and socially deprived as a measure for the unemployed to confirm their status and incomes. This dissimulates the part of the registered unemployed people (who are working in the SE and receiving social transfers from the GoM) to undertake preregistration thus decreasing the total unemployment and the SE.’

The authors also assess the scope of shadow economy in relation to the corruption level within the country by using the Freedom from Corruption Index by Heritage and determine that **the trend for decrease in the corruption index is ‘generally proportional with the decreasing trend of the shadow economy’**. Finally, they conclude that **the reduction of the social contributions and the employee benefits**, as well as the implementation of the gross salary policy, also reduced the possibilities for evasion and ‘increased the motivation of the employees to operate in the official economy’<sup>89</sup>

### Tax policies and tax evasion

CEA (Stojkov et al., 2008) conducted a survey among companies in 2008, where the **perception on the introduction of the flat tax** was assessed. In general, it was perceived as a positive measure for the business climate, although there were wide variations among companies with regards to their size, sector and ownership structure. Particularly, the majority of companies (65%) stated that it had improved the liquidity of their company, and

eased the calculation and reporting of the tax obligations for 78% of the companies. However, for most companies (61%) it had neither resulted in improved job creation nor created opportunities for new investments (for 57%).<sup>90</sup>

Since the introduction of flat tax has been accompanied by a new policy for stimulation of reinvested profit through enabling reduction of the company's tax base up to the amount of reinvested profits in the year following that in which the profits were realized, somewhat more than half of the companies (56%) considered this to be a better solution than the previous tax relief model. In this regard, about one third of companies, in particular large ones, reported *‘that the broadening of the bases for taxation has only partially annulled the benefits of the implemented flat tax’*<sup>91</sup>

Company representatives were also asked whether the flat tax policy will influence the reduction of the shadow economy, in particular misreporting wages and reporting exact number of employees. In general, employers had confronting views on this issue. However, almost half (46%) reported they expect moderate to outstanding progress in reducing the practices of misreporting wages. 15% of the respondents expected reduction of the hidden economy, as a result of the policy, with the micro-businesses being the most optimistic category.<sup>92</sup>

With regards to the tax morale, 58% of respondents perceived the strengthened tax inspections as a cause of the improved tax revenue collection. In addition, one half recognized the simplified tax reporting and tax administration procedures as an important factor.<sup>93</sup>

<sup>89</sup> Ibid.

<sup>90</sup> Stojkov, A.; Nikolov, M.; Smilevski, B., (2008) Flat Tax Policy Assessment in Macedonia, Center for Economic Analysis, Skopje

<sup>91</sup> Ibid.

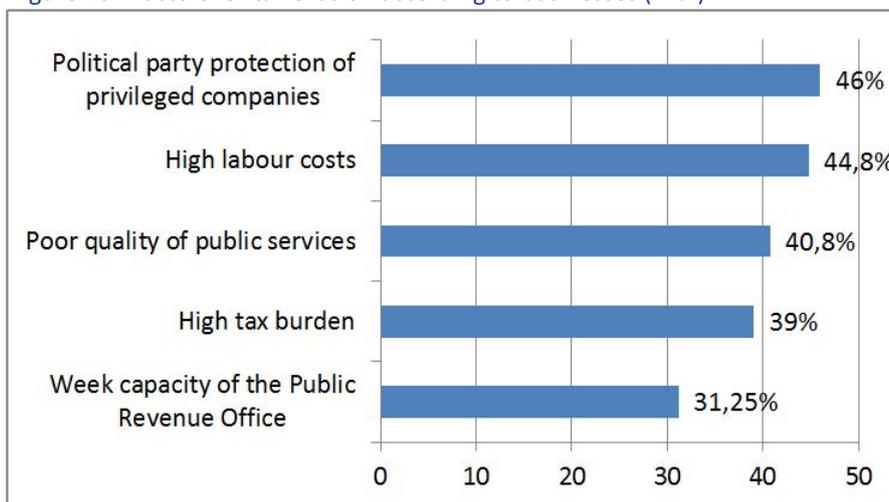
<sup>92</sup> Ibid.

<sup>93</sup> Ibid.

Although one third believed that the flat tax policy model will initiate a significant improvement of the conditions for doing business in Macedonia, still, numerous factors for tax evasion have been mentioned, such as: excessive tax burden, poor

quality of public services, weak capacity of the Public Revenue Office, political party protection of privileged companies and high labour costs. (See Figure 16)

Figure 16 - Factors for tax evasion according to businesses (in %)



Source: Stojkov, A.; Nikolov, M.; Smilevski, B., 2008, Flat Tax Policy Assessment in Macedonia

On the other hand, a research conducted by Mojsoska-Blazevski (2012, according to (Dzekova et al., 2014) on the influence of the labour legislation changes on the employment rate and the size of the informal economy showed a marginal effect of the flat tax policy. 'Mojsoska-Blazevski (2012) analysed the influence of the labour legislation changes on the employment rate and the size of the informal economy by estimating a labour demand function for the period 1998(Q1) - 2010(Q3). She disentangled the total tax wedge into two components: the income tax wedge and social contributions wedge to investigate their respective burden on the employed. The study found that **'the reduction of social security contributions had a positive impact on the employment rate, in contrast with the impact of the flat tax reform.'** The author argues that in high-unemployment environment, firms "consume" part of tax reduction. This, according to Dzekova et al. (2014) suggests that *'social contributions are the main*

*constraint on employment in the Macedonia. This is also explained through the predominance of low-skilled jobs in transition economies. Moreover, the introduction of the gross wage concept led to a shift from undeclared work to formal employment and correspondingly had a significant impact on employment.'*<sup>94</sup>

Mojsoska-Blazevski (2011, according to Dzekova et al. (2014)) concludes that the social security and tax reforms aimed at reducing labour costs had the following positive effects: (a) helped employees during the crisis, (b) had an effect on employment, (c) increased the net wage, (d) diminished the extent of informal economy, (e) improved tax compliance and (f) increased the number of individuals insured in the pension system.<sup>95</sup>

Trpeski and Tashevskva (2012), on the other hand, relate the effects of the decreased tax wedge on the financial sustainability of the pension and

<sup>94</sup> Dzhokova, Franic, Mishkov, C. Williams (2014), "Tackling the Undeclared Economy in FYR Macedonia" GREY Working Paper No. 3, University of Sheffield. p.44-45. Retrieved from: [http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM\\_10072014.pdf](http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf)

<sup>95</sup> Ibid.

health care system and note that both Funds have registered deficits throughout the years. In addition, they argue that the fiscal policy changes aimed at a lower fiscal burden on wages and lower labour costs, do not provide enough incentives to entrepreneurs concluding that 'in order to encourage entrepreneurs to invest, all segments of the investment climate need to be improved: stability, protection of property rights, regulation, corruption level, infrastructure etc.'<sup>96</sup>

Ristovska, Mojsoska-Blazevski and Nikolov (2013) analysed data from the European Values Survey to determine the characteristics of Macedonian respondents with regards to issues related to tax morale, based on previous research on predictors of tax morale. The analysis showed that 81% of interviewed individuals in Macedonia reported that the "tax morale is never justifiable", finding no differences with regards to gender of respondents; but noting age differences, with the percent of people not justifying tax cheating increasing with age. In addition, **full-time employees were strongly against tax cheating compared to the self-employed and the more educated were more strongly opposing compared to less educated.** With regards to regional differences, the vast majority of respondents from the Southeast region reported highest tax morale, in contrast to respondents from the Polog and Southwest region. Importantly, **respondents that stated high trust in the government and the judicial system reported higher tax morale compared to those who do not trust the civil service.** Finally, the strongest opposition to tax cheating was 'found among individuals who are proud of their country and those with more pro-democratic belief'. While the results can be disputed as influenced by socially desirable responses, they nevertheless point to some important elements of the tax morale,

specifically the importance of trust in institutions and patriotic feelings.<sup>97</sup>

However, the tax morale cannot exclusively be explained with the explored independent variables. The study shows that they explain about 28% of the variability of the tax morale, while additional unexplored factors may explain the rest. Another important finding is that results for Macedonia differ in some regards to those from studies for other European countries. Specifically, gender and marital status were not significantly related to tax morale in Macedonia, unlike in other countries. In addition, only **the income, out of the socio-economic variables, was found to be related to tax morale, but not the educational attainment and economic (labour market) status.**<sup>98</sup>

In line with the argument of the importance of trust within institutions, Petreski (2013) measured the relationship between the business regulation and size of informal economy in 30 transition economies, including Macedonia, and found that 'results robustly suggest that a business-friendlier regulation has a statistically significant shrinking effect on the informal economy only if accompanied by better institutions.' He continues to argue that **a friendly business environment in a typical transition country, personified through a less cumbersome regulation, would have effect on reducing the informal economy only if proper implementation and enforcement is ensured.** Petreski estimates that this would reduce the informal economy by 1.2 p.p. in GDP, but result in 2.4 p.p. additional growth. The research emphasizes the importance of good governance within institutions, which also includes the strive to facilitate constraints firms encounter and assist them in formalizing instead of closing.<sup>99</sup>

<sup>96</sup> Trpeski, P., Tashevski, B. (2012), Labour Tax Wedge in the Republic of Macedonia – Trends and International Comparison, *Annales Universitatis Apulensis Series Oeconomica*, 14(2)

<sup>97</sup> Ristovska, M., Mojsoska-Blazevski, N., Nikolov, M., (2013) An Alternative View to the Tax Evasion: The Effect of Tax Morale on Paying Taxes in Macedonia and EU Countries, *Serbian Journal of Management* 8 (2)

<sup>98</sup> Ibid.

<sup>99</sup> Petreski, M. Regulatory environment and development outcomes: Empirical evidence from transition economies. *Ekonomsky Casopis*, Submitted in September 2013.

### Unemployment and shadow employment

Bearing in mind that one of the most pressing economic concerns for Macedonia has been the high unemployment rate, estimating the share of informally employed persons is considered to be of great importance to policymakers. In this regard, the estimations of shadow economy can be used to estimate the shadow employment as well. Garvanlieva et al. (2012), through using the ECM method argues that the estimates indicate lower unemployment rate by 7pp to 13pp compared to the official rate, depending on the year. For instance in 2010, the recalculated unemployment rate is 24% compared to the official 31% by reducing the total number of officially unemployed by almost 71,000 officially unemployed.<sup>100</sup>

Nenovski (2014) also makes estimations of the unemployment rate and concludes that 'It is unofficially estimated, that around 34.5% - 38% or 95,000-105,000 of the officially unemployed persons in the Republic of Macedonia are employed in the unofficial sector', implying that the real number of unemployed persons is around 18% to 19% or 170,000 to 180,000 persons.<sup>101</sup>

Discussing the extremely high level of long-term unemployment in Macedonia (above 80%), Mojsoska-Blazevski (2012) supports the estimations that '**a considerable share of long-term unemployed in Macedonia (one-third to one-half) are working informally or are engaged in some economic activity in order to survive**' (Jackman and Corbanese, 2007; Lehmann, 2010; according to Mojsoska-Blazevski (2012)), through pinpointing several facts. 'Firstly, Labour Force Survey (LFS) data show that less than 70 % of the long-term unemployed receive some form of income support, while there is an absence of mass poverty in the country. Secondly, it is very unlikely that 43 % of all registered unemployed

have uninterrupted unemployment spells of five years or more. Thirdly, the share of unemployed that receive unemployment benefit (UB) is low (9.1 % at the end of 2011), while the duration of the (regular) benefit is up to 12 months.'<sup>102</sup>

However, she also notes that the **informal employment of long-term unemployed is linked to the disincentives of workers to accept formal jobs, primarily because of losing the unemployment benefits**, all of the social assistance and other benefits (paid or in-kind), and the requirement to pay social security contributions and personal income tax if formalized. She concludes that 'given that there is no system of partial benefits, workers are not willing to accept part-time, seasonal or temporary work. Similarly, informal workers need to give up a significant amount of their informal wage in order to formalise their status, while in return they get some social security entitlements (mainly pension and health insurance) and some other benefits (like employment protection).'<sup>103</sup>

In line with this, Mojsoska-Blazevski and Petreski (2012) propose that the Ministry of Labour and Social Policy – should consider the **introduction of the in-work benefits in the tax and benefit system of Macedonia, so as to combat inactivity and unemployment, and reduce social exclusion, especially among the poor and females who are among the most vulnerable groups in the economy.**<sup>104</sup>

Regarding the structure of informal employment, the Eurofound report (2013) notes that the 2010 ILO Labour Force Survey in Macedonia detected the following sectorial distribution: 8% of all jobs in manufacturing, 43.1% of jobs in construction, 13% in trade, 16.5% in transportation and 8.3% in other services. Male informal employees were mostly found in construction and transportation, while

<sup>100</sup> Authors note that this is a simplified estimate and should be considered with caution

<sup>101</sup> Nenovski, T. (2014) The Grey Economy in Macedonia: Macroeconomic Aspects, Implications and Possible Problem Solutions, Journal of Sustainable Development

<sup>102</sup> Mojsoska-Blazevski N., (2012), EEO Review: Long-term unemployment, former Yugoslav Republic of Macedonia, European Employment Observatory, p.6

<sup>103</sup> Ibid.

