

TO PAY OR NOT TO PAY

A BUSINESS
PERSPECTIVE OF
INFORMALITY IN
KOSOVO




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LIST OF ACRONYMS

ILO	→	International Labor Organization
OECD	→	Organization for Economic Co-operation and Development
IMF	→	International Monetary Fund
TAK	→	Tax Administration Kosovo
UNDP	→	United Nations Development Programme
WVS	→	World Value Survey
IAS	→	International Accounting Standards
EC	→	European Commission
BSPK	→	Union of Independent Trade Unions of Kosovo
MPMS	→	Ministry of Work and Social Welfare
AKR	→	Coalition for New Kosovo
GDP	→	Gross Domestic Product
VAT	→	Value Added Tax
MTI	→	Ministry of Trade and Industry

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INTRODUCTION

Informality is a widespread global phenomenon that has become a feature of societies in both developed and less developed countries. Yet, despite its global reach, and despite the negative effects it might have, it is a term that still causes a lot of disagreement – disagreement regarding its definition, its classification and its measurement. This study seeks to offer a general picture of the informality in Kosovo; its size, determinants and the potential economic consequences it may cause.

In this study, informality is defined as a phenomenon that describes all legal economic activities occurring hidden from the state and ignoring state regulations. As such, it includes phenomena such as tax evasion, informal employment and under-declaration of salaries.

To deal with the problem of informality and to find solutions to tackle it is of great relevance from both economic and socio-political perspectives because of the costs and influences it has. In general, informality imposes several economic costs on a state and therefore also puts social stability at risk: it slows economic growth by weakening the government's ability to provide adequate public goods and services; it provides an incentive for firms to remain small to facilitate (tax and labor) evasion, thereby missing opportunities to create new jobs in the formal economy; and it generates inequity between the evaders and the honest taxpayers by shifting the burden to the latter, creating an incentive for further evasion. Finally, it leads to unfair competition, placing a higher burden on formal sector enterprises. It should also be taken into account that the precarious nature of informal employment has significant implications for the economic well-being of the worker. Workers in informal employment tend to be underemployed, in that most of them either work fewer hours than desired or than normal, or work longer hours to attain a minimum wage. Secondly, they generally fail to benefit from pension or health care contributions due to lower reported salaries, a fact which in the long term increases the social costs for the state. Thirdly, the informal sector might result in certain gender imbalances. Only recently, concerns have been raised that the new regulation on maternity leave has a negative impact on the situation of women in the labor market. Apparently, it has not only become more difficult for women to get long term contracts, the risks of women being over-represented in informal working relationships has also increased.

While there have been many studies on the phenomenon of informal employment and the general implications it has for a country's economic and social development, this study will be the first one focusing on Kosovo. As such, it will provide policymakers of this country for the first time with a basis that can be used in order to come up with effective policy initiatives and proposals of how to tackle this problem that ultimately affects the well-being of this country's population.

Within this study, several aspects that have an effect on the informal sector will be identified, taking into consideration the new labor law. Further, links between certain policies, laws and regulations on the one hand, and informal employment/tax evasion on the other hand, will be revealed, leading to new conclusions and thus allowing for the development of new strategies to deal with the problems related to the informal economy. Accordingly, the findings could potentially be used by the Parliament and parliamentary committees, as well as the respective ministries that will have the chance to incorporate the results in their policy considerations. This may help policy-makers find solutions to improve the business climate in Kosovo, encourage foreign investors to invest, and also to advance the employees' position.

The study further seeks to precipitate a national discussion which is intended to enhance the public's understanding of the problems surrounding informality. Overall, the study has the potential to not only foster economic development, but also to set a socio-political agenda that will benefit all the citizens of Kosovo.

The study is organized as follows. The first chapter will provide the reader with an overview of the general academic debate on the subject. It will explain the origin of the concept and introduce the most important definitions of informality. Second chapter will provide a general review of methodological approaches that have been undertaken to conduct research on this issue. Further, the approach of this study will be described and explained. Chapter four and five, will report on, discuss and analyze the results of the research – that is findings from survey and case studies. Finally, the study will conclude with a summary of the major implications of those findings and will provide some policy recommendations.

RESEARCH HIGHLIGHTS

The following summarizes key findings of the survey, which was conducted with 600 Kosovo businesses on the field of informality (tax and labor) in Kosovo.

TAX EVASION HIGHLIGHTS

- Unfair competition (derived from the labor and tax evasion) was highlighted as the top barrier in doing business (out of a list of 22 barriers) by interviewed respondents. Compared to the previous studies measuring business barriers, the intensity of this perception has increased, suggesting that unfair competition in doing business is becoming prevalent problem in Kosovo.
- According to the survey data, business managers and owners believe that on average the businesses in their industry report about 65.6 percent of their sales, meaning 34.4 percent is evaded. Businesses are a major state budget contributor, and this means that public services, which could be financed by business contributions, are receiving over a third less funding than they could be.
- Each of Kosovo's seven regions was analyzed in terms of tax evasion on sales. The Gjilani region showed the highest percentage of evasive behavior (with 59.9 percent of sales evaded), while the most complying region was the Gjakova region (with only 20.2 percent of sales evaded).
- In terms of tax audit intensity, 37.3 percent of the respondents believe that there is a high or very high chance of getting caught evading taxes. However, 62.7 percent of the respondents believe that if they decided to evade taxes they could do so easily without getting caught.
- On average 42.4 percent of the respondents believe that the fine rate is high or too high. While a higher tax rate can lead to higher compliance level, it could also backfire if businesses perceive it as unfair.
- About 9 percent of respondents would always justify tax evasion. When this number is compared to the

World Value Survey, Kosovo ranks at the same level as India (8.9 percent), and Brazil (8.6 percent).

- Given the current level of public services offered, respondents believe that they should pay 60 percent fewer taxes than what they currently pay.
- In the hypothetical case of a tax increase of 10 percentage points, 78 percent of the respondents have shown readiness to evade taxes. The rate of potential evasion increases to 82.5 percent if taxes are increased an additional 20 percentage points.

LABOR INFORMALITY HIGHLIGHTS

- Managers and owners interviewed in the survey believe that businesses in their respective industries report on average 63 percent of their employees. This means that on average 37 percent of the total labor force is not reported.
- Additionally, survey results reveal that labor informality changes between different sectors; however, as the literature review discloses, agriculture is the sector where labor is least declared, with only 30 percent declaration. Over 60 percent of Kosovo's population is dependent on agriculture, while 70 percent of the workforce is undeclared in that sector. The sector with the highest employee declaration is Education with only 17.5 percent evasion.
- When questioned about their level of awareness regarding the new labor law, 41.2 percent of the respondents stated that they were not informed or aware. On a positive note, 73.3 percent of the respondents were aware of the minimum wage.
- Regarding maternity leave, 37 percent of respondents recommend changes to the payment scheme of the provision. The most common suggestion is to change the maternity leave payment so that the first six months are covered by the state budget and the remaining months of leave are covered by the employers.

1. DEFINING INFORMALITY

The concept of informality is complex and has led to intensive and also controversial academic debate. Due to its complexity, definitions of the concept greatly vary and there is no consensus on what exactly constitutes informality. Therefore, this section will first provide an overview of the different definitions and approaches related to informality and will then establish the delineations of informality used in this research report.

The term “informality” was used for the first time in the 1970s to describe economic activities that were occurring outside of state regulation. However, the social phenomenon of informal employment existed earlier. While not criticizing informal working relations, there were various social researchers before that – in their work – reported on informal economic activities, mentioning, for instance, street-entertainers, market traders, and sweatshop workers.

The dualism separating formal and informal economic activities did not become an issue though, until the International Labor Organization (ILO) published a report on Kenya and its labor market in 1972. The Kenya mission (ILO 1972) resulted in several observations on the characteristics of informal employment (Bangasser 2000) and raised awareness among the scientific community of its significance for a country’s socio-economic development. Interestingly, the Kenya mission report described the informal sector as a positive phenomenon, although it criticized the low wages that were commonly earned in it. It needs to be pointed out here that while this particular account emphasizes the positive aspects of informal labor markets, there are as many accounts that consider informality a phenomenon that hinders economic development, which therefore needs to be combatted.

When reviewing the more recent literature that seeks to define informality, one question that is consistently raised is whether the concept as such should entail both “legal” and “illegal” activities. Legal activities include unregistered business endeavors, which when caught, can be formally registered (following a fine and/or sanction) and do not cease to exist; i.e. these activities at best can generate additional tax revenues. Illegal activities, on the other hand, include activities that by definition are sanctioned to exist; such as human and drug trafficking. These activities, when caught, cease to exist and do not yield any additional tax revenues.

