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Professional Paper

## INFORMALITY IN KOSOVO

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### Abstract

In many developed countries and especially in developing countries the phenomenon of Informality is widely spreaded, which despite the global reach and despite the negative effects it has, this phenomenon has nothing to do with current activation and the definition of this placement of measurements and its classification.

Through this study, informality is defined as a phenomenon that encompasses all economic activities but also judicial activities that businesses undertake to hide from the state, activities that are undertaken to bypass and neglect compliance with other business and legal policies.

Therefore, as such, this phenomenon entails the concepts of tax evasion, informal employment and under-declaration of employees' wages as well as the financial turnover of businesses.

In general, informality causes economic costs when the state fails to establish stability of the business and socio-legal market operation and tax collection, which hinders economic growth, weakening the ability of the government to offer social goods for the citizens, as well as creating unsustainable operating environment.

Thus, by offering motivation for small firms to remain as such and continue to embrace the option of evasion (in taxes or labor), losing this opportunity to create more opportunities to work in the formal economy, also, generating inequality between evasionists and non-evasionist, that creates the motivation for greater evasion involvement.

So, informality leads to unfair competition, and puts more burdens on formal businesses.

In this paper, you will find identified a few of the several aspects that have affected the non-formal sector, considering labor laws, aimed to present the links between certain policies, laws, and regulations in one side and unofficial employment and tax evasion on the other side, gaining understanding of new conclusions, leading towards choosing new strategies facing the damage caused by informal economy.

**Keywords: Informality, Legal Strategy, business, Unemployment, informal environment.**

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### Properties of Informality

Many authors who have dealt with this phenomenon in the past have not concluded what exactly defines informality or the informal economy, which depending on the point of view of scientific researchers is referred to as "shadow economy"(Smith, 1994), "Cash economy"(Lewis, 1954). , "Hidden economy", "illegal economy", "informal sector", "underground economy", etc.

While Informality has been subject of discussion in academic research circles since the 1950s and 1960s(Gërxhani, 2008), this legal-economic phenomenon was analyzed in 1972 by the International Labor Organization (ILO, 2011), under the name "informal sector"(ILO, 2011).

Today, informality is an identified and serious problem in developed countries, including EU countries.(OECD, 2015).

While the important aspects of the "informal economy" refer to the "criminal economy"(SANDMO, 1972), which results from the production of products and services illegally and from activities prohibited by law. The difference between them is that in the criminal economy what is forbidden in it is the activity itself, while in the informal economy, the activity is legal in itself, but the income is hidden and avoided by illegal means.(Alm, 2012).

Another definition of "informality" is one that refers to "any legal economic activity that takes place outside the government's control radar."(Anderoni, 1998) In this sense, informality refers to economic activities that are normally subject to taxes and duties and excludes all types of activities that are clearly considered by law as illegal (drug trafficking, arms trafficking, money laundering etc.)(Oviedo, 2009)

### **Why does Informality happen?**

To understand and identify as a phenomenon, it is necessary to consider what are the causes that push and determine the degree of undertaking of the actions by the factors identified as determinants of the decision of the worker or employer to act in the gray economy. (Kanbur, 2009).

When it is known that the purpose of concealing information is evading taxes (Ordonez, 2014), the barriers related to bureaucracy and employment regulations should also be defined (Hazans, 2011), which play a very important role in determining businesses to operate informally (Smith, 1994).

When analyzing the nature and purpose, it is noticed the interconnection of employment regulations (Lake, 2006) and the tax burden which have the greatest effect on the extension and evolution of a country's informal sector.(Benno Torgler, 2007)

When these interconnections are analyzed as key barriers, which add to the decline in the quality and quantity of public goods and services, it is revealed the chain effect of the informal field's impact on the corruption of public officials and the poor and unfair treatment of taxpayers by tax authorities. Therefore, the reasons that lead to motivation for informal employment may be due to economic and non-economic reasons, which are:

- a). Economic stability.
- b). Unrealistic tax burden and complicated tax system,
- c). Complicated and particularly weak institutional and legal framework,
- d). Inefficient mechanisms of reinforcement and application of exit measures and strategies.
- e). High level of corruption and bureaucratic incompetence by government agents,
- f). Lack of trust in state institutions, "laissez-passer" approach to the informal sector.(Schram, 2002)

#### The Approach towards Informality

In the economy of gray activities and the institutional implication that this phenomenon finds the right scope of operation and bypasses efficient functioning, it is necessary to actively approach which should be done for several reasons:

- 1.) To accept the existence of the gray economy;
- 2.) To identify the exit strategy;
- 3.) Its extent should be as measurable as possible;
- 4.) Determining the zero element (basis for initiating the approach);
- 5.) Relevant institutional addressing; and
- 6.) Socio-legal effect of extra-rational influence

When talking about the effects, there should be a broad consensus, pointing out that many shortcomings exist for the economy as well as individuals involved in informality which implies the institutional aspect and the business factor.