<sup>104</sup> Mojsoska-Blazevski N., Petreski M. (2012), Increasing labour market activity of the poor and females: Let's make work pay in Macedonia, EUROMOD Working Paper No. EM16/13

female in manufacturing and services other than trade or transportation (Mojsoska-Blazevski, 2011, according to Eurofund, 2013). Referring to the 2010 LFS, authors note that ‘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.’ In addition, a high tendency of the self-employed to work undeclared was noted, ranging at about one third of the self-employed (mostly sole traders). **Informality, in the case of self-employed and employees was significantly higher for rural compared to urban areas.**<sup>105</sup>

Dzekova et al. (2014) note that when it comes to own-account work (self-employment), the LFS 2010 (ILO, 2011) shows that 34.7% of non-agricultural self-employment is informal, with 48.6% of all sole traders (own-account enterprise owners) operating undeclared. There is a notable urban-rural distinction, with undeclared self-employment being much higher in rural areas, where 44.8% of the self-employment is undeclared compared to 28.3% in urban areas. ‘When it comes to dependant wage employment, the survey reveals that 9.2% is undeclared wage employment (21.4% of agricultural employees and 8.8% of employees in all other sectors). **Undeclared wage employment is higher in rural areas where 14.5% of all wage employees are undeclared, while in urban areas only 6.9% of waged employment is informal.**’<sup>106</sup>

Mojsoska-Blazevski et al. (2009) conclude that the large informal economy is an indicator of the low quality of jobs in the country and represents the

‘single most important source of non-decent work’. They present the findings of Angel-Urdinola and Macias (2008), based on the LFS 2006 data, who found that **‘wage earners were much less likely to be informally employed (13%) than employers (27%) and self-employed workers (73%), as proxied by those not being registered in the pension fund.’** In addition, **informal workers were more likely to hold temporary jobs and work part-time, putting them at risk of poverty and social insecurity.** With regards to demographics, informal employment was more widespread among the young, among ethnic minorities, in the private and in the primary sectors and in rural areas. Mojsoska-Blazevski et al. (2009) conclude that **‘informal job (excluding unpaid family work) seems to be the point of entry to employment for persons who previously have been inactive or unemployed.’**<sup>107</sup>

### Public opinion and experience with informal economic activities

Risteski (2009) prepared an analysis, based on a field survey, which looks into one large economic sector influencing the shadow economy – the handicraft economy. The research used a direct approach and a cluster sample of 85 households around Macedonia. Households were asked about the services used within one year and whether they received a receipt, bill or invoice. Findings indicated that **‘one family is spending on average 22.8 % from the income in the handicraft economy’.** The largest part (almost half) of the income spent in the shadow handicraft economy went to the green markets, motor vehicle services and hairstyle and makeup services.<sup>108</sup> (see Table 10)

<sup>105</sup> Eurofund (2013) Tackling Undeclared Work in FYR Macedonia

<sup>106</sup> Dzekova, Franic, Mishkov, C. Williams (2014), Tackling the Undeclared Economy in FYR Macedonia, GREY Working Paper No. 3, University of Sheffield. p.20

<sup>107</sup> Mojsoska-Blazevski, N., Najdova, J., Stojkov, A. and Asenov, L. (2009) Labour Market in the former Yugoslav Republic of Macedonia. A Study for The European Commission Employment, Social Affairs and Equal Opportunities DG. Skopje: Euro-Balkan Institute.

<sup>108</sup> Risteski (2009), Assessing handicraft shadow economy in Macedonia, CEA

Table 11- List of sectors, annual household spending, percent from the handicraft shadow economy, percent from family income

Sector	Annual average spending from one household (in MKD)	Percent from the handicraft shadow economy	Percent from family income
Additional Education	7.970,1	9	2,0
Cleaning services	1.844,8	2,1	0,5
Motor vehicle services	12.913,4	14,5	3,3
Home maintenance	7.583,6	8,5	1,9
Green markets	41.809,0	47,1	10,6
Hair style and make up services	9.211,9	10,4	2,3
Software & Hardware services	3.747,0	4,2	1
Cutting firewood	3.291,0	3,7	0,8
Fortune tellers, priests, ministers, preachers etc	213,9	0,2	0,1

Source: Risteski (2009), *Assessing handicraft shadow economy in Macedonia*, CEA

The majority of households were found to spend more than 24000 MKD (400 EUR) a year at the green markets. Importantly, the vast majority of households (over 90%) reported that it was easy to access products or services from the handicraft economy, implying that these services are vast in number and easily available to everyone, making them a standard form of economic activity.<sup>109</sup>

Stankovic and Stankovic (2012) conducted a nationally representative field survey aiming to detect opinions of respondents on different shadow economy aspects. Data indicated a wide incidence of activities supporting the hidden economy among citizens. For example, one third of respondents on a “daily basis” buy products from the shadow economy, while one fifth do this “two to three times a week”. **If employed in the informal economy, every second respondent reported their intention to keep quiet and not report the employer, in order not to lose the job.** Only one fifth of all respondents would “report the employer to the inspection services”, whereas 15% “would quit that job and seek for another”. In line with

these tendencies is the observation that more than 40% of respondents would “substitute the deficit if the incomes in their family” through performing additional activities that are not registered. While half of respondents perceive the Government as the main culprit for the emergence of the shadow economy, 64% believe the Government is inefficient in tackling this phenomenon.<sup>110</sup>

### Recommendations by authors

In line with their findings, some authors propose policy recommendations. Nenovski (2014) considers that as cash flow is an important indicator of the dynamics of the grey economy, reducing the amount of cash in circulation would stimulate using more transactions which can be formally registered.<sup>111</sup> As an effect, this would lead to reducing the number of ‘informal’ transactions. Nenovski (2012) argues this is achievable through (1) increasing the usage of payment cards and other ways of non-cash payment, such as checks and bills of exchange; (2) establishment of a universal payment card (adopted by all the users of the payment transactions), (3) reduction of the legal

<sup>109</sup> Ibid.

<sup>110</sup> Stankovic, Mirjana and Stankovic, Bratislav, *Social and Economic Aspects of the Shadow Economy in the Republic of Macedonia: A Study* (2012). Available at SSRN: <http://ssrn.com/abstract=2162922> or <http://dx.doi.org/10.2139/ssrn.2162922>

<sup>111</sup> Nenovski, T. (2014) *The Grey Economy in Macedonia: Macroeconomic Aspects, Implications and Possible Problem Solutions*, *Journal of Sustainable Development*

opportunities and (4) limitation of the possibilities for executing different kind of payments in cash.<sup>112</sup>

In addition, he believes that ‘it is necessary to broaden the awareness of all the participants in the economic sector for the sake of respect for the regularity and the defined rules of the game, in the direction of enhancement of the institutional frame, judicial arrangement, the moral values and the stimulators of the economic functions in the country.’<sup>113</sup>

In general, Nenovski (2012) considers that the main recommendation is **to direct the activities and measures primarily to stopping and removing the causes of shadow economy, and afterwards punishing the consequences of that phenomenon.** He argues that the Government should restore the trust of citizens towards institutions, in order for them to internalize the liberal values and not feel them as imposed. In this regards, he also believes that improving the relations between the government and the economy is crucial and leads towards improvement of the institutional frame in the country. He adds that it is also crucial to **increase to capacity of the country to improve the ‘extent and quality of the public services’**, meaning: ‘organizational enhancement, efficiency, qualification and collaboration between separate authorities and bodies of the central government, reduction of the influence of the central government to economy, rationalization of the public consumption, improvement of the public sector quality (including the further necessary reforms in pension and health system), cutting down of public administration, etc.’<sup>114</sup>

Garvanlieva et al. (2012) recommend implementing **incentive-oriented policy measures for the purpose of reducing the shadow economy.** They consider that the implemented system of incentives for economic growth, exercising penalty provisions of the legislation, tax system reforms and social security system have proven to be effective. In addition, the authors consider the subsidising of self-employment to be another successful policy, which within five years lead to about 70% increase in self-employment and hence resulted in formalization of some businesses which previously functioned in the grey sphere.<sup>115</sup>

In this regard, Mojsoska-Blazevski (2012) notes that the **active labour market policies should be shifted from the long-term unemployed to youth and recent graduates/labour market-entrants**, while ‘the short-term focus should be on programmes that support job creation, such as: employment subsidies; targeted reductions of social security contributions; public work programmes; and entrepreneurship development schemes, although these programmes are relatively costly and their effects are uncertain.’<sup>116</sup>

Finally, as data indicate that informality affects specific demographic groups in particular, especially low educated, ethnic minorities, rural residents etc., **encouraging self-employment can be viewed as an effective tool for reducing unemployment, but higher consideration should be paid to targeting certain groups, as well as to the sustainability of the businesses.**<sup>117</sup>

<sup>112</sup> Nenovski T. (2012) Macroeconomic aspects of the grey economy - the case of Macedonia, Online at <http://mpra.ub.uni-muenchen.de/42253/>, MPRA Paper No. 42253, posted 24. February 2013

<sup>113</sup> Ibid.

<sup>114</sup> Ibid.

<sup>115</sup> Garvanlieva, V., Andonov, V., Nikolov, M. (2012) Shadow Economy in Macedonia. Skopje: Center for Economic Analyses

<sup>116</sup> Mojsoska-Blazevski N., (2012), EEO Review: Long-term unemployment, former Yugoslav Republic of Macedonia, European Employment Observatory

<sup>117</sup> Mojsoska-Blazevski, N., Najdova, J., Stojkov, A. and Asenov, L. (2009) Labour Market in the former Yugoslav Republic of Macedonia. A Study for The European Commission Employment, Social Affairs and Equal Opportunities DG. Skopje: Euro-Balkan Institute.

## VII. Media Reporting on the Hidden Economy

The media is an important stakeholder in the process of detecting and countering the hidden economy, especially bearing in mind the fact that 62% of respondents in the Stankovic and Stankovic (2012) survey reported to get informed on the grey economy from the media, while all other sources were far behind. Hence, the media can provide big and active contribution for improving the quality of the public debate on this matter, especially bearing in mind the unfavourable assessment of the freedom and quality of Macedonian media.

Specifically, in 2006, the international agency 'Reporters Without Borders' ranked Macedonia 46th on the Press Freedom Index which is the highest place since the independence.<sup>118</sup> Unfortunately, as the years went by, there was a steady fall of media freedom and standards. In the last report (2014) the country was ranked 123, which is a drop of 77 places for the last eight years. 'Judicial harassment based on often inappropriate legislation, the lack of access to public data, physical and psychological violence against those who work in news and information, official and private advertising market used as tool, **the grey economy's hold over vital parts of the media**. All of these are obstacles to the right to report the news and people's right to know.'<sup>119</sup> Another relevant agency – 'Freedom House' ranked the freedom of press in Macedonia on the **122** place, marking the country as "partly free".<sup>120</sup> These are indicators which put at stake the quality of the news, and this analysis aims to assess the quality of reporting of issues related to the hidden economy.

### Methodology

In order to assess the media activity in this area, short media analysis of the web content of 13 different media sources was conducted. Quantitative and qualitative analysis was carried out for more than 100 articles for the period 2011 – 2014.

The analysis included a search of the web-pages of 5 national TV stations, 3 daily newspapers and 4 internet portals (2 of which also air a radio program). Since the analysis took place in July 2014, only articles available at the web portals at that point have been analysed.

The key words for detecting relevant articles included: hidden economy, grey economy, tax evasion, Ministry of Economy, Ministry of Finance, Ministry of Labour and Social policy, Tax Inspection, Labour Inspection, Undeclared workers, State Revenue Office, working on the black market.

In addition, aiming to get more qualitative information on the challenges journalists face when covering these topics, a mini-survey was conducted among 4 journalists, on issues of: general interest for the topic of hidden economy, access to information, and cooperation with relevant institutions.

### Findings

According to the types of articles being presented, data from table 11 below indicate that the vast majority of articles are actually reports, typically from press-conferences of the Government and/or its agencies when a new policy measure is being presented; or presentation of data from research of international or domestic organizations. They usually consist of mere presentation of facts and do not include additional analysis or opinion from another party/stakeholder.

<sup>118</sup> Press Freedom Index, 2006. Available from: <http://en.rsfb.org/press-freedom-index-2006,35.html>

<sup>119</sup> World Press Freedom Index: Dashed Hopes After Spring, 2013.

Available from: [http://fr.rsfb.org/IMG/pdf/classement\\_2013\\_gb-bd.pdf](http://fr.rsfb.org/IMG/pdf/classement_2013_gb-bd.pdf) pg. 22

<sup>120</sup> Press freedom rankings, 2014.