Smith (1994), for example, included both kinds of activities in his definition of the shadow economy. According to him

(p.18), it is the “market-based production of goods and services, *whether legal or illegal*, that escapes detection in the official estimates of GDP”. Although this definition is very encompassing and thus – at least at first sight – might seem to be ideal, most authors suggest that while in the broadest sense illegal activities belong to the so-called shadow economy, a distinction between legal and illegal production or services within the sector is essential in order to not only facilitate the measurement of such activities, but also to make figures deriving from such research to be more precise and reliable. The critique is certainly valid, which is why this paper chose a narrower conceptual framework. One of those is offered by Friedrich Schneider (2012), for instance, who defines the shadow economy as “all market-based *legal* production of goods and services that are deliberately concealed from public authorities”, thereby excluding both so-called “underground activities” that entail illegal activities and household services and production.

A similar, more sophisticated and precise conceptual framework has been established by Bernabè (2002). Within the concept of informality, she (p.5) proposes the following four sub-categories: (a) Informal activities, which are undertaken ‘to meet basic needs’; (b) underground activities, which are deliberately concealed from public authorities to avoid either the payment of taxes or compliance with certain regulations; (c) illegal activities, which generate goods and services forbidden by the law or which are unlawful when carried out by unauthorized producers; and (d) household activities, which produce goods and services for own-consumption. Nevertheless, her categorization seems of particular relevance for this paper as her research also deals with informality in transition countries and thus might be applicable to Kosovo. In this definition, this study certainly seeks to measure both (a) and (b).

1.1 VOLUNTARY VERSUS INVOLUNTARY INFORMALITY

A great extent of the literature dealing with informality elaborates on the causes of this widespread phenomenon that is observable not only in developed but also in developing and transition countries (Gërkhani 1999, OECD 2004, Simons and Lake 2006, Bernabè 2008, Kucera and Roncolato 2008, Kanbur 2009, Ordóñez 2010, Lehmann and Muravyev 2012, Schneider 2012).

As most authors point out, it is important to understand whether workers take informal jobs because they *have* to or because they *want* to (Ruffer and Knight 2007). According to Ruffer and Knight (2007), there are currently two opposing views of informal labor markets. Firstly, there is one perspective, suggesting that the informal sector mainly fulfills the function of absorbing the surplus of labor. Accordingly, the growth of informality is interpreted as economic failure and informal employment is considered to be involuntarily imposed on the individual. Proponents of the second perspective insist that the informal sector should be seen as a very dynamic one that will ultimately foster economic development. In this case, its growth is seen as a sign of economic success and informal employment as voluntarily chosen to obtain greater profits. As the two authors point out, both views can be correct and might even apply in the same country. The same distinction is also made by Kucera and Roncolato (2008) who concentrate on the fact that there is a significant difference between voluntary and involuntary informal employment. As they point out, this distinction is usually closely connected to a country's development stage. According to them, more developed countries usually have a better social safety net and "thus open unemployment can more readily provide an alternative to involuntary informal employment in the face of job loss" (Kucera and Roncolato 2008).

In contrast, unemployment in less developed countries increases poverty such that workers in those countries can simply not afford to remain jobless, and consequently need to accept employment in the informal sector (Kucera and Roncolato 2008). A similar view is offered by Bernabè (2002) and Rutkowski (2006). They assume that usually, in transition countries, the motivation to work in the grey economy derives from a lack of formal opportunity and thus a need to survive. Bernabè (2008, p.5) – specifically referring to transition countries – states that in contrast to that "[underground activities in developed countries] are deliberately concealed from the public authorities" in order to evade taxes and/or violate labor or other legislation. While in this study, we will not focus too much on this distinction, we still value its importance and will, through a number of case studies and data, try to reveal some of the forces that motivate people to take jobs in the informal economy.

1.2. CAUSES OF INFORMALITY

As extensive as the literature on informality is, so are the factors that have been identified as determinants for an employee's and/or employer's decision to engage in the grey economy. First of all, there are a number of authors who suggest that the level of taxes, as well as barriers related to bureaucracy and labor regulations, play a key role in determining whether a business decides to operate informally (Demirgüç-Kunt, Klapper and Panos 2009: 10; also see De Soto 1989, OECD 2004, Chen 2004, Feld and Frey 2007, Lehmann and Muravyev 2012). On

the basis of their empirical research, Lehmann and Muravyev (2012), for example, come to the conclusion that labor regulations and the tax wedge have the most significant effect on the size of a country's informal sector.

While also listing tax and the intensity of regulations, Schneider (2007) additionally lists the reduced quality and quantity of publicly provided goods and services, corruption of bureaucracy and government officials and the maltreatment of taxpayers by the tax authority as some of the main obstacles. Similarly, Gërxhani (1999) notes that the motives for participation in the informal sector generally tend to range from economic to non-economic ones. *For countries in transition*, she enumerates the following as the most important motives: the insufficient economic development, a high tax burden and a complicated tax system, a weak and complex legal and institutional framework, inefficient enforcement mechanisms, a high level of corruption and bureaucratic incompetence among government agents, the general lack of confidence in state institutions, the laissez passer approach towards the informal sector, civil wars in some of these countries, and "the conflict between the established economic and social norms in the past and the reaction to a new reality in the present" (Gërxhani 1999, p.15).

Informality levels also vary with skill level and demographics. The skill level is usually measured by education or occupation in an industry. Intuitively, we would expect low skilled labor to operate more informally considering low wages and other factors. Studies do support this claim; for example, Hazans (2011), in his research on informality levels in Europe, finds that "overall average [informality rate] is 14.5 percent for low-educated workers, 8.4 percent for medium-educated, and 5.7 percent for those with higher education".

1.3. APPROACHING INFORMALITY

While some academic accounts concentrate very much on establishing a conceptual framework for measuring informality, there are also various papers focusing on the more practical challenges resulting from informality. Again, there is a divide between authors seeing informality as an obstacle that needs to be eliminated as fast as possible and others who suggest that it constitutes a phenomenon that can be used in order to foster economic growth in the long run. In the latter view, informality might not only protect the economy from a total breakdown by providing labor opportunities but also provide an income to people that would otherwise be unemployed. Accordingly, various scholars advocate that policymakers should concentrate on finding ways to gradually incorporate the informal sector into the formal one, rather than trying to eliminate it all at once. Nazia Habib-Mintz (2008), for example, is an advocate of this view. She demands that policies should aim at improving the productive units, and hints at China and India to stress that some countries

have become economically successful despite huge informal sectors. However, there appears to be a general consensus that many drawbacks exist to both the economy and the individuals who are involved in labor informality.

Ruffer and Knight (2007) account offers a more balanced view on informality. They see two major conflicts that have emerged. While there are some people who see formalization as the priority, others suggest that policies should be about improving the welfare of people employed in the informal sector. As the two authors correctly point out, this leaves policymakers with one

big challenge; they have to find policies that, on the one hand, help to ameliorate the lives of the poor, but, on the other hand, ensure that incentives to formalization are not removed.

Since this study takes the standpoint that informality is harmful to a country's socioeconomic development, and given its limited scope, it will not elaborate too much on potential beneficial issues from the informality. However, based on its empirical findings, it will formulate some valuable policy recommendations in this regard.

2. RESEARCH METHODOLOGY

Initially, this study seeks to measure the level of the informal economy in Kosovo, which includes legal undeclared activities and excludes illegal activities, as accurately as possible. Additionally, the study also aims to understand informality determinants and factors that cause informality such as: firm and industry characteristics, industry size, institutional barriers or general business environment. In order to measure the extent of informal activities in Kosovo, this study applies both qualitative (desk research) and quantitative (survey and case studies) research methods. Given the difficult to observe nature of informality, scholars have often had to rely on alternative, sometimes creative methods of *measuring informality*. The general literature on informality recognizes two widely used approaches. The first one, the indirect approach, tries to capture informality levels with aggregated data. The second one, the direct approach, relies on surveys – usually designed with indirect questions. Indeed, the need to understand individual-related determinants of informality has often favored the direct approach – hence indirect questioning – as compared to the understanding of general levels of informal sector reached by indirect approach. By designing questionnaires that captured not only informal behavior but also the individual characteristics of *informalists*, surveys became one of the strongest tools at scholars' disposal. The surveys, however, are often subject to *some* level of bias. According to Gerxhani (2002), individuals often do not have an incentive to answer honestly, making the results of such direct studies biased towards lower informality numbers. It is important to note that this study will focus on the employers' perspective (through surveys). However, through a number of case studies it will also seek to at least shed some light on the employees' side. While focusing less on the factors that drive workers into joining the informal workforce – assuming that most of them do so involuntarily - it seemed important to the researchers to reveal aspects of these laborers' "working reality".