While there are those who see formalization as a priority (Frey, 2007), other authors suggest that policies should be linked to improving the well-being of people employed in the informal sector (Becker, 1968).

We think that the authors rightly point out that this contradicts the selection of exit policies and the approach to informality.

Policy-makers face a major challenge. They need to make policies that, on the one hand, help improve the lives of the poor and thus increase social welfare, and, on the other hand, ensure that stimulation for formalization does not disappear.

Many works of Kosovar researchers on this topic define important areas where this phenomenon is most pronounced:

1. In the employment sector, and
2. Legal documentation of facts

The high unemployment rate harms economic growth in Kosovo, but at the same time it is an opportunity and a source of informality. It is well known that Kosovo has approximately 1.8 million residents, the average age (2011) is estimated to be 30.2 years. (KAS, 2019) This average of young population requires greater socio-political commitment and attention, in order to orient it progressively, on one hand, and eliminate the possibility of its orientation towards informal actions in society by becoming a possible source, serious, real and often frequent and powerful of Kosovar informality, on the other hand.

**Table 1.** Unemployment rate in Kosovo.

Unemployment rate throughout several years in Kosovo (KAS, 2019)	
Year	Unemployment rate (%)
2014	35.30%
2015	32.90%
2016	27.50%
2017	30.50%
2018	29.10%

Source: KAS

*Despite these data, it is worth noting that there are significant differences in the types of employment between the formal and informal sectors. More than a third of the informal sectors (36 percent) are employed in small firms; 28 percent are self-employed in non-professional jobs; 19 percent are employers in small firms; and the remaining 17 percent are unpaid family workers. On the other hand, the public sector offers most jobs in the formal sector (54 percent) along with large firms, which employ 41 percent of workers. (Cojocar, 2017)*

*Thus, informality is greater among young people, especially among uneducated or semi-educated young people.*

*In addition, informality is known to be a complex phenomenon, affecting many aspects of life, even according to Bektashi, who states that “the circulation of cash that does not pass through legal channels in Kosovo is quite high. In the first place this is due to the existence of ‘purple economy’*

- respectively criminal informality, which in our country is quite high and according to some international studies is estimated to be somewhere around 30 to 35 percent of the gross value of domestic product or converted to absolute values is estimated to be around 2 billion euros.(Bektashi, 2017)

*It is well known what are the consequences of these actions outside the fiscal and financial system, firstly affecting the reduction of the budget since the tax obligations are not fulfilled for such actions, secondly, creating criminal hotbeds of informality that consequently cause many other multidimensional problems in Kosovar society. In this case, through the informal economy, the owners are first and foremost determined to break the law by calculating the expected benefit from such actions compared to fully legal actions(Bektashi, 2017), which benefits them while greatly damaging the living standards of the citizens of Kosovo.*

*You may ask: what are the reasons for such an action?*

*First of all, it can be said that the reasons for the existence of such informal actions are that the work done can be paid in cash, this enables non-authentic evidence of the payment system, non-fiscalization of businesses, then the tradition of Kosovars for cash payments, low awareness of the population, then in particular and very important the lack of penalties from the legal authorities or even in case of punishment, not meritorious punishment, etc.*

Thus, Kosovo lags behind in terms of economic development compared to neighboring countries and European countries. Positioned in southeastern Europe, Kosovo has the highest level of poverty, with more than 30% of the population living below the minimum standard of living, and the highest unemployment rate of 30.9%. (Davis, 2016) According to official labor statistics, unemployment has remained around 30% over the last 4 years. World Bank estimates show that youth unemployment is higher, exceeding 55%. (Davis, 2016). The above-mentioned causes of informality create a poor quality of education and limited employment opportunities, making it more difficult for young people to find work. As a result, many of them are involved in work that require low qualifications or in the informal economy. For many economists, the informal sector is a disruptor of the national economy and an obstacle to development.

Therefore, it can be freely pointed that the the transition stages are the most flourishing period of informality that has been known on post-socialist experience, showing that establishing genuine competition is an extremely important aspect of the transition (Davis, 2016) but not sufficiently developmental for social welfare.