Available from: [http://freedomhouse.org/report/freedom-press-2014/press-freedom-rankings#.U9I\\_5PmSy-0](http://freedomhouse.org/report/freedom-press-2014/press-freedom-rankings#.U9I_5PmSy-0)

Table 12 - Type of article

Type of article	Frequency	Percent
Report	76	66 %
Topic	18	16 %
Investigative story	6	5 %
Interview	15	13 %

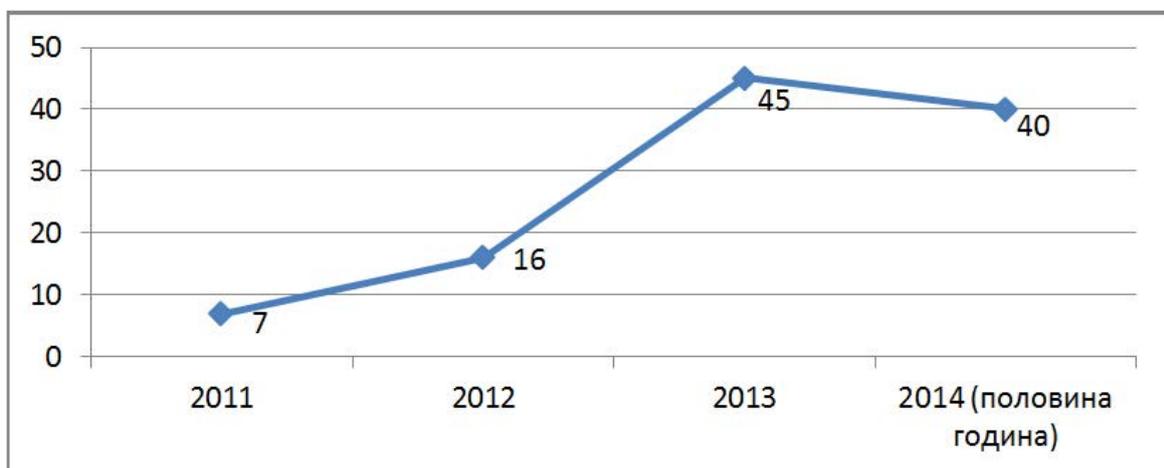
There can be many reasons why there isn't a sufficient number of news which do not result in a more developed story. In the mini-survey conducted for the aim of the analysis, a journalist covering economic issues, when being asked about the challenges when reporting about the hidden economy, answers:

*“The biggest problem when reporting about the hidden economy is the inability to obtain official statistics and data regarding this problem. Also, only a small portion of the affected (institutions, employers, workers) are willing to openly discuss this topic. Usually, the answers we get from the*

*state institutions are too general and can be rarely used as a reliable indicator of the real situation.”*

The chart below shows **increasing number of news stories for the years 2013 and 2014** (half year). The absence of news related to hidden economy for the year 2010 and 2011 indicates that either a small number of activities have been carried out in this period or they have not been promoted enough in the media. Also, the growing number of news can be due to the fact that some of the analysed media have just republished the same story coming from different media outlets or journalists.

Figure 17 - Number of stories related to “Hidden economy”



When talking about the different issues comprising the hidden economy phenomenon, the majority of articles relates to the general topic of grey economy, about one in four is dedicated to tax reforms/policies, while only 4.4 % of the news is specifically related to the issue of undeclared labour (Table 12). The journalists surveyed generally held the same opinion regarding the cause of small number of articles addressing this issue, noting that **people directly affected by this problem are not ready to**

**talk in public.** Their opinions can be summarized in the statement of the journalist below:

*“Definitely the fear not to lose the job and the low level of awareness about the negative effects of the issue makes them reluctant to discuss the phenomenon in a situation when they are not sure whether they will get the proper protection from the state if they decide to share the problem with the public and to stand behind it with their name.”*

Table 13- Topics covered

<i>Topic</i>	<i>Frequency</i>	<i>Percentage</i>
Hidden/grey economy (general)	55	47.8 %
Tax policy	32	27.8 %
Undeclared workers	5	4.4 %
Other	23	20 %

However, when succeeding to receive a statement from a worker belonging to this vulnerable group, it can open the way for interesting and informative articles (see Box 2)

Box 2.

In one article by Radio Free Europe one undeclared worker when asked: **“How do you handle with the health insurance, (health insurance blue slips), in case of disease?”**, claims:

*“The companies do not pay these expenses. So, we go, at least I go, to the Agency for Employment and register myself as unemployed. The compensation that I receive is justified as honorarium. If the employer pays, than it is ok. If he does not pay, than God help us.”<sup>121</sup>*

In another article from the same media, opinions of several citizens are presented, who claim to deliberately accept undeclared labour and being exploited as a result of the poverty they are experiencing:

*“Salaries are so small and everyone tries to make more out of them. People don’t think about the future, would they need them or not, whether they’ll be able to retire or not.”*

*“You accept working for less money, you allow to be exploited, that’s it.” (...) The bosses say: “I am the boss. If you like it - continue working, if you don’t like it - fell free to leave, another one will come...”<sup>122</sup>*

Another issue that media face is the journalists’ lack of striving to include more than one opinion when creating a news article. Table 13 shows that half of the articles are stories where only one viewpoint is presented.

Table 14 - Number of opinions / persons consulted in the text

<i>Number of opinions / persons consulted</i>	<i>Frequency</i>	<i>Percentage</i>
1	57	49.5 %
2	32	27.8 %
3	11	9.6 %
4	7	6.1 %
5 and more	8	7 %

All this gives space for doubt and raises questions about the professional standard of the journalists. It also **prevents the presentation of the topic as multidimensional and complex, but instead presents it as rather simple and one-dimensional.** With regards to the issue of consulting several sources, the surveyed journalists noted the following problems:

<sup>121</sup> Radio Free Europe, „Сива Економија – мирна глава“ [Превод на англиски], 10.12.2011

Available from: <http://www.makdenes.org/content/article/24417377.html>

<sup>122</sup> Radio Free Europe, „Сива економија за свет низ розови очила“ [Превод на англиски], 10.08.2012

Available from: <http://www.makdenes.org/content/article/24672676.html>

*“Communication with institutions is always followed by long procedures, directing from one to another person in the hierarchy etc. (...) the difficulty in gaining relevant information, opinions or statements from undeclared workers, who are afraid to talk about their condition in order to keep their job. When asking opinion from companies, on the other hand, the response is always the same: they care for the workers’ rights, all are declared and enjoy their rights according to the Labour Law.”*

*“(...) inability to get official statistics and data concerning the problem. Also, small part of the relevant institutions are open to speak openly about the issue.”*

*“We receive responses on the questions related to the grey economy, but the problem is that the responses are too general and can rarely be used as a relevant indicator for the real situation.”*

There are notable exceptions in this decreasing tendency in the quality of the media reporting. Only **few media (internet portals, daily newspapers) which have relatively small number of audience can be distinguished as media that apply investigative journalism**, committed to share information which is important for all stakeholders. However, considering that the general public prefers TV instead of newspaper or internet media, the problem is reaching a wider audience. The mentioned media present news and articles that raise questions and provide solutions on different issues related to the hidden economy. **Their conclusions can often be critical and expose policy deficiencies, which is probably the purpose why mainstream media do not explore these issues in depth, but remain on the safe side of only reporting uncontroversial news.**

One of the media dealing with the issue of hidden economy in more depth is the daily newspaper

**Kapital**, specialized in economic issues. For example, one of its articles noted:

*“In Macedonia, only 5 % of all payment transactions are performed through credit cards, while the cash is undisputed. What is more interesting is that even those who use cards as payment instrument prefer to withdraw money at ATM and spend it. And just as a reminder, Macedonians bribe public officials to do some service, an average of 470 Euros per year. In the area of illegal economy, according to the Ministry of Economy, 2 billion Euros are in the spin. Given this data, the idea of replacing the cash with the “plastic money” is revolutionary to the least. If the people distance themselves from the cash, risk of corruption and grey economy will be minimal.”<sup>123</sup>*

The data below show solid representation of the facts, opinions or combination of both when making a story. Articles which present facts are 35.7 % of the whole number, which is mostly because the news are filled with direct broadcasting of the state institutions press conferences for promoting new policies towards the fight with the hidden economy. The Ministry of Finance and the Public Revenue Office occur as the most frequent correspondent with the journalists. The most common example of this practice is this article by the public service media MTV 1, where the journalist is using a sensational and populist tone in order to glorify the capability of the public institutions (in this case the Public Revenue Office). In an interview with the head of the Public Revenue Office, when being asked where Macedonia stands compared to other tax administrations in the region, he answers:

*“...Macedonia is leader in tax administration for Southeast Europe”<sup>124</sup>*

<sup>123</sup> Kapital, „Ако картичките го заменат кешот, ќе снеса корупција и сива економија“ [If cards replace the cash there will be no corruption and gray economy], 28.06.2013, Available from:

[http://kapital.mk/MK/magazin/95807/ako\\_kartichkite\\_go\\_zamenat\\_keshot\\_kje\\_snema\\_korupcija\\_i\\_siv\\_a\\_ekonomija.aspx](http://kapital.mk/MK/magazin/95807/ako_kartichkite_go_zamenat_keshot_kje_snema_korupcija_i_siv_a_ekonomija.aspx)

<sup>124</sup> MRT 1, „Македонија е лидер во даночната администрација во Југоисточна Европа“ [Macedonia is leader in tax administration for Southeast Europe], 18.03.2014, Available from: <http://www.mrt.com.mk/node/6124>

Table 14 - Number of opinions / persons consulted in the text

<i>What is being presented</i>	<i>Frequency</i>	<i>Percentage</i>
<b>Facts</b>	41	35.7 %
<b>Opinion</b>	48	41.7 %
<b>Combination</b>	26	22.6 %

Consequently, journalists very often will use sensationalist tone in order to spike interest among the stakeholders. One example is this article by Sitel TV, where the journalist gives his own interpretation of the hidden economy condition, without any reference, saying:

*“...in the last 5 years the hidden economy has been twice reduced. Measurements show that now it reaches only 20 percent, which is only 5 to 6 percent more than the European average.”<sup>125</sup>*

The hidden economy is securing the social peace that is obvious in a country with high unemployment rate, where there is no mass expression of displeasure. This is maybe the biggest reason why the public and the authorities do not show bigger interest for this issue. In an article by Radio Slobodna Evropa one sociologist raises very interesting question:

*“It is surprising that, although as a country we have the highest percentage of unemployment rate among the countries in the region, we still have not witnessed people going out and reacting to this problem. In addition to this, a big percentage of the Macedonian economy is grey economy. This means that huge amount of money is in circulation,*

*and it seems that, somehow, everybody solve their problems out of the society, the institutions etc.”<sup>126</sup>*

The general picture regarding Macedonian media, as the main stakeholder for raising awareness is that they **do not provide enough quality information about the issues of the “hidden economy”**. The research showed that although there is a significant growth of the number of news related to this topic in 2012 and especially 2013, there is still a big gap between the researched stories (investigative journalism) and the simple presentation of the news. The main conclusion is that the **local media in most of the cases transmit already presented information, usually by the state institutions, referring to new policies for reducing the hidden economy.**

The reasons for the lack of quality news related to hidden economy can be different. For example: (1) journalists themselves are part of the hidden economy through receiving part of their salary in cash or as a honoraria; (2) there is a general lack of education and in-depth understanding among journalists on the hidden economy issues; (3) the hidden economy is securing the social peace in the country, which gives space for the biased media not to be investigative when writing about this issue.

<sup>125</sup> Sitel TV, „Сивата економија двојно се намалила за пет години“ [For 5 years the grey economy is twice reduced], 05.06.2014 Available from: <http://www.sitel.com.mk/sivata-ekonomija-dvojno-se-namalila-za-pet-godini>

<sup>126</sup> Radio Free Europe „Македонија 87 години зад ЕУ“, [ Macedonia 87 years behind EU], 09.07.2011 Available from: <http://www.makdenes.org/content/article/24260162.html>

## VIII. Policies and methods for tackling hidden economy and effectiveness

An array of approaches and policy measures is available for the purpose of tackling the hidden economy. They are generally preconditioned by the understanding of the underlying causes of hidden economic activities and hence, can be divided into two main approaches.

- A **neo-liberal approach** argues that the undeclared economy is a direct result of high taxes, over-regulation of the economy and too much government interference in the realm of welfare provision. Therefore, economies should pursue tax reductions, deregulation and minimal state intervention to prevent the growth of undeclared economy.
- A **social democratic** approach argues that the undeclared economy is a by-product of the deregulation of economies and reductions in state welfare provision, and that one should therefore bolster state expenditure on the labour market and welfare provision to tackle the undeclared economy.<sup>127</sup>

The focus of all Macedonian governments, especially since 2006, has been to promote measures with the sole purpose of attracting FDI and decreasing unemployment. However, despite a large body of legislation that deals with countering and sanctioning hidden economic activities, public policy measures that dealt directly with the negative consequences of the hidden economy were lacking. Recently, there has been a renewed interest in tackling hidden economic activities, spurring basic labor rights, and reforming institutions and inspection services that deal with the hidden economy. The part that follows elaborates on the most important policies directly or indirectly aimed at reducing the hidden economy in the country and their effectiveness, through applying the model developed by Williams and Rennoy (2009).