The remainder of this chapter reviews the tools that have been applied in this research to observe and capture several characteristics of informality in Kosovo.

2.1. DESK RESEARCH

Desk research sought to thoroughly familiarize the research team with informality and its complexity as a phenomenon. The literature reviewed in this initial step included online papers,

academic journals, web, institutional reports such as World Bank and IMF, and other statistical institutions. The aim of this research was to define the focus of this paper, which for our purpose includes only undeclared legal activities. Due to the sensitive nature of the topic, many studies focus on the methodology of developing questionnaires for studies that rely on the respondents' honesty and willingness to answer even uncomfortable questions. Therefore, a great portion of the desk research concentrated on the analysis of survey and question design, in order to retrieve crucial information from the respondents for the purpose of this research. More than six directly related surveys¹ were analyzed, in addition to other analyses done specifically for the case of Kosovo. Designing the optimal questionnaire was a crucial aim of the desk research.

2.2. SURVEY

The quantifiable data was collected through a survey involving 600 companies in Kosovo, selected from the Tax Administration Kosovo (TAK) database, at the confidence interval 99 percent. This sample is statistically representative of the number of registered companies in Kosovo. Since this study did not seek to focus on one specific economic sector, a wide range of different businesses was randomly selected. This also allowed the researchers to identify the sector(s), in which informal activities are particularly prevalent. Accordingly, for the conceptualization of the survey, it was deemed crucial to include questions pertaining to the business owners' perception of various policies related to labor or tax regulations, and regarding their own business practices as well as those of their competitors' (second part of the survey). Also, it was essential to incorporate several general screening questions (first part of the survey), which intended to reveal certain trends that might exist between a company's characteristics and its business practices.

Before the survey was released to be fully conducted, it was initially tested with 50 businesses to see if the questionnaire had visible 'defects' or if certain questions needed to be modified in order to obtain true answers from the respondents. The

¹ UNDP Human Development Report Questionnaire; International Labor Office questionnaire(s); EBRD Business Environment and Enterprise Performance Survey

survey was conducted only with company owners or managers, who are informed and allowed to share their viewpoints and/or experiences regarding their own companies' compliance with tax and labor regulations. On the basis of their subjective perception, they were further given the chance to comment on their direct competitors' business practices and business barriers their sector generally encounters in Kosovo.

2.3. CASE STUDIES

In order to present a comprehensive picture of the size of and reasons for informality in Kosovo, and to understand the many facets of this highly complex phenomenon, four journalistic case studies were conducted. In this instance, a journalist from the daily newspaper 'Zëri', found three real life cases in Kosovo that face or have faced informal activities and pronounced their

case. The case studies are complementary to the survey, given the inability for the case studies to provide a complete picture of such a sensitive issue. The aim of these case studies was to close any potential information gaps that remained after the completion of the survey. In light of this, the interviews included the viewpoints on the topics of labor declaration, tax evasion, labor law effects, and business bribery.

The case studies provided some insights into the grey economy, including revealing the working conditions that informal employees have to cope with on a daily basis. The topics of the case studies were chosen by the research team carefully, after observing the survey results, while the journalist investigated cases that corresponded to those topics. Complete anonymity was assured in all cases, except if the person voluntarily chose to reveal his/her identity. These insights will significantly affect the policy recommendations this study will ultimately propose.

3. SURVEY RESULTS:

General Picture

This section provides a general overview of the screening questions from the questionnaire, in order to provide a descriptive profile of businesses subject to our study. We note that in order to obtain credible results from the survey, the survey team interviewed only owners or executive managers. This has enabled our researchers to obtain more precise information on the current state of businesses in Kosovo. The credibility of respondents also adds further certainty in regards to evaluation of sensitive questions, such as questions related to the tax evasion and labor informality. The following paragraphs provide some general characteristics of firms interviewed for our study:

- Given the nature of the sample selection in the pre-interview phase, the majority of businesses surveyed for the purpose of this study were sole proprietorships; roughly 87 percent. Around 10.5 percent of surveyed businesses were partnerships, while 1.3 percent were corporations; the remaining 1.2 percent belonged to the “other” category. This distribution ensures the credibility of survey implementation, as well as its statistical representation.
- Survey results also revealed that the vast majority of interviewed firms were established during the pre-independence period; around 64.8 percent of all firms started their operations during 2000-2007. It is interesting to note that since 2008 until today, around 17.7 percent of the surveyed firms were established – a figure that is roughly similar to the 1968-1999 period.
- Moreover, around 30 percent of the respondents revealed that they were unemployed prior to their entrepreneurial endeavor. The majority of the owners, roughly 38.5 percent, were employed previously in the private sector. Around 11.2 percent were students; while the remaining 17.7 percent were employed in the public sector.
- Individual characteristics of owners, screened through our survey, show that 91.8 percent of businesses are owned by male entrepreneurs, while only 8.2 percent of the businesses are owned by female entrepreneurs. Again, the vast majority of the owners have secondary education (54 percent) and undergraduate (33 percent). Roughly 13 percent of owners have only primary education. We note that the average age of business owners in Kosovo is 42 years.
- Only 14 percent of interviewed businesses revealed that they are not members of any business association in Kosovo.

4. SURVEY RESULTS: Informality in Kosovo

In 2011, a survey conducted by Riinvest and UNDP showed that Kosovan businesses perceive unfair competition – driven by tax evasion and informality – as the top barrier in a list of 22 other barriers. This was the very first time where “unfair competition” topped the list of barriers, following a set of studies from previous years that introduced corruption and/or electricity supply as the main barriers in doing business.

This result is also confirmed from the present study (survey) when respondents (for the second time in a row now) consider “unfair competition”, driven by tax evasion and informality, as the main barrier in doing business. Moreover, the responses from this survey show that the perceived unfairness has increased considerably in intensity, as compared to the previous year, from 76 to 84 percent of respondents. These findings suggest that informality in Kosovo is not only a serious problem, but also a continuously increasing one - hence, it requires an immediate action plan to tackle it (for more on ranking of business barriers in Kosovo derived from this survey, please visit: www.riinvestinstitute.org).

In this study we look at two types of informality, namely tax evasion and labor informality. We do so by introducing two, perhaps main, questions of the whole survey, which ask respondents to provide their perception about the level of sales declared (tax evasion) and labor force declared (labor informality) by firms similar to theirs. This section and the following one provide a general picture of the level of tax evasion and labor informality in Kosovo.

4.1. TAX EVASION IN KOSOVO

The question made to measure the level of tax evasion in Kosovo is as follows:

Q.18 *What percentage of the sales of a typical firm in your area of activity would you estimate is reported to the tax authorities, bearing in mind difficulties with complying with taxes and other regulations?*

Respondents were asked to provide a single answer on the proportion of sales reported to the authorities, measured as a percentage. The response provides a rate of tax compliance, which is then subtracted from 100 in order to get the perceived level of tax evasion. The average values of all responses finally provide country level of tax evasion. Understandably, this is not a direct measure of tax evasion; however, in the absence of tax measurement programmes, studies with subject of transitioning countries have adopted survey measures and

indirect questions as the most appropriate. As already argued under the literature review, the indirect questioning of generally hidden activities is the most commonly used method among scholars.

According to the survey data, business managers and owners believe that on average the businesses in their industry report about 65.6 percent of their sales, meaning 34.4 percent is evaded. Similar results were obtained in 2012 UNDP Human Development Report (2012). The report found that in 2011, around 39 percent of sales was not reported by businesses. Current figures also show that the level of tax evasion has slightly decreased in the past two years, yet the current levels of tax evasion are alarming. Businesses are a major budget contributor, and this means that public services, which could be financed by business contributions, are receiving over a third less funding than they could be.

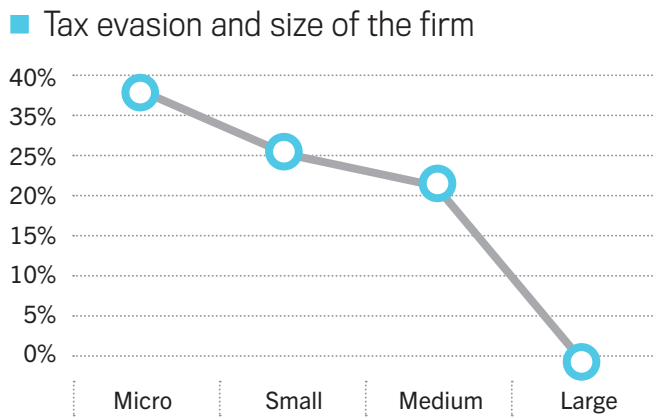
A further disaggregation according to the size of the firms shows that there is a strong negative correlation between alleged tax evasion and company size (by proxy of the number of employees – Fig. 1). Results show that the large companies tend to evade less; while smaller firms are more prone to evade behavior.