Therefore, the desire to get rich quick is the basis and the main impetus for informality, in which case the perpetrator commits legal violations, a phenomenon that must be examined from different points of view or as the European Committee on the issue of crime says, pointing out that there is no typical criminal and everyone has the opportunity to conflict with the law when performing work. (Committee, 1981)

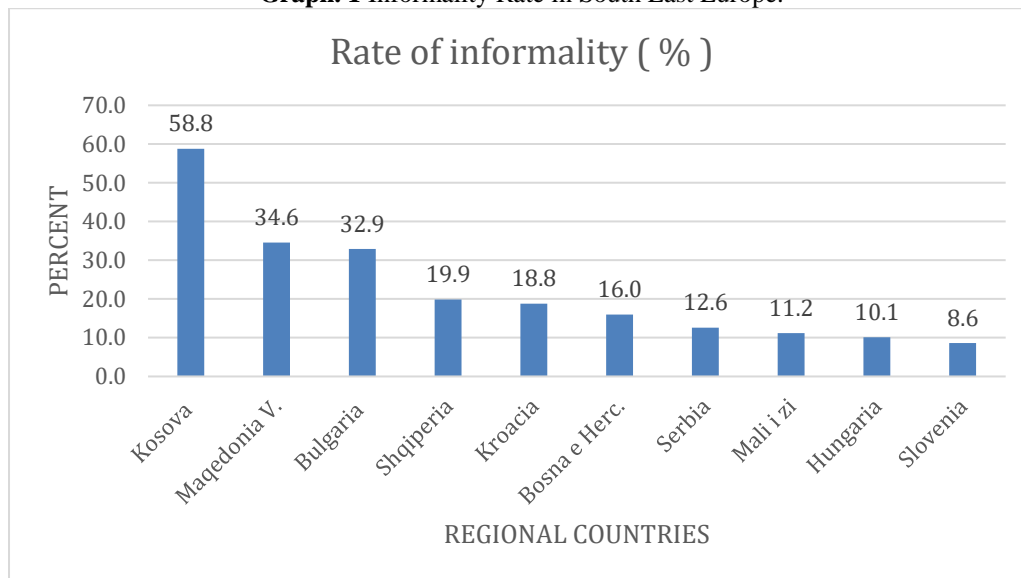
It is worth mentioning on this occasion as an example, the findings of the National Audit Office of Kosovo, that the Tax Administration of Kosovo, in terms of risk treatment for 2017, one of the main objectives TAK had determined the identification and fiscalization of businesses, which are required to be fiscalized and not yet equipped with fiscal cash registers.

According to TAK data, the total number of businesses engaged in business activities is a total of 65,745, of which 46,558 are declarants in the TAK taxpayer system in 2017. (TAK, 2017)

So somewhere 19187 businesses (or about 30 percent) work without fiscal cash registers which is a basic form of informality, with a high possibility of abuse over the payment of tax liabilities, which on one hand harm the budget of the Republic of Kosovo, affect the reduction and weakening of providing quality public services, harming the living standards of the population, creating personal illegal benefits and enabling unfair and unequal competition in the respective field of business, on the other hand.

Nearly six out of ten firms classify informal competition as a major or serious obstacle to their growth.(Cojocar, 2017). These data of informality in Kosovo compared to the percentages of world levels are among the highest in the world, even higher than in neighboring comparative countries, which is more than Northern Macedonia somewhere over 24 percent, even with Croatia with 40 percent more while with Slovenia there is more informality with over 50 percent.

**Graph. 1** Informality Rate in South East Europe.



Source: Alexandru Cojocar. 2017.

Based on these comparative data on informality in Kosovo and beyond, the question arises: What next?

1. Identification of informality and work on its continuous reduction
2. Raising the awareness of the population regarding the action and consequences of informality
3. We must work to prevent these informal actions that cause great negative consequences in society.
4. Work in the direction of factual evidence about individual and business informal action.
5. It is required to increase the professional and staffing capacities of the inspection and control and legal bodies in the economic-legal sphere, and since inferiority is a complex phenomenon, it is required, among other things, experience.
6. Clarify and promote what it means and what encourages informality as a phenomenon and its perception from an economic, political, psychosocial and legal point of view.
7. To work towards the discovery of areas where informality is more present and to work towards narrowing the scope of their operations until the neutralization of these actions.

8. Through the evidence of the competent authorities and the evidence, the informalists should be confirmed and receive the deserved punishment.
9. Reducing informality improves civic life and well-being.