### Review of Types of Approaches and Measures Applied in Macedonia

The policy approaches framework used in Table 15 (established initially by Williams and Rennoy, 2009) shows clearly some of the more prominent measures undertaken by the Government of Macedonia (GoM) in order to deter and prevent undeclared work. Illustrating the key features of the measures aimed at the undeclared economy is a good starting point for evaluation and modification of implemented measures and a cornerstone for future measures.

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<sup>127</sup> Colin C. Williams, Piet Rennoy, (2013) "Tackling undeclared work in 27 European Union Member States and Norway: Approaches and measures since 2008." (Eurofound, 2013, p.25) Retrieved on 22.04.2014 from: <http://www.eurofound.europa.eu/publications/htmlfiles/ef13243.htm>

Table 16 - Policy framework adapted from Williams and Renooy (2009) used in GREY Working Paper No.3 and updated (text in green).

Approach	Method	Type of implemented measure
Deterrence (pursue and punish)	Improving Detection	<p><b>Labour Inspections</b></p> <ul style="list-style-type: none"> <li>Establishment of a Misdemeanour Body within the Ministry of Labour and Social Policy consisting of two commissions – one for labour relations and one for occupational safety and health (2009/10)</li> <li>Strengthened rules for registered unemployed, e.g. required verification of job search activity (2012)</li> <li><b>Creation of the Inspection Surveillance Council which is to coordinate the efforts and resources of all inspection and oversee their work. (2012-2014)</b></li> </ul> <p><b>Control over the payment of income tax and social contribution</b></p> <ul style="list-style-type: none"> <li>Establishment of 'Centre for debt collection', 'Centre for seized goods', 'Tax Academy for training' and a 'forensic laboratory' within the Public Revenue Office to tackle high-risk fraud and tax evasion (2011)</li> <li>Strengthened administrative cooperation and mutual assistance through electronic data exchange (Public Revenue Office, State Labour Inspectorate, etc.) (2012 and 2013)</li> <li><b>Temporary service contracts reform to tackle avoidance of social security contributions (07.2014)</b></li> </ul>
	Increase penalties Increase	<ul style="list-style-type: none"> <li><b>Obligation of the employer within 8 days to officially employ an undeclared worker upon detection by a labour inspector, as well as to pay to the worker three gross wages and not reduce the number of employees for three months. Fine of 1000 EUR for every undeclared worker (2013)</b></li> </ul>
Enabling formalisation / compliance		<p><b>Simplification of regulatory compliance</b></p> <ul style="list-style-type: none"> <li>Simplifying regulations for starting a business ('one-stop-shop' system) (2009);</li> <li>Decentralisation of the tax service payments, e.g., opening of local 'Service Points' (2011)</li> <li>Encouragement of electronic filing of tax returns and electronic payment of the corporate income and VAT taxes (2013/14)</li> </ul> <p><b>Direct tax incentives</b></p> <ul style="list-style-type: none"> <li>Reduction and equalisation of the corporate and the personal income tax rate ('flat-tax rate') at 10% (2008)</li> <li>Tax rate of 1.5 % on total income for small businesses with an annual turnover of up to 3 million MKD (2008)</li> <li>Tax relief for reinvested profit (for investments over 100,000 EUR) (2008/09)</li> <li>Zero corporate income tax for non-distributed profits (2011)</li> </ul> <p><b>Incentives for involvement in official employment and business operations</b></p> <ul style="list-style-type: none"> <li>Tripartite Collective Agreement for social dialogue (2009)</li> <li>Harmonisation of the minimum and maximum social contribution base with the amount of the individual gross wage (2009)</li> <li>Progressive reduction in the compulsory social contribution rate to 26.5% (2011) and the pension contribution rate to 18% of the gross wage (2010)</li> <li>Adoption of the 'Minimum Wage Law', setting the national minimum wage at 36.9% of the national average gross wage for the given branch for the previous year (2012)</li> <li>Decrease in the maximum period of remuneration for unemployment from 60 to 18 months (2012)</li> <li>Provision of microfinance to business start-ups (particularly SMEs) (2012/13)</li> <li>Reduction in the cost of seasonal workers by easing the requirements for severance pay (introducing trial work in seasonal jobs and reducing the time for a firing notice) (2013)</li> <li><b>Temporary service contracts reform –a set of amendments to several Laws<sup>128</sup>, stipulating that employers that employ workers with temporary service contracts and whose gross wage exceeds the minimum wage in 2015 (9,500 MKD) have the duty, by law, to pay healthcare, social and employment contributions. (2014)</b></li> </ul>
	Preventative (Deter Entry)	

<sup>128</sup> Laws amended concerned: Law on Labor Relations, Law on Mandatory Fully Funded Pension Insurance, on Mandatory Social Security Insurance Contributions, Law on Healthcare Insurance, Law on Pension and Disability Insurance (Official Gazette of the Republic of Macedonia, No 113/2014.) Available at: <http://www.mtsp.gov.mk/zakoni.nspix> or

Curative (encouraging movement out of the shadow economy)	<ul style="list-style-type: none"> <li>➤ Lower tax base for registered individual farmers (20% of the national average net wage (2008).</li> <li>➤ Farmers with an annual income &lt;300,000 MKD are exempted from paying an income tax (2008).</li> <li>➤ <b>Activation of registered unemployed persons, mediation for employment, preparing individual employment plans to avoid working in the grey economy. One such measure is 'Subsidizing employment of users of social assistance' (2014)</b></li> <li>➤ <b>Formalization of existing businesses and self-employment program of the Employment Agency of Macedonia. Provision of a one-day entrepreneurship training, 3000 EUR grant and free registration of the business. (2007-2014)</b></li> <li>➤ <b>Transforming grey economy among Roma into a legal employment, as part of the activities for higher employment of Roma (part of the Roma Inclusion Decade 2005-2015)</b></li> </ul>
Fostering commitment	<p><b>Public campaigns and rising awareness initiatives</b></p> <ul style="list-style-type: none"> <li>➤ Hotlines for reporting undeclared work and labour-related irregularities (Ministry of Labour and Social Policy, National Employment Agency, Pension and Disability Insurance Fund and State Labour Inspectorate).</li> <li>➤ Checklist for employers and employees of their respective legal rights and obligations (web page of the State Labour Inspectorate)</li> <li>➤ Awareness raising campaign targeted at youths to promote successful transition from school to decent work.</li> <li>➤ <b>"Ask for a Receipt" awareness campaign to foster tax compliance and hinder tax evasion. (2014)</b></li> <li>➤ <b>Campaign of 'public shaming' by the PRO publishing a black list of unpaid debts and late paying debtors on a monthly basis (2014)</b></li> </ul>

Source - [http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM\\_10072014.pdf](http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf) p.41.

### Institutions and Policy Effectiveness

The Action Plan for the reduction of the grey economy (Ministry of Economy, 2013; MLSP, 2014) was drafted by MLSP and represents a consultative effort to coordinate and monitor the activities of several institutions and regulatory bodies into the field of tackling undeclared labor and its different

facets while at the same time clearly delineating responsibilities among them. Comparing them analytically side by side (Table 16) one can evaluate the focus of the national efforts in tackling the hidden economy as well as the direction where these efforts are headed to.

Table 17 - Comparative table of action plans 2013 and 2014 of the Ministry of Labor and Social Policy (MLSP) and responsible departments. The novel unrepeated measures are marked in bold green font.

Responsible Department/s	Planned Actions for 2013	Planned Actions for 2014
<p><b>Enforcing formal employment:</b> Ministry of Labor and Social Policy And Employment Agency</p>	<ul style="list-style-type: none"> <li>• Measures aimed at improving the regulations related to seasonal workers</li> <li>• Measures aimed at incentivizing the registered unemployed workers and testing their activity.</li> <li>• Support for formalisation of undeclared work by unemployed/unregistered businesses.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Analysis of the possible effects of establishing a voucher system for personal services.</b></li> <li>• <b>Improving the regulation for employment subsidies for receipts of social benefits.</b></li> <li>• <b>Activating and incentivizing receivers of social benefit to accept</b></li> </ul>

<sup>129</sup> Action Plan for the reduction of the grey economy (Ministry of Economy, 2013; MLSP, 2014). Retrieved from: [www.mtsp.gov.mk/content/word/siva.doc](http://www.mtsp.gov.mk/content/word/siva.doc)

	<ul style="list-style-type: none"> <li>job positions.</li> <li>Establishing a system for registering employers who are willing to employ recipients of social benefits.</li> <li>Establishing a system for registering persons who work abroad through agencies for temporary employments, registering them in the social security system and performing monthly controls.</li> <li>Improving the regulation concerning the registration of and licensing of foreign agencies that mediate or employ workers abroad.</li> <li>Improving the regulation establishing jurisdiction for determination of undocumented workers by the State Market Inspectorate and PRO.</li> </ul>
<p><b>Increasing tax compliance:</b> Ministry of Finance and Public Revenue Office</p>	National campaign for increasing citizens' tax morale and public awareness of the benefits of paying taxes.
<p><b>Education:</b> Ministry of Education and Science</p>	Educating students in secondary schools on the negative effects of the undeclared work (project "Reject undeclared work")
<p><b>State Inspections and Control:</b> State Labor Inspectorate (SLI)</p>	<p>Publishing a 'Black List' of firms with detected irregularities</p> <ul style="list-style-type: none"> <li>Strengthening inspection and control on a sectorial basis</li> <li>Strengthening cooperation between regional inspectors</li> </ul>
<p><b>Tax revenue collection and control:</b> Public Revenue Office</p>	<ul style="list-style-type: none"> <li>Detecting taxpayers performing undeclared activities (with SLI)</li> <li>Detecting taxpayers in temporary employment</li> <li>Detecting undeclared taxable income of individual taxpayers</li> <li>Implementing and monitoring the fiscal cash registers system</li> </ul>
<p><b>Customs duties collection and control:</b> Customs Administration and Ministry of Interior</p>	<ul style="list-style-type: none"> <li>Strengthening border control (legal and illegal border passages) and determining correctly the size of the customs duties</li> <li>Enhancing control over individuals crossing the borders ('shuttle trade')</li> </ul>
<p><b>Market regulation:</b> Ministry of Economy (incl. State Market Inspectorate, State Inspectorate for Technical Inspection, State Inspectorate for Construction and Urban Development)</p>	<ul style="list-style-type: none"> <li>Strengthening control over undeclared commercial activities at restricted places (green markets, pavements and squares)</li> <li>Strengthening control over undeclared activities in catering and tourism</li> <li>Strengthening control over concessionaires performing geological research and exploitation of mineral resources</li> <li>Regionalization of the State Inspectorate for Technical Inspection</li> <li>Strengthening control over marketed products in line with the Law on Product Safety and the Law on Construction Products</li> <li>Strengthening control in relation to consumer rights observance</li> </ul>

Having an action plan does what its name suggest: it rounds up all or most important institutional stakeholders, it coordinates their activities, assesses the need for different measures and evaluates the efficiency of already established measures and policies through some concrete indicators.

By putting MLSP's action plans for 2013 and 2014 side by side one can evaluate where the policies are headed and to what extent do they address the challenges posed by undeclared labor in particular and hidden economic activities in general. Moving from the action plans of 2013 to 2014 activities

remain similar or continuous in the following areas: increasing tax compliance, education, state revenue collection and control and market regulation. The two most notable developments are within the responsibilities of the MLSP and the Employment Agency as well as the State Inspection and Control. The MLSP, in cooperation with the Employment Agency, has been made responsible for a number of new measures, from activating and subsidizing social benefit recipients, through measures for improving regulations (related to seasonal workers, determination of undocumented workers, licensing foreign agencies for mediating or employing workers abroad). It is evident that in **2014, the Action Plan is more focused on socially disadvantaged groups, especially social benefits receivers**, signifying that institutions became more **aware of the vulnerability of these individuals towards hidden economic activities** and the vicious circle it creates with regards to their socio-economic status. However, the effects from these policies are yet to be seen.

The second development is within the domain of State inspection and control, whose obligations with relation to the action plan have been specified with regards to: strengthening inspection and control on a sectorial basis and strengthening cooperation between regional inspectors.

The 2014 Action Plan contains within a preventative and repressive dimension but also enhances the role of measures aimed at fostering commitment and tax morale. It also shows how the fight against the hidden economy entails the utilization of decentralized efforts coming from a multidisciplinary range of government institutions and bodies with shared but complementary responsibilities. However, the coordination between the SLI and other relevant enforcement agencies has been pointed out as inadequate formal coordination procedures, joined-up strategies, and common

targets for different departments<sup>130</sup>. Another issue is the weak performance of inspections, which are prone to political influence (Stojkov, Nikolov and Smilevski, 2008). This provides a secure shield for some privileged companies engaged in informal operations.<sup>131</sup>

In this respect, the creation of the new government body-Inspection Surveillance Council (ISC) tries to combat some of the coordinative deficiencies between the several enforcement bodies. According to the law establishing this body the function of the new council, consisted of members/directors of the inspectorates, is oversight over the work of the inspectorates and coordination of their work, reviewing the work of inspectorates where irregularities have been reported or detected, putting in place training programs, inspector certification, and in general working towards increasing the efficiency of the inspectorates while decreasing costs.