This correlation is in line with general theoretical expectations and previous empirical investigation conducted in this field (see for instance Nur-tegin 2008) given the presence of two important factors. First, larger firms are usually more consolidated; hence, they have less intention to gain their competitive advantages by engaging in risky illegal activities. Second, given the limited resources of the tax administration, and the need to



Business managers and owners believe that on average the businesses in their industry report about **65.6 percent** of their sales, meaning **34.4 percent** is evaded

Figure 1. Sales not reported for tax purposes (cross-tabulation with company size)



Source: Authors' calculation based on survey results

optimize these resources in line with maximizing tax revenues, tax officers usually target larger firms – where the bulk of taxes are collected. This finding will also help us draw an important policy recommendation in regards to the audit strategies by TAK, at the end of this study.

The negative relationship between a firm's size and tax evasion is also established when cross-tabulating the levels of sales reported with firms' sales; which is another proxy for the firm's size.

Figure 2, however, shows also a slight change in the trend of the relationship, with firms belonging in the sales category of (50-100.000 euros). This could be an indication of the least evasive group in Kosovo.

Further disaggregation according to the sector differences shows that the "construction" sector, followed by "education" and "arts, entertainment and recreation" sectors are the most compliant ones; the most evasive sectors in Kosovo are "accommodation and food services", "manufacturing" and "agriculture". This finding comes as no surprise given the general expectations that sectors involving higher cash transactions and/or less observable industries are prone to more evasive behavior, as appears to be the case in current Kosovan business environment.

The sales reported for tax purposes also seem to vary across seven regions of Kosovo. According to the survey results, the region of Gjilan is the most evasive one, with roughly 60 percent of sales being hidden from the tax authorities; followed by the

region of Peja with 45 percent of sales evaded; the region of Mitrovica with 44 percent of sales evaded; the region of Ferizaj with 40 percent of sales evaded; the region of Prizren with 33 percent of sales evaded; and the region of Prishtina with 27 percent of sales evaded. The last region, which is the most compliant, is the region of Gjakova, with 20 percent of sales evaded (see Figure 3).

The regional characteristics and differences on sales reported, as emerged on this study, can serve to adjust accordingly the audit strategy of tax administration in Kosovo.

Respondents were also asked to provide a general perception on the intensity of tax audits (inspections). Roughly 37.3 percent of respondents claim that there is high or very high chance of getting caught evading taxes. The remaining 62.7 percent of respondents believe that they can easily get away if they decide to cheat. These alarming levels of perception towards audits, and consequently to fine rates, perhaps provide a general picture of perceived deterrence mechanisms of tax inspectorates in Kosovo by businesses. The low level of "fear of being caught" is an important determinant on general evasive behavior, most notably on the risk perception by businesses, which ultimately affects their "to pay or not to pay" decision.

Also, 42.4 percent of the respondents consider the fine level to be high, or too high. At present, given the information available from this survey, it is impossible to define whether the current fine rates are high or low and how they can stimulate or trigger compliance. The tax literature acknowledges that the positive impact of fine rates on tax compliance (i.e. the harsher the penalties, the higher the risk from undutiful behavior), leads to a higher level of compliance. Understandably, a high fine level can backfire if businesses consider the punishment to not be credible; it also makes corruption more likely, as is often the case with heavy regulation.

Regarding the tax administration, businesses claim that they often get bribed and the tax inspectors misuse their authority. On a scale from 1 to 10 (1-never, 10-very often) businesses average on 4.48. They also believe that tax officials often abuse their authority (Mean: 4.35, 1-Never, 10-Always). It is alarming that such a large number of businesses report abuses from tax authorities. The tax authority in Kosovo is praised by the government (and many other institutions for that matter) for being very successful in collecting revenue. The survey results, however, reveal that businesses have quite some room to maneuver. When asked about the chances of getting caught evading taxes (1-low chance, 10-high chance), respondents gave an average


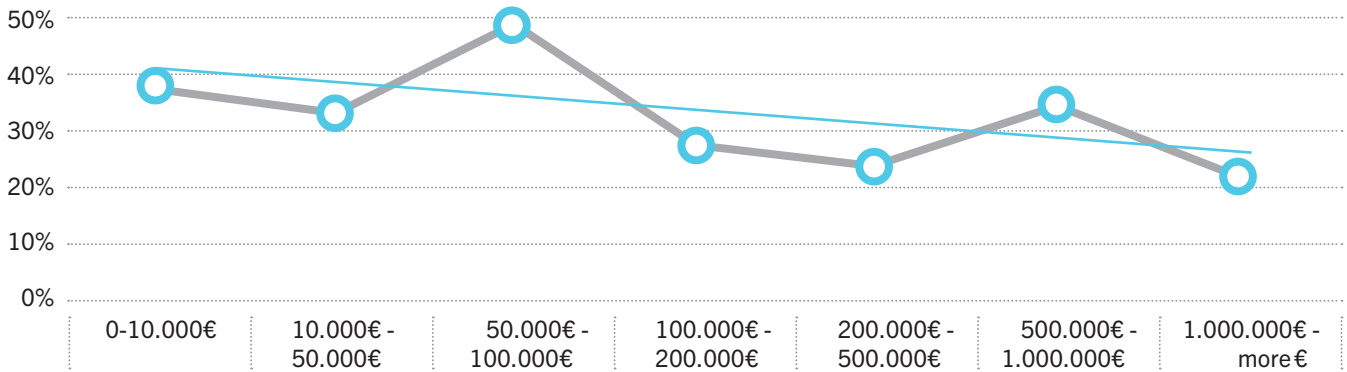

Roughly **37.3 percent** of respondents claim that there is high or very high chance of getting caught evading taxes. The remaining **62.7 percent** of respondents believe that they can easily get away if decide to cheat

Figure 2. Sales not reported for tax purposes (cross-tabulation with sales levels)

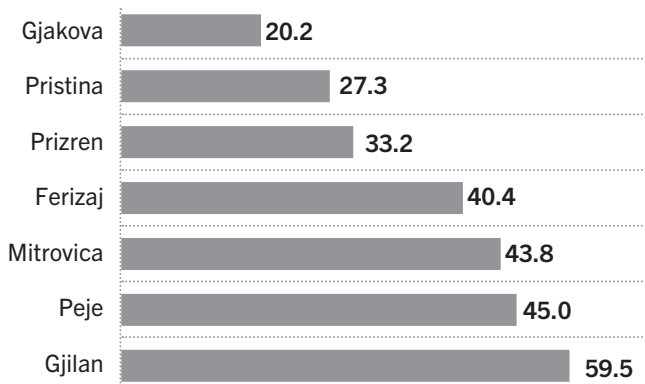
■ Tax evasion and sales levels



Source: Authors' calculation based on survey results

Figure 3. Percentage of non-reported sales by region

■ Percentage of non-reported sales



Source: Authors' calculation based on survey results

of only 5.51. Accordingly, there is a 50 percent chance to get away with it. Nonetheless, businesses consider the fines for punishing tax evaders to be relatively high (Mean: 6.26, 1-too low, 1-too high).

4.1.1 TAX MORALE AND JUSTIFIABILITY OF TAX EVASION

In 1972, Allingham and Sandmo adopted the Becker (1968) model of economics of crime to describe how an individual, under the conditions of uncertainty, makes a decision to comply. The model, rather simple, argued that the level of tax evasion depends on tax, audit and fine rate (mainly deterrence fac-

tors). The traditional model was often criticized for its simplicity. Subsequent developments on tax evasion literature have largely argued in favor of incorporating other non-traditional determinants and thus include other non-deterrence factors.