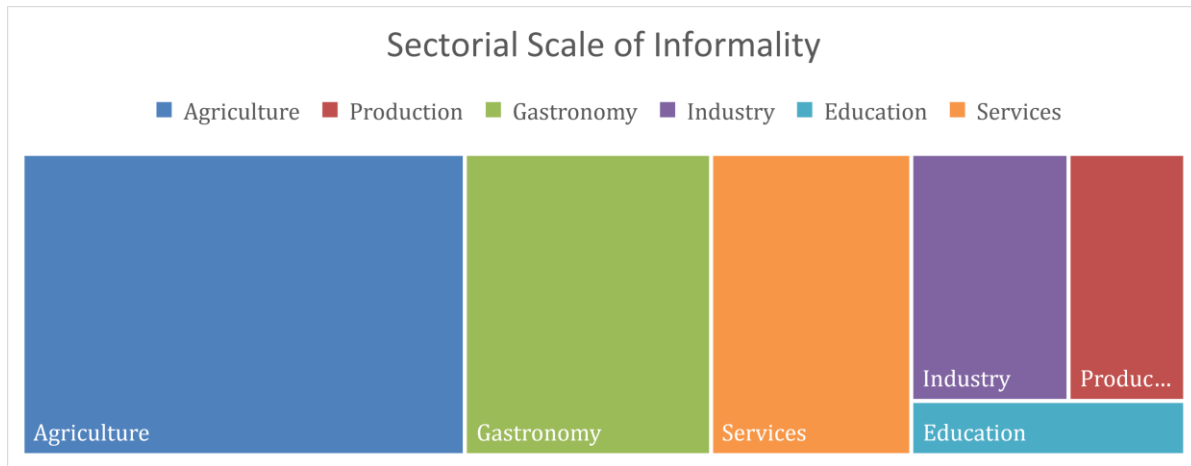
In order to understand the level of informality of the labor force in Kosovo, within the registered businesses, we have analyzed the reports of the tax-collection institution in Kosovo. (KAS, 2017) Interviewed managers and owners believe that there is informality present on businesses in their industry on average report 63 percent of employees. This means that on average 37 percent of the total workforce is not reported. (Balijsa, 2017) Also, the same number (approximately 37 percent) is revealed by the reports of the institutions and the surveys of the scientific researchers who have researched this phenomenon. (Syla, 2017)

This important fact was strongly supported and unmasked the revelation when in the case of pandemic, a considerable number were formalized involving more than 11300 new employees and also with emergency aid package providing data on how the institution intended to fight informality in the employment sector such as:

- a) Open the possibility of formalizing a part of the informal economy
- b) Provide the opportunity for workers who have been informal not to be left without income
- c) Increases the safety of the worker, by providing him with a one-year contract through which his pension contributions are paid, he is provided with annual leave and rights according to the labor law
- d) Provide the opportunity for employers to not lay off workers who have not been declared previously, at no additional cost which makes it easier to continue the business after the pandemic phase, reducing recruitment costs (IMF, 2010)

However, a question has been launched in this sector to ask and measure this data by asking if the assertion that supportive policy has reduced the number of informality, respondents indicate that the business has applied only to receive support from the package and will still continue to operate the same manner as before, 65.74% of them point out that these measures were not appropriate to combat informality but the politicization of the support package for gaining political points is being used by both the creators of the support package and businesses.

According to the UNDP HDR report from 2018, we also notice that about 30 to 40 percent of the workforce has been informal, and when compared to another research we can conclude that about 40% of the workforce is not declared or it is under-declared.

**Graph 2. Sectors' Scale of informality**

According to the results of this research, the sector that has the highest degree of informality remains agriculture with 38.06%, followed by Gastronomy and other services, while knowing that Kosovo is represented as a rural country with over 60% of the total employed work force. This research reveals that the agricultural sector has the highest level of informality in rural areas, while education, which is mainly represented in urban areas, has the highest level of declaration of employees and thus the lowest level of informality.

However, the research made focused on gender in the sector gives us the intention that employed women are more likely to work with a formal contract and have the lowest rate of under-declaration.

According to this fact, when it is known that a large part of the workforce has not been declared, it creates a great burden for these workers who are not declared, while, on average, companies pay about 60% of workers' salaries and benefits through banking transfers.(TAK, 2018)

The survey shows that when salaries are collected through a bank account, larger control checks come into play and the declaration cannot be avoided, while when salaries are given in cash then the declaring is done on a voluntary basis which reminds us of the expression "Cash economy" and at the same time an element of informality and irresponsible behavior of businesses who may under-declare or even not declare at all their employees.