However, the European Commission in 2013 stressed that the **legislation itself is not the root problem but moreover enforcement** thereof which remains to be a problem for most candidate countries. “Empowering the Public Revenue Office, improving judicial efficiency and ensuring greater independence of inspectors are therefore three crucial objectives in the fight against undeclared work in Macedonia.”<sup>132</sup>

The 2014 Progress Report is even stricter in its conclusions. Based on the argument that ‘the large size of the informal economy continues to hamper competition and the development of a formal private sector’, it argues on the lack of sufficient information on the effectiveness of the 2013 action plan for reducing the shadow economy, and the adoption of the 2014 action plan ‘without clear evidence of a results-based assessment of previous measures’.<sup>133</sup>

<sup>130</sup> Dzhokova, Franic, Mishkov, C. Williams (2014), “Tackling the Undeclared Economy in FYR Macedonia” GREY Working Paper No. 3, University of Sheffield. Retrieved from: [http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM\\_10072014.pdf](http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf) p.25)

<sup>131</sup> Ibid, (p.34)

<sup>132</sup> Ibid (p.25)

<sup>133</sup> EC Progress Report on Macedonia, 2014

### Repressive measures

The **State Labor Inspectorate (SLI)** is the main enforcement body of the labor legislation and thus is responsible for exercising control over undeclared work through its four departments: a) The Labour Relations Department, b) Safety and Health at Work Department, c) Department for Legal Matters in the field of Safety and Health at Work, and e) Department for Coordination, Training and Administrative Enforcement.<sup>134</sup> As the main body executing deterrence and repressive measures (improving detection, increasing penalties and risk perceptions) in the period 2008-2012 the SLI conducted: 38.741 inspections in 2008, 32.406 in 2009, 34.045 in 2010, 31.146 in 2011 and 34.275 in 2012<sup>135</sup>. A drop of 78% of detected undeclared workers in 2009 is one indication that increased control of the SLI led to positive results even

though some of this decrease can be attributed to the general decrease of employment due to the economic crisis of 2008.<sup>136</sup> As an illustration, out of the detected inconsistencies with the Labor Code, the SLI also detected 2,918 undeclared workers in 2010; 1,269 in 2011; 1,033 in 2012 and 966 in 2013.26 Faced with the fine of 1000 EUR for each

Table 18 - SLI Annual Report (2008-2012), Retrieved on 10.01.2014 from: SLI archive and [http://dit.gov.mk/godisnilzvestai\\_full.php?id=2012](http://dit.gov.mk/godisnilzvestai_full.php?id=2012),

	Regular inspections	Control inspections	Total Inspections	Number of detected undeclared workers
2008	33.917	4.824	38.741	15.626
2009	30.810	1.596	32.406	3.405
2010	31.571	2.474	34.045	2.918
2011	28.748	2.398	31.146	1.269
2012	28.745	5.530	34.275	1.033
2013	23.286	3.454	26.740	966

detected undeclared worker, information from the SLI states that since 2013 and 2014 majority of employers pay the sum, and in 2013, on this basis, 140,000 EUR have been paid.<sup>137</sup>

Figure 18- Number of inspections performed by the SLI in the period of 2008-2013. Source: SLI annual reports and physical archives

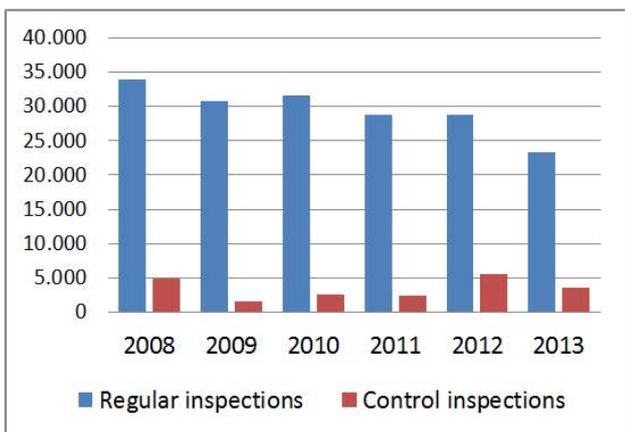
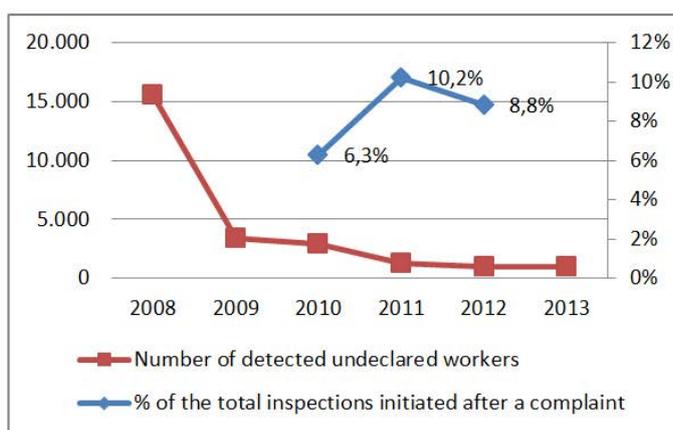


Figure 19- Undeclared workers (Left Axis) VS. Complaint initiated inspections as % of total inspections performed (Right Axis). Source: SLI Annual Reports and physical archives



<sup>134</sup> <http://www.mtsp.gov.mk/drzaven-inspektorat-za-trud.nsp>

<sup>135</sup> SLI Annual Report (2012), Retrieved on 10.01.2014 from: [http://dit.gov.mk/godisnilzvestai\\_full.php?id=2012](http://dit.gov.mk/godisnilzvestai_full.php?id=2012)

<sup>136</sup> Mojsoska-Blazevski, N. (2011) Supporting strategies to recover from the crisis in south eastern Europe: Country Assessment Report: The former Yugoslav Republic of Macedonia. Geneva: ILO. Retrieved on 10.05.2014 from: [http://www.ilo.org/wcmsp5/groups/public/@europe/@ro-geneva/@sro-budapest/documents/publication/wcms\\_167032.pdf](http://www.ilo.org/wcmsp5/groups/public/@europe/@ro-geneva/@sro-budapest/documents/publication/wcms_167032.pdf)

<sup>137</sup> Presentation of Zlate Stojanovski, State Labour Inspection, at the conference on Countering Undeclared Labour, CRPM and CSD, 27 November, 2014, Skopje.

The **number of detected undeclared workers continues to drop** (see Table X17 and Figure 19) while the incidence of inspections initiated by complaints reported through written requests, web tool and call center continues to rise, representing 8.8% of the total inspections performed in 2012. The International Labour Organizations for the preceding years estimates that only 4% of the total inspections were initiated after a complaint has been filed.<sup>138</sup> Nevertheless, the increased reporting of undeclared work indicates raised awareness on behalf of employees and other stakeholders, as well as increased trust within the SLI. In this regard, it is worth mentioning that the SLI did not act only through punitive measures but also through providing the necessary information and education to employers. Brochures with the legislative changes have been prepared and distributed to employers, as a preventive measure, and such measures are assessed as often more efficient compared to the punitive ones.<sup>139</sup>

Another measure the SLI has started implementing since 2013 for the purpose to ‘blame and shame’ is publishing a so-called ‘black list’ of companies

where irregularities have been detected. These lists are available at the SLI’s web page, but only for the first four months of 2014. It is evident from Table 18 that the largest number of companies listed are from the sectors ‘services’ and ‘trade’ and most of the irregularities refer to unpaid salaries, while relatively less to undeclared workers and unsigned contracts. However, in relatively few cases the Inspectorate took the measure of closing the company’s workplaces.

Despite its successes there are areas within the work of SLI that need improvement:

- **Joint inspections** – between Operational Safety and Health (OSH) and Labor Relations inspections constitute only 10-20% of all inspections. There are lack of common targets for different departments as well as lack of formal coordination procedures and joined-up strategies.<sup>140</sup> An increasing impetus is notable in the sphere of joint inspections between the SLI and the Public Revenue Office (PRO) in the field of tax collection.

Table 19 - Black list of companies with detected irregularities from the field of labour relations (2014)

		January	February	March	April
<b>Number of companies listed</b>		6	41	37	11
<b>Sectors</b>		Services 2 Production 1 Construction 1 Finances 1 Other 1	Services 17 Trade 9 Production 6 Construction 1 Education 1 Other 7	Services 9 Trade 18 Other 10	Services 5 Trade 4 Production 1 Education 1
<b>Breach of the law with regards to:</b>	Unpaid salaries	3	8	17	8
	Unsigned contracts	1	6	6	
	Undeclared workers		6		1
	Overtime work		4		
	Other	2	17	14	2
<b>Closing workplace</b>		0	4	6	1

Source: State Labor Inspectorate, [http://dit.gov.mk/pmeseecnilzvestai\\_rp.php](http://dit.gov.mk/pmeseecnilzvestai_rp.php)

<sup>138</sup> International Labour Organisation (2011b) Labour inspection country profile: The former Yugoslav Republic of Macedonia. Geneva: ILO [Online]. Retrieved from: [http://www.ilo.org/labadmin/info/WCMS\\_114938/lang--en/index.htm](http://www.ilo.org/labadmin/info/WCMS_114938/lang--en/index.htm)

<sup>139</sup> Presentation of Zlate Stojanovski, State Labour Inspection, at the conference on Countering Undeclared Labour, CRPM and CSD, 27 November, 2014, Skopje.

<sup>140</sup> Williams, C.C., Baric, M. and Renooy, P. (2013) Tackling Undeclared Work in FYR Macedonia. Dublin: Eurofound.

- **Poor organization** – visits are poorly organized due to lack of data, time and registers. Inspectors do not use any procedural manuals, checklists or templates in their visits.<sup>141</sup>
- **Data sharing and connectivity** - is insufficient or non-existent. There is currently no registry that exists in the MLSP. “Some public institutions such as the Central Register of Enterprises, the Taxation Authority, the Employment Agency, the State Statistics Office, the Health Insurance Fund and the Pension and Disability Fund have computerized systems at their disposal. However inspectors are not provided access to these databases.”<sup>142</sup> Having said that, steps are taken towards implementing network software allowing the SLI access to pertinent data from relevant institutions such as the EA, the PRO, the Central Registry etc.

The **State Market Inspectorate** (or so called Market Surveillance Inspectorate) is an important stakeholder in the fight against the hidden economy. As indicated in the 2014 Action plan for the fight against the grey economy in Macedonia, its responsibilities have been enhanced in terms of strengthening control over undeclared activities in the fields of catering, tourism and at restricted places such as green markets, pavements and other public spaces. Strengthening control

in relation over marketed products and consumer protection is also being enhanced. However, in 2013 out of 4.000 consumer complaints received by the SLI only 1.5% were addressed. In the first half of 2014 this figure has only slightly increased to 2% of addressed consumer complaints.<sup>143</sup> To address this deficiency the SLI was tasked to submit their reports to the Ministry of Economy on a monthly instead of quarterly basis as it was the case till recently.<sup>144</sup>

The total number of inspections carried out has increased from 26,599 in 2011 to 40,582 in 2013 (See Figure 20 ). A significant change can be observed within the structure of the performed inspections where in 2011 surprise checks consisted only 4%, in Q3 2014 they equated to 12% of all inspections. This might be explained by the increased number of joint inspections by the Public Revenue Office, the Financial Police and the State Market Inspectorate which might not be planned by SLI’s administration.

Figure 20 - Types and number of inspections performed (2011 - Q3 2014). Source: SMI annual reports

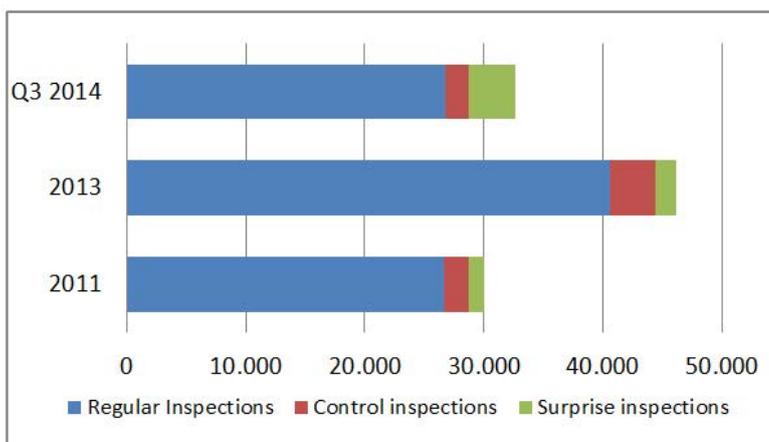


Table 20 - Payment orders and fines paid (In mln. MKD) to the SMI and number of inspectors used. Source: SMI annual and quarterly reports available at:

[http://dpi.gov.mk/index.php?option=com\\_content&view=article&id=117&Itemid=162&Name=Value](http://dpi.gov.mk/index.php?option=com_content&view=article&id=117&Itemid=162&Name=Value)

	Issued payment orders	Paid payment orders	Issued penalty fee	Penalty fees paid	Value of products confiscated from unregistered traders	Number of Inspectors	Number of Inspections performed per inspector
2011	73,3	3,2	1,2	0,2	1,7	144	208
2013	86,3	7,8	10,1	0,9	2,5	125	369
2014 Q3	70,8	4,1	16,8	2,4	1,8	126*	259

\* The number of inspectorates in Q3 2014 is an average value taken from the 3 separate SLI quarterly reports.