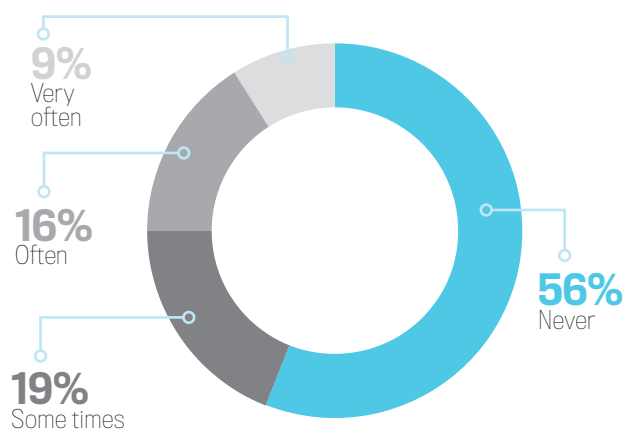
Almost three decades from the introduction of the Allingham and Sandmo (1972) model, Sandmo (2004) argues that explanation based on the taxpayer's subjective probability, which is not necessarily equal to the frequency of actual audit rates, is not entirely convincing to describe the puzzle between empirical investigation and theoretical predication. He further argues (p.11) that:

Common sense and everyday observations tell us that people refrain from tax evasion - as well as from speeding, shoplifting and polluting the environment - not only from their estimates of the expected penalty, but for reasons that have to do with social and moral considerations.

Frey and Feld (2002) argue that tax evasion/compliance is driven by a psychological tax contract between citizens and tax authorities and that, in order for the contract to be upheld, incentives such as rewards or punishment need to be provided; in addition, loyalties and emotional ties that go well beyond transactional exchanges must be taken into account. In order to explain the puzzle of tax evasion/compliance Frey (1997) argues about the importance of "intrinsic motivation" of tax compliance, which due to "civic virtue", makes taxpayers comply; as opposed to "extrinsic motivation", known also as deterrence impact, in which taxpayers pay because they fear the punishment. This "intrinsic motivation" is known today as tax morale.

To capture tax morale in our study, we apply the now the standard technique, of asking respondents whether or not they

Figure 4. Justifiability if possible (in percentages)



Source: Authors' calculation based on survey results

justify – on a scale from 1 to 10 – the level of tax evasion in Kosovo. As expected (see figure 4), most of the respondents – around 56 percent - have answered that they do not justify tax evasion, if possible.

From the figure above, it is important to note that around 9 percent of business respondents would always justify tax evasion. Obtained data enable us to compare business tax morale in Kosovo with individual tax morale worldwide, using data from World Value Surveys (WVS). Of course the assumption here is that individual tax morale can act as a proxy for business tax morale. Data from WVS cover surveys in 55 countries worldwide in periods between 2005 and 2007 (note, not all surveys were conducted at the same time). When comparing negative extremes, that is respondents stating that they always justify tax evasion, Kosovo with its 9 percent level ranks quite close with Serbia (15 percent), a neighboring country. Such evenness could also indicate the reliability of our data. The same level puts Kosovo below India (8.9 percent) or Brazil (8.6 percent), and considerably below western countries.

Similar results were retrieved when we asked respondents to evaluate the justifiability of tax evasion if competition evades, rather than if they can evade. Indeed, we note very small differences across the categories of justification regardless the “possibility” or “peer influence” by competitors. Still, the fact that over 40 percent of respondents would justify tax evasion – regardless of the degree – is quite alarming. There could be many reasons behind low levels of tax morale in Kosovo. Some of these reasons can be found within the survey results.

For instance, given the current level of public services to the firms, 60 percent of owners believe they should pay fewer taxes; 35 percent believe they should pay same amount they are currently paying; while only 5 percent believe they should pay more. The following graph (5) sketches the responses on tax evasion moral justification in different scenarios:

As the chart above (Fig. 5) clearly indicates, the respondents did not justify evading taxes in any of the scenarios, but there is a relatively higher score for the questions asking for the economic necessity of evasion and for the unfairness of the tax system. The economic necessity argument is justified with competition pressures caused by evaders. The unfairness of the system has to do with the former, but also with the tax rate system itself; the flat corporate tax rate is seen as unfair by some businesses because they think that larger businesses should pay more.

Other important relations, or lack thereof, that we found are between tax evasion and factors such as managers age, gender, or whether the business is a member of an organization or chamber of commerce. We find a statistically significant relationship, even at the 99 percent confidence level, that managers under 35 evade less. Ironically, these young managers justify tax evasion more than their older colleagues who evade more. The causal mechanism is unknown, but the finding is significant. We do not find a difference between male and female managers (an insignificant 0.9 percentage point more sales reported by men). Similarly, there is no difference between members of business chambers and others (1 percentage point more sales are reported by non-members).

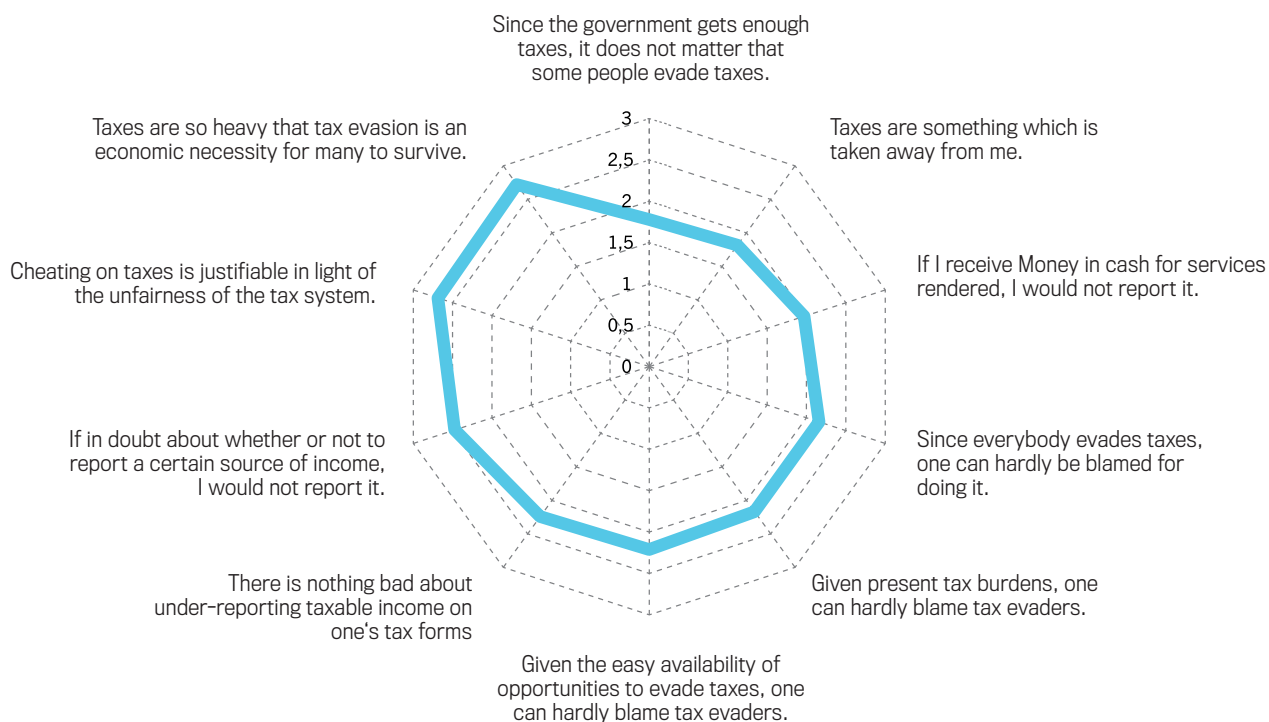


Given the current level of public services firms receive, **60 percent** of owners believe they should pay fewer taxes

4.1.2. AN EMPIRICAL INVESTIGATION

Beyond the general descriptive statistics provided in this study, an empirical investigation of main determinants of tax evasion was also conducted. We follow the very recent theoretical considerations on tax evasion and tax morale literature, notably provided by Torgler et al. (2010) and Alm and McClellan (2012). The questionnaire was specifically designed to capture a combination of traditional determinants of tax evasion (tax, audit and fine rate) provided in Allingham and Sandmo (1972) model; as well as a set of other non-traditional determinants that have been introduced throughout the four decades of research on the field of tax evasion. Andreoni et al. (1998, p.850) have argued in favor of incorporation of morals and social dynamics, beyond traditional determinants: “...it has been suggested that factors such as a moral obligation to be truthful, or the social consequences of being a known cheater, may add further enforcement incentives that are not accounted

Figure 5. Justifying tax evasion, 1-Strongly Agree; 5-Strongly Disagree



Source: Authors' calculation based on survey results

for in our models". Further, they elaborated three main groups of factors that are important when treating tax evasive models that are beyond the range of tax, audit and penalty rates. The first group involves moral rules and sentiments; the second group relates to the fairness of the tax system; the last group includes taxpayer's evaluations of government within the standards of performance, corruption and transparency. Given the business context of tax evasion elaborated on in this study, we also introduce a set of firm characteristics that appear to be additional determinants.