Therefore, informality can be considered as one of the phenomenon that affects the creation of preconditions and even favors of all other criminal actions and has very harmful multi-dimensional consequences. The different forms of informality and criminal activities feed each other continuously. Repercussions due to informality are difficult to be eradicated easily and quickly, moreover in many cases the perpetrators of such acts remain undiscovered or unsanctioned, leaving consequences in all social spheres. The above data from the World Bank on the impact of informality on business development, where about 60 percent see it as an obstacle to genuine competition, a phenomenon that causes quite high costs in economic and financial terms, on one hand, but also loss of hope or and the trust in the relevant state bodies to get out of this socio-economic and legal-political stalemate of the society, on the other hand.

When we talk about informality, we must analyze, focus and explain the different types of delusions, deceptions and promises, whether material or ideological, becoming a much more

important factor and having a great impact on society, especially on the young generation, uneducated and unemployed, for whom it seems like the only hope of solving their problems.

The incrimination of the new generation in such informal actions does not exclude the possibility of their involvement, in almost all actions such as informal trade, informal products, trafficking and transportation of narcotics, weapons and even terrorist acts. Informality attacks all areas of development, justice, health, the environment, including education etc. The bosses of informality from their work create funds to support and attract not only these young people but also beyond, even to high state levels. In this way they create the opportunity to exercise their activity without any possible punishment, in which case the society and the state are required to coordinate the work of all bodies at all levels towards reducing the informal scale and bringing its symbolic levels of presence. So, the penalties of the justice system are not enough and that is why more action is needed or improvement of the governance as a whole.

## **Conclusions**

The assessment of the damage caused by the informal activity of the country's economy was seen to include unfair wages, gender discrimination, and undeclared taxes, but that informality is largely in the firms that declare but not in full, i.e. partial (incomplete) declaration which is more difficult to identify and control by the respective tax administration institutions which may have contributed to the state budget and social welfare.

However, it should be understood that the extension of informality creates "unfair competition" and is one of the priorities that weighs on business and is a barrier in the sphere of doing business in Kosovo. From this it is understood that if approximately 37.6 percent of sales are not declared, the state is deficient in budget revenues and the ability to collect these revenues which, to be fair, are not even included in the annual plans of the Kosovo budget, which to a large extent contributes to the spread of informality because there is no exit policy from this situation, which means that contributions to the state from taxes are about a third lower than they can be.

When analyzing the extent of informality, it is seen that small and medium-sized businesses are able to engage in tax evasion more than the large ones. Also, the sectors with the highest evolution of informality in Kosovo were: agriculture, hotel and food services and construction, while the least evasive sectors were seen to be: education, recreation and art.

While, when it was mentioned about the reasons why informality is happening, it was seen that they include but are not limited to: high level of taxes, barriers related to bureaucracy, rules employment policies, quality and quantity of public goods and services, corruption of public officials, the poor treatment of taxpayers by the tax authorities, and the fear that the employment sector is the sector most affected by fiscal changes leaving room for the spread of informality.

## **Recommendations**

- Greater work is needed to increase pressure on businesses through campaigns that promote benefits from social and pension contributions in the long run. This would make workers demand more rights.
  - Stimulate workers who declare that they are employed and their contributions are not paid.
- Mitigation policies should be more oriented toward education rather than punishment of corporations and the level of responsibility of employees should be increased and not only employers with



intensive work should work in collective labor agreements, where some rights of workers are reinforced.

- Financial barriers with special focus on maternity leave are reviewed, so that women are not subject to short-term contracts and discrimination at work.
- Relevant institutions should continuously target the mentioned sectors that have the highest degree of informality and cancellation of all subsidies and financial stumps if there are violations of the under-declaration within 5 years from receiving the financial stimulus and after receiving it.
- Professional training and increasing the potential of staff so that the workforce is not under-declared and stressed about finding a stable job.
- Increasing the awareness of tax inspectors and the efficiency in the professional aspect of identifying violations and calculating the degree of informality.
- Equipping businesses with “Formal Economy Status” (FES) certification after checking and recording findings from an independent agency, which would motivate many other companies to receive this certification and public authorities to enable the receipt of services only by those companies that meet this criterion.
- Simplify laws on reimbursable taxes, such as VAT. If the time required to reimburse VAT is long, this will discourage persuasive behavior, then regardless of tax level, avoidant behavior will be more likely.

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