<sup>141</sup> International Labour Organization, (2011). Labour Inspection Country Profile: Macedonia. Retrieved from: [http://www.ilo.org/labadmin/info/WCMS\\_114938/lang--en/index.htm](http://www.ilo.org/labadmin/info/WCMS_114938/lang--en/index.htm)

<sup>142</sup> Ibid

<sup>143</sup> Independent.mk, “Consumer Protection Activities Intensified in Macedonia”, 02.07.2014. Retrieved from: <http://www.independent.mk/articles/6746/Consumers+Protection+Activities+Intensified+in+Macedonia>

<sup>144</sup> It has to be noted that available data on the annual and quarterly activities of the SLI is limited, especially for the period 2006-2010, whereas the annual and quarterly reports for 2012 are missing altogether

The available data does not allow for straightforward conclusions about the effectiveness of the SLI, however, data on payment orders issued and penalty fines collected due to offences which are within the domain of the law on State Market Inspectorate<sup>145</sup> might give some insight (See Table XX). Collection rates of payment orders in 2011 was mere 4% while reaching 6% in Q3 2014. Collection rate of penalty fines ranged from 9% in 2013 to 14% of all issued penalty fines by Q3 2014.

In order to enhance interoperability, institutional cooperation and data exchange in the domain

of market surveillance in 2010 a Coordinative Body for market surveillance was established (O. Gazette, 90/2010) which consisted of representatives from<sup>146</sup>:

- State Market Inspectorate (coordinator)
- State Labour Inspectorate (deputy coordinator)
- State Technical Inspectorate and Ministry of Economy
- Bureau of Medicaments
- State Sanitary and Health Inspectorate Food Directorate

Table 21 - General Tax Inspectorate and its audit activity (2011 – 2014)

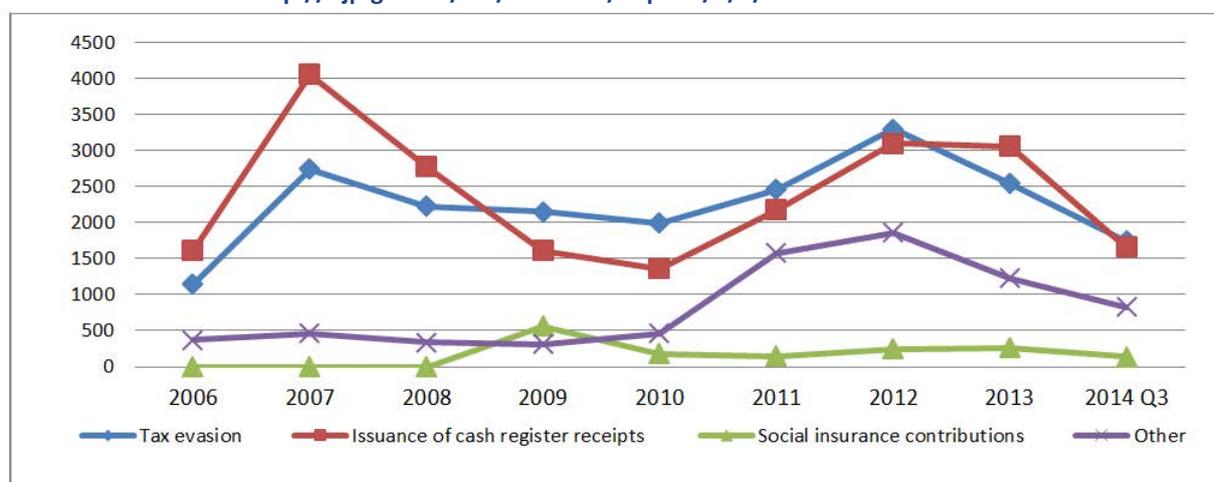
	Total audits conducted	Audits with irregularities detected	Ratio of irregularities detected/total audits performed
2011	7.771	3.522	45%
2012	7.292	3.698	51%
2013	6.806	3.171	47%
2014 Q3	4.942	1.951	39%

- Customs Administration
- State Inspectorate for Environment
- Agency for Electronic Communications
- Inspection of Transport and Communication

**The Public Revenue Office** functions as part of the Ministry of Finance and is responsible for tax collection and other receivables while at the same time being tasked with tackling tax evasion

and fraud as well as other violations of the tax code by using its General Tax Inspectorate (GTI) to perform audits. Looking at Table 20 in the period 2011-2013 can be observed that **nearly half of the audits were protruded with irregularities** with a slight decline in 2013 (6.806 audits) which is expected to continue by the end of Q4 2014.

Figure 21 - Reports of irregularities through the PRO's hot line (198) and E-report.  
Source: PRO statistics <http://ujp.gov.mk/mk/statistika/naplata/9/0/0>



<sup>145</sup>Official Gazette of RM, Nr. 35/97, 23/99, 7/02, 20/02, 24/2007, 81/2007

<sup>146</sup> Chingarovska, Elizabeta (2010) "State Market Inspectorate and Market Surveillance." Retrieved from: <http://192.232.255.119/~cefta/sites/default/files/folder1/Ms%20Elizabeta%20Chingarovska%20Ministry%20of%20Economy%20Macedonia.pdf>

By using the reports for irregularities submitted through the PRO's hot line and e-reports tool the types of violations can be diversified. **Tax evasion and issuance of cash register receipts were the leading causes for reporting irregularities throughout the period 2006-2013.** These two types of violations represented 78% of all reports in 2013.<sup>147</sup> By the end of 2014, a new measure is being implemented which establishes a crossover to GSM fiscal cash registers that gather transactions data in real time from the point-of-sale to the PRO, which in practice should enhance the investigative powers of the PRO and other interconnected agencies and registers. The real-time data flowing from the GSM fiscal cash registers should enhance the PRO's targeting capabilities while at the same time decrease the amount of ineffective audits that do not detect irregularities.

Irregularities concerning social security contributions have amounted to the least amount of reports throughout the same period. The category 'Other' consists of violations concerning misconduct of a PRO's official and irregularities within the jurisdiction of other

institutions which show a tendency to increase.

Additionally, in 2013 a **Forensic Laboratory was setup within the PRO's which was responsible for tackling high-risk fraud.**<sup>148</sup> The PRO also started a campaign of 'public shaming' by publishing a black list of unpaid debts and late paying debtors on a monthly basis whose debts were above 120,000 MKD (2,000 EUR) for individuals and above 300,000 MKD (5,000 EUR) for legal entities.<sup>149</sup> Generally, the efforts were focused on decreasing business costs for compliance with the tax system by means of simplifying rules and regulations and in the process making the tax authorities more efficient and effective.

**The Financial Police** also takes part in joint inspections with the PRO and the State Market Inspectorate in order to detect and punish offences and acts of misdemeanor within their jurisdiction. Accordingly, the FP is an important partner in the joint fight against hidden economic activities. The table below presents the types of offences and their occurrence through the period of 2006-2013.

Table 22 - Types of offences detected by the Financial Police. Source: Financial Police Reports <http://www.finpol.gov.mk/statistiki.html> and [www.mkbudget.org](http://www.mkbudget.org)

Types of offences	2006	2007	2008	2009	2010	2011	2012	2013	Total
Tax Evasion, Art. 279	47	16	47	67	41	46	23	48	403
Falsifying and destroying business record journal, Art. 280			37	62	38	24	21	35	217
Money laundering and other income from punishable acts, Art. 273	47	14	2		1	1	1		131
Abuse of position, Art. 353		11	5	8	18	11	7	8	69
Fraud, Art. 247	1	1	1	1	3	1	13	3	26
Damaging or unlawfully privileging creditors, Art. 257		1	2	1	5	1	2	4	16
Embezzlement in the service, Art. 354-353					2		14		16
Falsifying documents, Art. 378		1	1		3		3	2	12
Other	3	2	0	5	4	4	7	10	37
<b>Total</b>	<b>98</b>	<b>46</b>	<b>95</b>	<b>144</b>	<b>115</b>	<b>88</b>	<b>91</b>	<b>110</b>	<b>927</b>
<b>Total damages (Mln. MKD)</b>				668	708	569	1.241	662	3848

<sup>147</sup> The Public Revenue Office (PRO) statistics on audits and irregularities. Retrieved from: <http://ujp.gov.mk/mk/statistika/naplata/9/0/0>

<sup>148</sup> European Commission (2013) Commission Staff Working Document. The Former Yugoslav Republic of Macedonia, 2013 Progress Report. [SWD(2013) 413 final]. Brussels: European Commission. P. 34.

Retrieved from: [http://ec.europa.eu/enlargement/pdf/key\\_documents/2013/package/mk\\_rapport\\_2013.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2013/package/mk_rapport_2013.pdf)

<sup>149</sup> Official Gazette of the Republic of Macedonia nr. 13/06...187/2013.

Retrieved from: [http://www.ujp.gov.mk/files/attachment/0000/0587/Zakon\\_za\\_danocna\\_postapka\\_187\\_\\_30.12.2013.pdf](http://www.ujp.gov.mk/files/attachment/0000/0587/Zakon_za_danocna_postapka_187__30.12.2013.pdf)

It is apparent that the vast majority of the offences are focused within 2 misdemeanor categories, tax evasion (art. 279), and falsifying and destroying business record journal (art. 280). In fact, in 2013 these 2 categories represented 75% of all detected offences (Table 21). In financial terms all 110 offences in 2013 have accounted for damages amounting to 662 mln. MKD (10.7 mln. EUR) which are significant compared to the FP's operational annual budget of around 30 mln. MKD (0.5 mln. EUR)<sup>150</sup>. However, due to lack of data concerning the collection rate of the detected damages, it would be difficult to

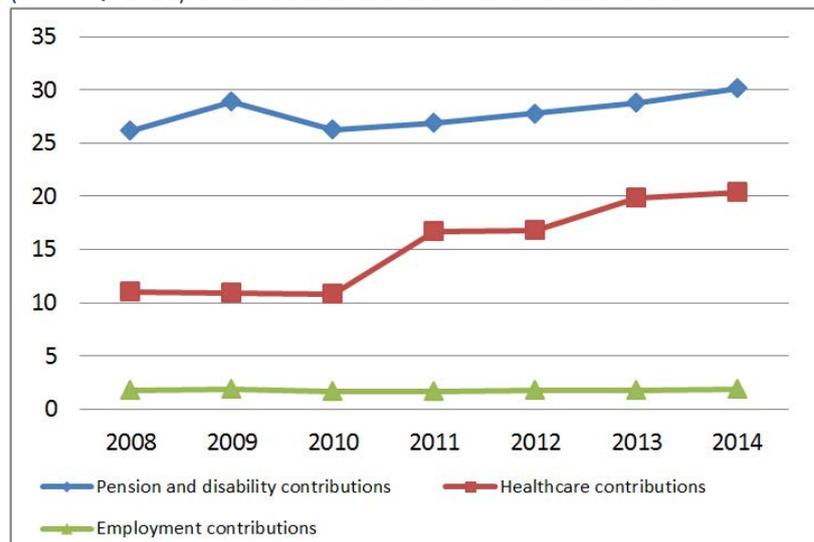
estimate the effectiveness of the FP's operations and policy impact.

### Preventative measures

The weak capacity of the Public Revenue Office is yet another obstacle indicated by businesses. Both the insufficient number of tax officers and the unsatisfactory level of skills of existing personnel often cause undesirable complications in the process of paying taxes. This certainly directs a proportion of firms into the informal realm, which is the easiest strategy to avoid hassle with the administration.<sup>151</sup>

Looking at the statistical data coming from the PRO, a **positive trend is evident in tax revenues from pension and disability, and healthcare contributions** especially since 2010 with an average annual increase of total contributions by 4.7%. At the end of Q3 of 2014 the percentage fulfillment of revenues compared to total revenues coming from social security contributions in 2013 is 69%. However, pension and disability contributions and employment contributions have not increased dramatically, in fact, throughout the 2008-2013 period, the revenues remain at average values of 27 billion MKD and 1.75 billion MKD respectively. The positive trend in total tax revenues from social security contributions stems solely from the rapid increase in revenues from healthcare contributions which in 5 years has almost doubled

Figure 22 – Tax revenues from social security contributions for the period (2008- Q3 2014). Source: Public Revenue Office of Macedonia



from 11 billion MKD in 2008 to 20 billion MKD in 2013. This could be attributed as a positive effect from the consecutive amendments applied to the Law on mandatory and social security contributions (LMSSC).<sup>152</sup> More research is needed in order to assess whether the additional tax income has resulted in increased expenditure

<sup>150</sup> MKBUDGET (2013), Realization of the project financially is supported by the Think Tank Fund (TTF) and Information Program (IP) from Budapest, Hungary. © 2012 CEA budget. <http://www.mkbudget.org/rashodi/details/ime/%D0%A3%D0%BF%D1%80%D0%B0%D0%B2%D0%B0%20%D0%B7%D0%B0%20%D1%84%D0%B8%D0%BD%D0%B0%D0%BD%D1%81%D0%B8%D1%81%D0%BA%D0%B0%20%D0%BF%D0%BE%D0%BB%D0%B8-%D1%86%D0%B8%D1%98%D0%B0/godina/2013/vidrashod/9>

<sup>151</sup> Law on mandatory social security insurance contributions (LMSSC), Official Gazette of RM, No. 42/08, 64/09, 156/09, 166/10, 53/11 and 185/11)

<sup>152</sup> Dzhokova, Franic, Mishkov, C. Williams (2014), "Tackling the Undeclared Economy in FYR Macedonia" GREY Working Paper No. 3, University of Sheffield. Retrieved from: [http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM\\_10072014.pdf](http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf) p.44

on different public services such as healthcare, and maternity payments. However the budget of the Ministry of health has doubled from almost 3 billion MKD in 2011 to 6 billion in 2014.<sup>153</sup> Additionally the expenditures of the Healthcare Fund for maternity leave have increased from 0.59 billion. in 2007 to 1.7 billion MKD in 2013.<sup>154</sup> However the absolute amount of the budget of the Healthcare Fund has averaged around 21 billion MKD<sup>155</sup> in the period of 2010-2013. This indicates that any increase or decrease of particular budget lines (such as the increase in maternity leave expenditures) is rather due to reallocation of budgetary resources from one line to another than to increases in tax revenues.