In line with the recent theoretical and empirical considerations in the field of business tax evasion, to investigate the determinants of business tax evasion in Kosovo we will apply the following model:

$$TAXEVASION_i = \beta_0 + \beta_1 TRADITIONAL_i + \beta_2 INSTITUTIONAL_i + \beta_3 INDCTRL_i + \epsilon_i$$

Where index i refers to observations $1, \dots, n$. $TAXEVASION_i$ stands for the level of tax evasion for observation i ; $TRADITIONAL_i$ includes all three traditional factors as modeled in the Allingham and Sandmo (1972) conventional model, notably Tax Rate, Audit Rate and Fine Rate. The second group of variables $INSTITUTIONAL_i$ captures Tax Morale, Trust in Government and Compliance Costs. The third group captures for both firm characteristics (such as

International Accounting Standards and Firm Size) and owner characteristics (such as gender, age and level of education).

We use Tobit Model to estimate determinants of tax evasion. According to Wooldridge (2003), optimizing behavior often leads to corner solutions for some nontrivial fraction of the population; in other words, it is optimal to choose zero evasion. Around 20 percent of respondents in our data have declared full compliance i.e no evasion, therefore tax evasion has a population distribution that is spread out over a range of positive values, but with a pileup at the value zero. Regardless of that, a linear model will likely lead to negative predictions for some of the firms, while taking the natural log is not possible because many observations are at zero. Therefore the Tobit model is explicitly designed to model corner solution dependent variables.

Table 1 is a summary of Tobit estimations. Technical details of the econometric model used here are available from the authors, upon request. Note that in Tobit regression, one cannot straightforwardly interpret the β coefficient as the effect of X_i on Y_i , as one would do in the context of linear regression. Instead, we have to calculate both conditional (Column 2) and unconditional marginal effect (Column 3), which measure the effects of changes in each independent variable on evasion that occur via changes both in the incidence of evasion and in the propensity to evade.

Table 1. Tobit Results

	1	2	3
Traditional Determinants			
Tax Rate	2.84 ***	1.80 ***	2.40 ***
Audit Rate	-2.55 **	-1.62 **	-2.16 **
Fine Rate	0.48	0.30	0.04
Institutional Determinants			
Tax Morale	-15.33 ***	-9.99 ***	-13.10 ***
Trust in Government	-2.25 **	-1.43 **	-1.90 **
Compliance Costs	1.69 ***	1.07 ***	1.43 ***
Firm Characteristics			
International Accounting Standards	-7.39 **	-4.68 **	-6.20 **
Size	-0.13	-0.08	-0.11
Owner Characteristics			
Male	0.86	0.54	0.72
Age	0.12	0.07	0.10
Primary Education	8.39 *	5.59 *	7.29 *
Secondary Education	5.79 *	3.66 *	4.88 *
Constant	31.47 ***		
Sigma	29.13		

*** at 1% level of significance; ** at 5% level of significance; * at 10% level of significance;

There is no clear recommendation on preferable marginal effect, but since coefficient sizes are similar, and since the unconditional marginal effect applies to the whole sample, we will interpret only Column 3 or unconditional marginal effects.

Results from Table 1 show that the decision to comply or not by business owners in Kosovo depends largely on traditional factors, namely deterrence factors, as well as from institutional factors such as tax morale, trust or cost of compliance. The Tobit model finds significant effect on the tax reporting rate for two of the three “usual suspects” in tax evasion analysis, *tax rate* and *audit rate* (no significant effect of fine rate is found, similar to most studies). Our results show that the association between tax rate and tax evasion is positive and significant at the 1 percent level. When all other factors are held constant, an increase in the tax rate barrier by one category increases tax evasion by roughly 2.4 percentage points. The positive relationship between tax rate and tax evasion is in line with both theoretical expectations and empirical investigation conducted so far for the transition economies (Abdixhiku et al 2013).

On a further investigation from our survey descriptive analysis, we note that there is a confirmed positive relationship between tax increase and evasive behavior. For instance, only 22 percent

of respondents have declared that they would continue to pay the same amount of taxes after an increase of only 10 percentage points; the remaining 78 percent have shown readiness to evade if such scenario occurs. The rate of potential evasion increases to 82.5 percent if taxes are increased an additional 20 percentage points.

The empirical results from Table 1 also show a negative and statistically significant relationship (at 5 percent level of significance) between audit rate and tax evasion; suggesting a fall in evasion if tax inspections increase. No statistical significant relationship is observed between fine rate and tax evasion.

The second group of determinants, as already suggested, consists of non-traditional determinants of tax evasion. The major finding of our empirical estimations lies within the relationship of tax morale and tax evasion; we note a strong, negative and statistically significant relationship between tax morale and tax evasion. Holding other factors constant, tax evasion drops by a full 13.1 percentage points for a firm that never justifies tax evasion. Indeed, the size of coefficient, supported by a convincing statistical significance, provides us with sufficient base to consider tax morale as the main determinant of tax evasion in Kosovo.

Moreover, the relationship between taxpayers and government, captured by the trust in government, appears to be statistically significant at 5 percent level. Tax evasion falls by almost two percentage points if trust in government increases by one category. This finding is in line with general theoretical considerations and expectations. Hanousek and Palda (2004), amongst many others, looked at tax evasion as a form of legitimate protest by citizens against their governments.

The importance of the institutional relationship between firms and government is also confirmed by the statistical significance of compliance costs experienced by firms. Firms that spent a large amount of time dealing with paperwork and other compliant requirements are less likely to comply at all.

The third, and the last group of determinants supports, to some extent, the general expectation that individual characteristics of both firms and business owners are important when tackling tax evasion. We note for instance a statistically significant relationship at 5 percent level for “International Accounting Standards”; that is, tax evasion falls by 6.2 percentage points if a firm is applying IAS.

Last, but not least, we note a positive relationship between tax evasion and owners’ level of education. Tax evasion falls as the level of education increases. We fail to establish any statistically significant relationship between size of the firm, gender and age of owners, vis-à-vis reported levels of tax evasion; however, it is encouraging to see the signs of coefficients being in line with the theoretical expectations.

4.2. LABOR INFORMALITY IN KOSOVO

Following the descriptive and empirical analysis of tax evasion in Kosovo, our second focus in this study is related to labor informality. Indeed, the contrasting numbers on the level of unemployment have always been subject to contrasting calculations about the degree of labor informality in the private sector. This study attempts to provide a rough estimate of the amount of unregistered/unreported labor within the registered firms in Kosovo. As explained previously, our focus in this particular study does not cover unregistered, hence completely informal businesses in Kosovo.

In order to understand the level of labor informality in Kosovo, within the registered businesses, we have constructed two survey questions. The first one, similar to the case of tax evasion, is an indirect measure of labor taxes being hidden from the tax authorities by businesses operating in the same sector

as the survey respondents are. The second question is rather direct. Though potentially subject to a sample selection bias from “truthfulness”, it asks our interviewed business owners to provide a single number of unregistered labor force in their actual business.

The question made to measure the level of hidden labor for tax purposes is as follows:

Q.29 *What percentage of the total labor force of a typical firm in your area of activity would you estimate is reported to the tax authorities, bearing in mind difficulties with complying with taxes and other regulations?*



Survey results show that, on average **37 percent** of the total employed workforce is not legally declared

Respondents were asked to provide a single answer on the proportion of labor reported to the authorities, measured as a percentage. The response provides a rate of labor compliance, which is then subtracted from 100 in order to get the perceived level of hidden workforce. Managers and owners interviewed in the survey believe that businesses in their respective industries report on average 63 percent of their employees. This means that on average 37 percent of the total labor force is not reported. Notably, that exact same number (37 percent) is also received from direct questioning. This important fact adds a great deal of robustness to the findings, by proving the efficacy of the methodologies applied to the research. Note that we asked respondents to reveal the number of full time employees in their firm that are not registered at all; i.e. employees that are fully informal. We then subtracted this number from the labor force that was declared at the beginning of the survey – part of screening questions – for each firm. By averaging the individual proportions of informal labor force to total labor force, we obtained a percentage of the total unregistered labor force in Kosovo; which, at roughly 37 percent, again reinforces our method.