Schneider looking at empirical data from dozens of studies which suggest different factors and their influence on the undeclared economy has identified that “the major contributory factor is the increase in tax and social security burdens. This relates not only to the amount paid but also to the ease of, and difficulties involved in, paying such tax and social security contributions, thus suggesting that reductions in the undeclared economy are to be achieved by simplifying compliance.”<sup>156</sup> Tax morality, as a second major contributing factor is moreover a symptom of increased social security contributions rather than a cause of undeclared labor. In a similar fashion, the study of Mojsoska - Blazevski (2012) concluded that the reduction in social security contributions, as a percentage of the gross wage, induced a positive impact on the employment

rate.<sup>157</sup> Given that the new amendments of the LMSSC set progressive reductions in the social security contribution rates for 2014 and 2015, the impact should have a continued short and midterm positive influence on the employment rate and the undeclared economy.

**Reducing the social security contributions** and their positive **impact on tax compliance** have moved side by side with the simplification of regulatory compliance and e-government. Simplification of regulation and e-government is a process that offers continued benefits since its inception in 2004 with the USAID supported e-government project which aimed at improving communication among the administration and citizens. The present electronic services which are available to citizens and legal entities entail “company registration, paying taxes (e-Tax), an online employment registration system, online payments of social security contributions, e-procurement platform, online job application in public services, an online system for cargo transport licensing, a system for import-export licenses.”<sup>158</sup> As an illustration, taxpayers that have registered for e-taxes have almost doubled from 47.000 by the end of 2013 to 90.000 by the end of Q3 2014.<sup>159</sup>

A process of **decentralization of taxpayers’ services** is also under way since 2010 which enveloped:

- opening of service point centers in 2011 throughout Macedonia.<sup>160</sup>

<sup>153</sup> Association for Emancipation, Solidarity and Equality of Women (2014). Retrieved from:

<http://www.esem.org.mk/en/pdf/Publikacii/2014/%D0%90%D0%BD%D0%B0%D0%BB%D0%B8%D0%B7%D0%B0%202.pdf>

<sup>154</sup> Healthcare Fund of Macedonia, Annual Report 2013. Retrieved from:

<http://www.fzo.org.mk/WBStorage/Files/Godisen%20Izvestaj%202013.pdf>

<sup>155</sup> Healthcare Fund of Macedonia, Annual Budget 2010-2013. Retrieved from:

<http://www.fzo.org.mk/default.asp?ItemID=54D32B09ACC52C4D879570A45E3C307E>

<sup>156</sup> Eurofound (2013), Tackling undeclared work in Croatia and four EU candidate countries, Eurofound, Dublin.

<sup>157</sup> Mojsoska-Blazevski, N. (2012) Taxation of labour: the effect of labour taxes and costs on employment in Macedonia. *Post-Communist Economies*, 24 (2), 241–256.

<sup>158</sup> Dzhekova, Franic, Mishkov, C. Williams (2014), “Tackling the Undeclared Economy in FYR Macedonia” GREY Working Paper No. 3, University of Sheffield. p.45

<sup>159</sup> The Public Revenue Office, Statistics. Retrieved from: <http://www.ujp.gov.mk/mk/statistika/naplata/6/0/0>

<sup>160</sup> European Commission (2011) Commission Staff Working Paper. The Former Yugoslav Republic of Macedonia 2011 Progress Report. [SEC(2011) 1203 final]. Brussels: European Commission.

- Reforms that continued in 2013 extended the electronic services and mandatory registration of cash payments.<sup>161</sup>
- electronic filing of VAT and profit tax returns was enforced as a compulsory obligation.<sup>162</sup>

A **law on business registration** was adopted in 2009 which aimed at reducing the time, procedural steps and in general total financial costs required to start a business. The second phase of the 'one-stop-shop' system was initiated in 2010, and it consisted of three modules:<sup>163</sup>

- 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.

However, **sustainability of these measures is put into question by the weak judiciary**. According to the European Commission, "the business environment continues to be impaired by weak rule of law, notably by a slow judiciary and weaknesses in contract enforcement, market regulation and supervision."<sup>164</sup> This has a direct

influence on the company's incentive to stay within the formal economy especially if contract enforcement and the slow judiciary negatively affect their business operations. However, according to a report published by the European Commission in 2012, improvements have been made in the sphere of increasing efficiency and transparency of the courts and related legal procedures. The result was a decline in court cases from 5,782 at the end of 2011 to 2,152 in mid-2012<sup>165</sup>.

**Direct tax incentives.** Incentives in 2006 for business to be involved in under-declaring wages and tax evasion mainly due to the fact that labour was taxed at a much higher rate than profits were.<sup>166</sup> However since then the tax system in Macedonia experienced a complete overhaul, especially since 2007 where the progressive tax system (15%, 18% and 24%) was replaced with 12% across the board and in 2008 was reduced further to 10%<sup>167</sup>. The flat tax refers to personal income and corporate profits<sup>168</sup> being taxed at the same marginal level. Consequently, reducing labour costs have probably aided employers during the crisis, possibly diminished the extent of the informal economy, increased the net wage, and improved tax compliance by increasing the number of insured individuals, since with the new payment system, payment evasion is difficult to achieve.<sup>169</sup>

<sup>161</sup> Ibid

<sup>162</sup> Ibid

<sup>163</sup> Bertelsmann Stiftung (2012) Bertelsmann Transformation Index 2012: Macedonia Country Report. Gütersloh: Bertelsmann Stiftung. p. 19. Retrieved from: [http://www.bti-project.org/uploads/tx\\_itao\\_download/BTI\\_2012\\_Macedonia.pdf](http://www.bti-project.org/uploads/tx_itao_download/BTI_2012_Macedonia.pdf)

<sup>164</sup> Ibid

<sup>165</sup> Ibid

<sup>166</sup> World Bank, 2008. Increasing employment in FYR Macedonia: The role of labour taxation, A Policy Note, June 27, p.9

<sup>167</sup> O, Gazette of RM no.142/08, 64/09, 156/09

<sup>168</sup> Profit Tax Law (Consolidated text), (O, Gazette of RM nr. 80/93, 33/95, 43/95, 71/96, 5/97, 28/98,11/2001, 2/2002, 44/2002, 51/2003, 120/2005, 139/2006, 160/2007, 159/2008, 85/2010, 47/2011, 135/2011,79/2013 and 13/2014)

Retrieved from: [http://www.ujp.gov.mk/files/attachment/0000/0599/Zakon\\_za\\_danokot\\_na\\_dobivka\\_13\\_2014\\_od\\_21\\_01\\_2014.pdf](http://www.ujp.gov.mk/files/attachment/0000/0599/Zakon_za_danokot_na_dobivka_13_2014_od_21_01_2014.pdf)

<sup>169</sup> Mojsoska-Blazevski, N. (2011) Supporting strategies to recover from the crisis in south eastern Europe: Country Assessment Report: The former Yugoslav Republic of Macedonia. Geneva: ILO. Retrieved on

In parallel to the flat rate tax system several other incentives were adopted since:

- lower tax rate of 1.5% was introduced for small businesses whose annual turnover did not exceed 3 million MKD.<sup>170</sup>
- Additionally, the existing tax relief for investments over 100,000 EUR was replaced with a new stimulation policy for reinvested profits which allows a reduction of the company's tax base up to the amount of reinvested profits in the year following that in which the profits were realized.<sup>171</sup>
- New stipulations to the Profit Tax Law in 2010 made profits taxable only if dividends were paid out to non-residents legal entities or individuals.<sup>172</sup>

Mojsoska-Blazevski (2011) concludes that the social security reforms and tax reforms aimed at reducing labour costs had the following positive effects:

- helped employees during the crisis
- had an effect on employment,
- increased the net wage,
- diminished the extent of informal economy,
- improved tax compliance and,
- increased the number of individuals insured in the pension system.<sup>173</sup>

Figure 23 - Tax collection rates of the Public Revenue Office (In Bln. MKD). Source: The PRO <http://ujp.gov.mk/mk/statistika/naplata/1/0/0>

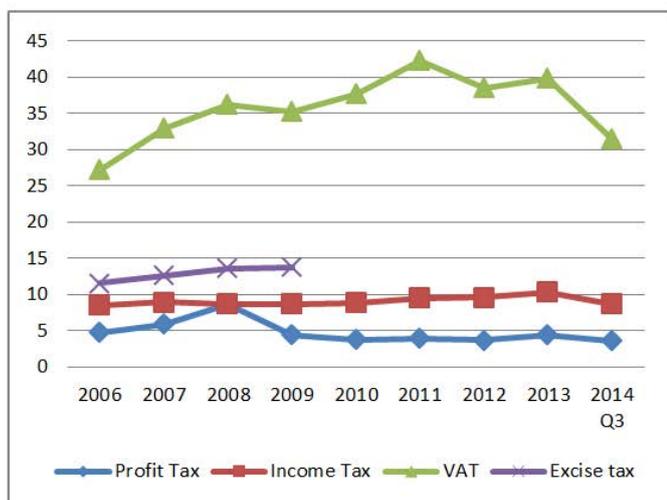
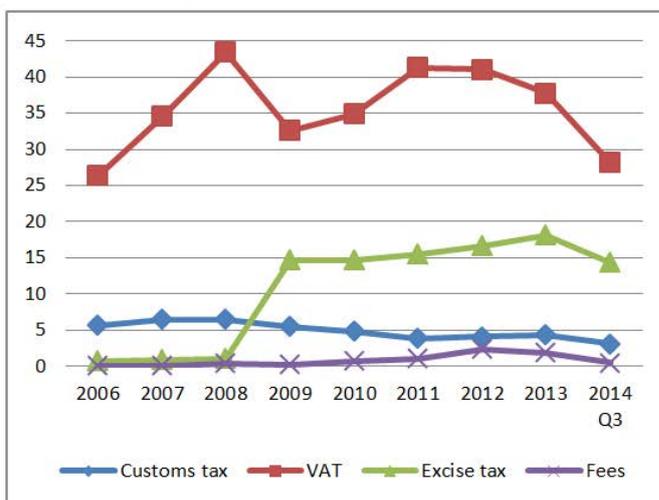


Figure 24 - Tax collection rates of the Customs in Bln. MKD. Source: Annual Reports of the Customs, <http://customs.gov.mk/>



10.05.2014 from: [http://www.ilo.org/wcmsp5/groups/public/@europe/@ro-geneva/@sro-budapest/documents/publication/wcms\\_167032.pdf](http://www.ilo.org/wcmsp5/groups/public/@europe/@ro-geneva/@sro-budapest/documents/publication/wcms_167032.pdf)

<sup>170</sup> Stojkov, A., Nikolov, M., Smilevski, B. (2008) Flat Tax Policy Assessment in Macedonia. Skopje: Center for Economic Analyses. Retrieved from: [http://pdc.ceu.hu/archive/00004278/01/CEA\\_Final\\_fiscal\\_report\\_final.pdf](http://pdc.ceu.hu/archive/00004278/01/CEA_Final_fiscal_report_final.pdf)

<sup>171</sup> Ibid.

<sup>172</sup> European Commission (2010) Commission Staff Working Document. The Former Yugoslav Republic of Macedonia, 2010 Progress Report. [SEC(2010)1332]. Brussels: European Commission. P. 49. Retrieved from: [http://ec.europa.eu/enlargement/pdf/key\\_documents/2010/package/mk\\_rapport\\_2010\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2010/package/mk_rapport_2010_en.pdf)

<sup>173</sup> Mojsoska-Blazevski, N. (2011) Supporting strategies to recover from the crisis in south eastern Europe: Country Assessment Report: The former Yugoslav Republic of Macedonia. Geneva: ILO. Retrieved on 10.05.2014 from: [http://www.ilo.org/wcmsp5/groups/public/@europe/@ro-geneva/@sro-budapest/documents/publication/wcms\\_167032.pdf](http://www.ilo.org/wcmsp5/groups/public/@europe/@ro-geneva/@sro-budapest/documents/publication/wcms_167032.pdf)

The data for collected tax revenue from the Public Revenue Service and the Customs (Figure 23, Figure 24) in the period of 2006 – Q3 2014 shows that despite having introduced the flat rate system (10%) and different VAT exemptions that are less than the regular 18%, **revenues collected coming from personal income tax and VAT remain stable and show a positive trend.** In turn, this indicates the presence of positive tendencies in terms of tax compliance and the ability of the institutions of Macedonia to enforce tax collection.

Similar situation is observed with the collection of excise taxes which have increased by 63% in the period 2006 – 2013. The gap in excise tax collection within the data provided by the PRO can be explained by the change in jurisdiction starting from 1st of January 2010 by which excise tax management was transferred from the PRO to the Customs Administration.<sup>174</sup> Despite the fact that they represent a smaller fraction of total tax revenues compared to the other types of taxes, tax revenues collected from profit tax, customs tax and customs fees, have stagnated drastically.

In spite of the fact that the past years have seen a number of reforms within the area of tax collection and tax compliance, the EC, in the 2014 progress report, concludes that 'further efforts are needed to combat tax fraud, tax evasion, and the informal economy. IT infrastructure needs to be improved. On the whole, preparations in the area of taxation are at a moderately advanced stage.'<sup>175</sup>

### Curative measures

In the frame of curative measures, Dzekova et al. (2014) point out the two measures which aim at **fostering formalisation in the agricultural sector.** Specifically, 'the Law on Obligatory Social Insurance Contributions in 2008 postulated a lower tax base for registered individual farmers. The tax base for self-employed has been determined as the national average net salary per employee in the current month, while the tax base for individual farmers was calculated at 20% of the national average net wage. Furthermore, farmers with an annual income below 300,000 MKD (5,000 EUR) have been fully exempted from the income tax (Bexheti, 2010; Mososka-Blazevski, 2011).'176

Additional measure is the **subsidizing employment of users of social assistance,** introduced in 2014, which envisions providing the employer a certain sum for a period of six months to employ social assistance users, as a group particularly vulnerable to undeclared work, followed by a responsibility to keep the employee for at least 12 months. So far, 60 employment contracts have been signed, and the advantage was given to young people up to 20 years age.<sup>177</sup>

The **regulation of seasonal employments** is emphasized by the MLSP as another important measure, as this field has been noted as one of the biggest sources for occurrence of grey economy, especially in the sectors of agriculture and tourism. The effects have been visible in 2014, with 1839 registrations for seasonal employment being submitted during the last

<sup>174</sup> European Commission (2010) Commission Staff Working Document. The Former Yugoslav Republic of Macedonia, 2010 Progress Report. [SEC(2010)1332]. Brussels: European Commission. P. 49. Retrieved from: [http://ec.europa.eu/enlargement/pdf/key\\_documents/2010/package/mk\\_rapport\\_2010\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2010/package/mk_rapport_2010_en.pdf)

<sup>175</sup> EC Progress Report, 2014

<sup>176</sup> Dzhokova, Franic, Mishkov, C. Williams (2014), "Tackling the Undeclared Economy in FYR Macedonia" GREY Working Paper No. 3, University of Sheffield.

<sup>177</sup> Presentation of Mladen Frckovski, MLSP advisor, at the conference on Countering Undeclared Labour, CRPM and CSD, 27 November, 2014, Skopje

trimester, which is considered a success since until then, they haven't been recorded at all.<sup>178</sup>

Furthermore, the program for **formalizing existing businesses (currently part of the self-employment program)** which has been in place since 2007 has lead towards formalization of over 1000 businesses so far, 160 of which in 2014.<sup>179</sup> However, the EC continuously criticizes the national policymakers that the 'national budget allocated to the active labour market programme remains inadequate' and 'the implementation of active labour market policy is still a challenge for the Employment Service Agency'<sup>180</sup> Additional criticism is directed to the under-developed monitoring and evaluation system of the programme, and the fact that the effectiveness is primarily based on basic quantitative approach.<sup>181</sup>

The **activities for integration of the Roma population into the formal economy yielded only minor results.** Specifically, through the program for subsidising employment, in 2012 – 31 person was employed out of 81 applicants and in 2013 – 13 out of 91 applicants. The program for 'in-service training with a known employer' resulted in 13 employments in 2011, 9 in 2012 and 4 in 2013. Finally, the program for formalizing existing businesses lead to 1 registered company in 2012, 14 in 2013 and 6 in 2014.<sup>182</sup>

### Fostering commitment

**Hotlines** are an integrative part of fostering commitment and are available for reporting undeclared work and labour-related irregularities (Ministry of Labour and Social Policy, National Employment Agency, Pension and Disability Insurance Fund and State Labour

Inspectorate). On their web page the SLI offers information to employers and employees of their respective legal rights and obligations as well as an employer's checklist concerning compliance with labor regulations.

The most recent public awareness campaign "Ask for a Receipt" started in late 2013 with the goal of raising public awareness on the negative effects of underreporting transactions. Specifically, the campaign gave incentives to participate in the formal economy by keeping fiscal bills following any purchase within Macedonia and submitting them to a monthly lottery. The participants then had the chance to win prizes ranging from cars and apartments, to store vouchers. The effects of the campaign have not been evaluated yet.

ILO supported the Government of Macedonia in setting up and implementing awareness-raising campaigns with the goal of **increasing awareness of the negative effects of undeclared work, especially among SMEs in agriculture and construction**<sup>183</sup>. Accordingly, the advantages of formalizing businesses were pointed out within the agricultural and construction sectors, while special attention was given to decent working conditions.

The Government of Macedonia (through the Ministry of Education and Science) has initiated a campaign to raise awareness among secondary school students of the negative aspects of working informally while engendering tax morality. The campaign targeted vocational school students in the first instance, as they were seen as the most likely group to engage in undeclared work.<sup>184</sup> Different stakeholders took place in the campaign with the aim to clarify to students what it means to be a declared

<sup>178</sup> Ibid

<sup>179</sup> Ibid.

<sup>180</sup> EC Progress Report for Macedonia, 2013

<sup>181</sup> EC Progress Report for Macedonia, 2012

<sup>182</sup> Analysis: Between Implementation and Reliety of the National Strategy for roma Inclusion – Roma Decade 2005-2015, Helsinki Committee of RM, 2014

<sup>183</sup> ILO (2012), "Awareness raising campaigns to reduce undeclared work occupational risks and improve gender equality at work", available at: [http://www.ilo.org/global/about-the-ilo/media-centre/press-releases/WCMS\\_183459/lang--en/index.htm](http://www.ilo.org/global/about-the-ilo/media-centre/press-releases/WCMS_183459/lang--en/index.htm).

<sup>184</sup> Eurofound, Labour Market, Tackling Undeclared Work in Europe, 31.07.2014.

Retrieved from: <http://www.eurofound.europa.eu/areas/labourmarket/tackling/search.php>

worker, the related benefits and the protection that comes with this status. Entrepreneurship teachers are also trained to further expand the students' knowledge on the issue. In 2013, 90 schools and a total of 1480 students from years 3 and 4 have been encompassed with the program, but the effects are expected to be seen within the next 2-3 years.<sup>185</sup>

However, in 2011, the European Commission stated in a progress report that the impact of these publicity campaigns in Macedonia was limited. They drew attention to the fact that efficient cooperation and coordination between enforcement bodies was still lacking and that the budget allocated to the active labour market program was still inadequate.<sup>186</sup>

## VIII. Conclusions and Recommendations

The case of Macedonia shows no clear and long term commitment to either the neo-liberal or the social democratic approach towards tackling the hidden economy, but displays a mixture of crossovers between them. The neo-liberal approach, especially since 2006, has been the main driver of most reforms embodied through measures such as the introduction of the flat tax rate across the board instead of the complicated progressive tax code, the simplification of labor and tax regulations, the simplification of start-up business procedures, fiscal cash registers reform, and the gross salary reform. Furthermore, by following a consistent growth in GDP, inflow of FDIs, economic output in general and decrease in unemployment rate, a social-democratic policy trend can be identified, particularly towards measures such as progressive minimum wage, increase in social transfers, introduction of self-employment and agricultural subsidies, and sustainable reinforcement of labor rights.

With regards to tackling undeclared employment, as most EU 27 countries, employs measures addressing undeclared work which focus predominantly on repressive measures despite some recent measures towards enabling formalization of labor (self-employment program) and fostering commitment. Improved data sharing and coordination among government bodies is of utmost importance in combatting undeclared labor, together with an increase in the number of incentives for suppliers to join the declared economy and measures to increase public awareness on the risks and downsides of joining undeclared labor market.

However, in order to effectively implement measures and improve operational capacities of the government institutions, more research is required on the conditions that lead to the existence of hidden economy in Macedonia in general, and on undeclared labor in particular, in order to capture the country specifics and better explain discrepancies within available data such as the one concerning active and passive job seekers.

Moreover, there is evident absence of evaluations of different policies, especially in-depth assessments which go beyond the basic numeric indicators, which prevents more valid estimations of their effectiveness. Finally, the level of enforcement of regulations needs to be strengthened in order for effects to take place.

Therefore, informal economy must be addressed on several levels, using a two-pronged approach, while also ensuring targeted communication towards all layers of the Macedonian society. The latter can be pursued through a bottom-up approach that includes the civil society, which, in spite of moving in the right direction lately, is still behind in developing a culture/portfolio, as well as methods and skills in monitoring public policies, especially in corruption and the

<sup>185</sup> Presentation of Mladen Frckovski, MLSP advisor, at the conference on Countering Undeclared Labour, CRPM and CSD, 27 November, 2014, Skopje

<sup>186</sup> European Commission (2011), The former Yugoslav Republic of Macedonia 2011 Progress Report, COM (2011) 666 final, Brussels.

hidden economy, and producing measures and instruments to adequately respond to these public policy challenges. At the same time, with the FDI, employment levels and the GDP expected to increase in the following period,<sup>187</sup> it is the vulnerable groups of the Macedonian society that might not receive the appropriate care during this transition. The suggested **two-pronged approach** will ensure that such groups proportionally benefit from the growth of the formal economy.

Specifically, the two-pronged approach should include:

- **Top-down approach:** Government investing in reforming its public institutions and agencies dealing with hidden economic activities. More actions similar to the deployment of the Inspection Surveillance Council, Hidden Economy Action Plan, Awareness campaigns, Labor law reforms and simplifying business procedures are needed.
- **Bottom-up approach:** With CSO's taking responsibility, together with representatives of the media, public institutions, and the business sector, in creating a sustainable and adequate hidden economy monitoring system. Finally, this multi-stakeholder synergy will be used to provide viable policy recommendations, which are to deal with the negative consequences of the hidden economy.

Through this approach, the government and CSO's should work towards addressing six general goals:

1. create more jobs.
2. register informal enterprises and regulate informal jobs.
3. extend state protections to the informal workforce, especially the working poor.<sup>188</sup>

4. increase the productivity of informal enterprises and the income of the informal workforce.

5. diversify Macedonian exports structure

6. close educational gaps.

By following steps one through four, as Chen (2012) argues, the self-employed would like to receive the benefits of operating formally in return for paying the costs for entry into the labor market; "including: enforceable commercial contracts; legal ownership of their place of business and means of production; tax breaks and incentive packages to increase their competitiveness; membership in trade associations; protection against creditors and clear bankruptcy rules; and social protection."<sup>189</sup> Informal wage workers, on the other hand would be enabled to obtain a formal wage job, with a secure contract, worker benefits, membership in a formal trade union, and employer contributions to their social protection. Chen notes that "formalizing wage work requires a focus on employers, as employers are more likely than employees to avoid compliance with labour regulations."<sup>190</sup>

By diversifying the structure of Macedonian exports, with more value added products, new sets of skills and trainings can be absorbed by the labour force. In doing so, increasing its competitiveness and productivity of labour on the supply side as well as answering the needs of businesses for more skilled and mobile labour on the demand side. Enhancing technological spillovers to the local economy will only enhance the FDI's impact and its positive externalities. Additionally, closing the educational gaps by ensuring attendance and high standards of local school and universities, especially primary and secondary education, will enhance technology absorption and economic output.<sup>191</sup>

<sup>187</sup> IMF Country Report No. 13/179, June 2013, (p. 12-15). Retrieved from: <http://www.imf.org/external/pubs/ft/scr/2013/cr13179.pdf>

<sup>188</sup> Chen, Martha, Alter, The Informal Economy: Definitions, Theories and Policies (2012). Retrieved online on 07.03.13 from: [http://wiego.org/sites/wiego.org/files/publications/files/Chen\\_WIEGO\\_WP1.pdf](http://wiego.org/sites/wiego.org/files/publications/files/Chen_WIEGO_WP1.pdf) (p.17)

<sup>189</sup> Ibid. p.15

<sup>190</sup> Ibid p. 15

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