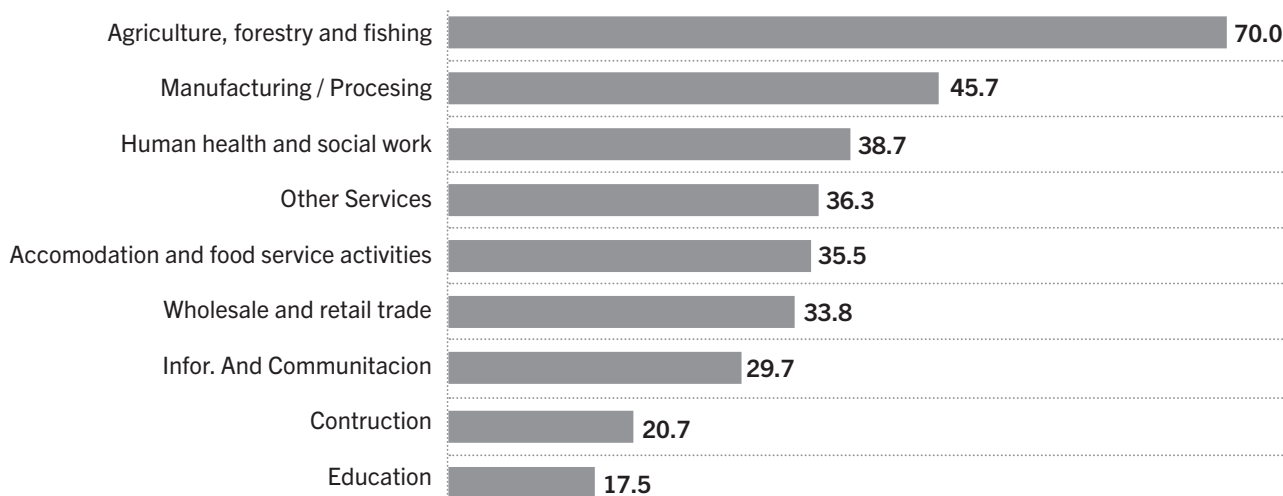
We note that, using survey data from 2011, the UNDP, Human Development Report 2012 approximated that around 30 to 40 percent of the Kosovo labor market is informal. These studies correspond with each other, emphasizing the point that a big portion of the workforce is not formally declared.

Additionally, survey results reveal that labor informality changes between different sectors; however, as the literature review discloses, agriculture is the sector where labor is least declared, with only 30 percent declaration (see Fig. 6). It is interesting to note that following agriculture, the other sector where employee declaration is also low is the manufacturing and processing industry. While agriculture is influenced from seasonality fluctuations and one can expect a greater labor turnover, low labor declaration in the manufacturing indus-

try.

Figure 6. Labor evaded for tax purposes in different sectors (in percentages)

■ Total labor evaded for taxes in different sectors




Source: Authors' calculation based on survey results

try is very surprising. The industry where the greatest number of employees is declared is education at 82.5 percent.

Considering that roughly 60 percent of Kosovo's population lives in rural areas, and relies heavily on agriculture and farming for income generation (EC Agriculture and Rural Development), it is evident that the level of informality is quite high seeing that only 30 percent of the workforce in this industry is declared. This data seems to correspond with the Human Development Report too (2012), where it is stated that only 2 percent of all registered businesses are in agriculture, although employment growth in this sector has been high between 2009 and 2010. This indicates that Kosovo has only a few agriculture businesses that operate formally and, as such, would explain the low level of labor declaration.

The fact that a significant portion of the workforce is not legally declared creates a big burden for these informal employees. Unregistered employees cannot make legal accusations towards their employers if they are treated unfairly. Unregistered employees do not contribute to pension funds and as such they become a burden for future generations. Moreover, employees in the informal sector are usually paid less than their peers who work formally. On the other hand, the burden of safeguarding social development is shifted to legally registered employees who have to contribute more to make up for the unregistered employees and the unemployed workforce. Accordingly,

businesses that under-declare the number of employees are taking away money the state needs to maintain some kind of social safety net. In these cases, both the businesses and the employees prioritize personal short-term wellbeing rather than long term social benefits (Kosovo Human Development Report, 2012).


 Around
68.2 percent
 of business owners
 declare that their
 employees ask to be
 paid in cash rather
 than through bank
 transfers

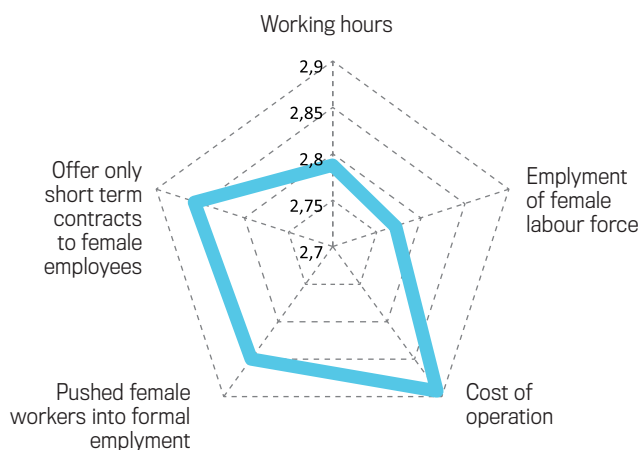
Another interesting issue to note from the survey is that 409 out of 600 employers (68.2 percent) declare that their employees ask to be paid in cash rather than through bank transfers. Yet companies on average pay 66.6 percent of the employees' salaries and benefits through bank transfers. We note that when salaries are paid through banks, it is mandatory to declare the employees' taxes and as such to declare the employees for tax purposes too; however, when they are paid in cash there is no need for employers to declare employees. Additionally, employees will have no incentive

to declare their income taxes if they are paid in cash, as they will want to retain as much as they can from the sum.

4.2.1. THE LABOR LAW

The new labor law – introduced in 2010 – has provided a set of basic rights for the labor force in Kosovo. It has, however, caused several controversies in regards to its impacts on employment practices by firms. Most notably, the general perception provided so far by business representatives in Kosovo is that the law itself,

Figure 7. Impact of labor law and minimum wage



Source: Authors' calculation based on survey results

especially the maternity leave provisions, has caused several restrictions, including those on women's employment.

We have directed our survey research also towards the perceptions of businesses in regards to the labor law and the minimum wage. We started by asking the respondents whether they have heard about the "new labor law". Surprisingly, around 41.2 percent of the surveyed businesses answered with "No" and roughly 57.2 percent with "Yes". Such a high unawareness rate of business owners with regards to the existence of the labor law is unfortunate; indeed, it is highly unlikely that these businesses comply with most legal requirements.

A higher rate of affirmative responses was provided when respondents were asked whether they are familiar with minimum wage requirements. Around 73.3 percent of them have answered with "Yes", while the remaining 26.7 percent have responded with "No".

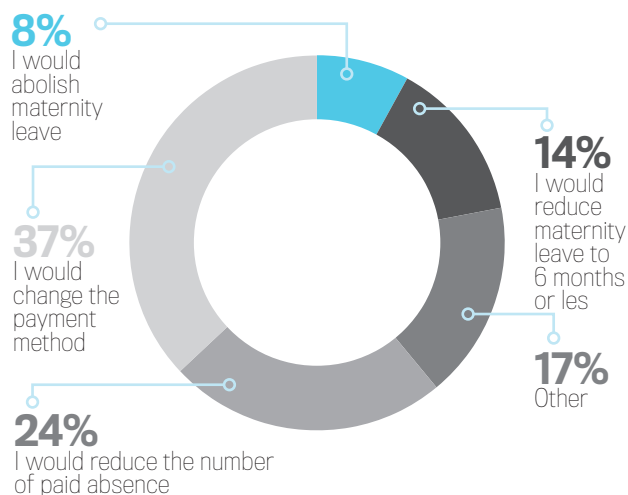
We further investigated the impact of both the "labor law" and the "minimum wage" in those businesses that obviously were aware of their existence. Initially when the law was passed, the first perception was that this law will affect the following: (i) working hours, (ii) imbalance in gender composition at work, (iii) in short term contract for the female workforce.

Figure 7 shows respective results. Note that, according to interviewed businesses, both the "minimum wage" and the "labor law" have mostly affected, as expected, their operational costs. Moreover, businesses generally argue that they were forced to

Roughly 41.2 percent of interviewed businesses have declared that they have never heard about the Labor Law; or its requirements.

Figure 8. Proposed changes in the labor regulations by respondents (in percentages)

■ If you could change anything in the labor regulations, what would it be?



Source: Authors' calculation based on survey results

employ female labor force both with short-term contracts and informally. Details on how the labor law has affected female employees' working conditions are elaborated further in case studies. Considering the barriers that businesses faced once the new labor law was introduced, the respondents did have the

opportunity to recommend changes to the law (see figure 8). Those recommendations reveal that employers consider maternity leave pay to be very high – to the extent that around 8 percent of interviewed businesses believe that maternity leave should be abolished completely. Around 14 percent of businesses argue in favor of reducing the maternity leave to 6 months or less, while roughly 24 percent of them suggest reducing the number of paid absence. More than 37 percent recommend changes in payment of the maternity leave. The general recommendation is to change the maternity leave payment scheme so that the first six months are covered from state budget and

the remaining maternity leave months are covered by the employers; alternatively, respondents suggest that the gross maternity leave should be reduced so the covering can become more affordable for businesses.

In summary, we note the fact that employers state that under-declaration of employees in their industry is quite high.

One concrete example is agriculture where only 30 percent of the workforce is declared, while studies show that roughly 60 percent of the population depends on and works in this sector. Moreover, employees that are paid in cash generally do not declare their cash salaries for income taxes. This puts the employees that are not formally declared at a disadvantage, especially when it comes to pension in old age, or bank loans. Cash payments also significantly affect the state budget and shift the burden to the registered employees in order to maintain a social safety net.

Regarding the maternity regulation, the law has introduced a different set of problems that have significantly increased the cost of operation for businesses. Businesses have to pay the biggest share of the maternity leave, while the state covers only a small portion of the remaining time on maternity leave. This poses a heavy financial burden on businesses, since they have to pay the employee who is on maternity leave and also the temporary replacement.

5. CASE STUDIES

The following section will present three case studies, which were written by an Investigative Journalist from Zëri newspaper. These cases were conducted with the aim of providing complementary information to the survey findings of this research.

The first case study, evaluates the perspective of women employment in the vein of legal requirements from the new labor law. The case study identifies the main weaknesses of the labor law, in terms of gender equality for employment, and it also provides an assessment of the counter effects that the law has produced.

The second case study, assesses the lack of legal enforcement of contractual agreements (or lack thereof) between the employees and employers. In this case, the employees working conditions, overtime payment, and standards of safety are assessed as well.

Finally the third case study, analyses the current level of combat against tax evasion in all of Kosovo, starting from the border points. The case also analyses the effects of no fiscal cash registers for many companies and how that effects unfair competition, leaving many companies out of the VAT. In this case the social safety net is jeopardized by evasive companies.

5.1. WOMEN - THE VICTIMS OF THE LABOR LAW

The labor law was evaluated as good and necessary for working class women; however, this law has resulted in negative effects, where women are faced with discrimination and lack of opportunities for employment, since the employees consider the maternity leave payment “a waste of money”.

Prishtina- While M.Musa was on maternity leave - her baby was only 2 months old - she received an email which notified her that her working contract was terminated. Although her contract was valid for one more year, her employer decided to cut the contract short in order to avoid paying her, despite his obligation under the labor law. However, in contrast to hundreds of other Kosovar mothers in similar cases, Musa decided to fight for her rights.

Under the new labor law, which entered into force in November 2010, women have the right to maternity leave for one year; as opposed to the old law where paid leave was guaranteed for only three months after giving birth. The first six months of maternity leave are paid by the employer, and employees receive 70 percent of their salary; the three following months they are paid from the central government and employees receive 50 percent of the average salary in Kosovo; finally, the last three months leave are not paid. The 70 percent payment for six months from the employer's side has raised objections, especially in the private sector.

The law is leaving women jobless

Evaluated by lawmakers as a good and necessary law for pregnant working women, in reality it has resulted in negative effects for them. As a consequence, women face discrimination and small chances of employment. There is no study to show exactly how high women's unemployment is since the new labor law was implemented; however, official statistics show that the percentage of unemployed women continues to be 75 percent.

The officials that deal with employee rights complain that women whose rights have been breached are afraid to make their cases public. M.Musa is one of the few women that has had the courage to push her case all the way to the end and to not let her name be anonymous, says Shukrije Rexhepi, head of professional services in the Union of Independent Trade Unions of Kosovo (BSPK). When Musa received the notice of the contract termination, first thing she did was to put forth the case in BSPK, says Rexhepi.

“Musa did not ask to remain anonymous, as other women do. I advised her to present her case to the work inspection. She also contacted women at the Parliament and as a result of not giving up her rights, the employer was forced to pay her maternity leave. Today she is still in maternity leave”- says Rexhepi.

For two years only twelve women complained

In 2011, the work inspection department, as part of the Ministry of Work and Social Welfare (MPMS), has received only four

cases of women who's rights for maternity leave have been breached; however, in 2012 there have been eight cases, which totals to twelve cases for the past two years- says the head inspector Basri Ibrahim. He indicates that all twelve cases, which the work inspection dealt with, resulted in positive outcomes for the women.

However, the number of presented and identified cases from the inspectors is much smaller than what it can be in reality. "There cannot be only 12 cases in the last two years, but women do not complain about violations from fear of losing their job. Then the other problem is that the women see the economic crises and how hard it is to find a job, so they prefer to be silent and to not enjoy their maternity leave right, just to keep their job", says Ibrahim.

Even the women that come forth to the labor inspection request to remain anonymous. There were cases when a woman complained to the work inspection, and inspectors have requested information from her employer, but then the woman denounced their declaration and did not accept that her rights have been violated - says Ibrahim - who also states that if mothers continue to be silent, their rights will continue to be violated.

Shukrije Rexhepi from the Union of Independent Trade Unions of Kosovo complains about the same issue. When women visit her office, they tell of different work violations made from employers, but they never tell their names, or if they do reveal names to the inspector they want to remain anonymous to the public. There are women that complain once and never report again, and as such there is no real evidence of how many women inform on their employers for violations, in a week, month or year.

"Ever since the labor law entered into force, I remember only M. Musa as a women who did not hesitate, and who did not hide her name. Only one - this is very concerning", says Rexhepi.

The risk of shortening maternity leave

Although the data are missing, there is doubt that women have lower employment opportunities, especially if they are around the "motherhood" age, says the head inspector of labor Ibrahim. As a consequence, a lot of debate has come about and requests to shorten maternity leave, not only from the private sector, but also from officials in the civil society and deputies in the Kosovo Parliament.

Suzana Novobërdali, deputy from the political party Coalition for a New Kosovo (AKR), who is also the leader of the commission for human rights and gender equality, says that the shortening of the maternity leave should be connected to the type of labor, which is also connected to the start of maternity leave (with the new labor law 28 days before giving birth), for example, five months off and part time work for the next four months.

"Still this issue requires inclusive debate using good practices and consulting experts from different fields", says Novobërdali. Last year the American Chamber of Commerce in Kosovo, proposed that the 12 months of maternity leave to be shortened to 9 months. They concluded this by saying that the long maternity leave is a big burden for businesses, and as a consequence they avoid hiring women during their recruitment procedures.

According to the Chamber of Commerce in Kosovo, maternity leave should not be shortened but a different payment method should be found. Their proposal is that the first four and a half months to be paid by the employer 70 percent of the salary value, while the other remaining four and a half months to be paid from the Ministry of Work and Social Welfare, again with 70 percent of salary value, and the last two months no payment.

The maternity leave problem would not exist if the law for health insurance existed, says Shukrije Rexhepi from BSPK. "With a fund for health insurance, this problem would be solved automatically, because this fund would cover maternity leave payment", says Rexhepi. The head inspector, Basri Ibrahim, agrees with this statement as well. He also states that due to lack of health insurance law, these problems exist. However, he notes that this year the labor law will be put on the Assembly again for review, where one of the articles that will be discussed will also be the maternity leave.

Alma Lama, Vetëvendosje deputy in the Parliament of Kosovo, says that the maternity leave should not be shortened, but also that the country should create policies that encourage increased birth rates, since statistics show that birth rates are falling fast in Kosovo.

According to the Kosovo Agency of Statistics, in 2011 around 34.449 births have been registered in Kosovo, while in 2012, the birth rates have dropped to 27.912. Lama also criticized the work inspections saying that they are not doing a good job in the field. "Law violations should be fined, with very high fines. However, the inspectors are not doing a good job, and even if they do, they select businesses and don't touch many of them even if they violate laws", says Lama.

Basri Ibrahimidi denies these allegations. When asked if he had fined anyone from these 12 cases, he said no; however, he gives his reasoning for that. According to him, the inspectors do not intend with the first case to punish the business. “Sometimes we give a warning, and we give them a short period of time to react, and if they don’t, then we fine them. In those 12 cases we have achieved results which favor the employee with only a warning to the employer”.

Otherwise, according to Ibrahimidi, discrimination based on gender is not really an issue. With the exception of the maternity leave problem, other violations happen to both genders, like working without contracts, low wages, and so on. These are evident in the private sector, while in the public sector the problems are different, he says. “In the public sector there are no such problems. The main complaints that come from the public sector is when a job vacancy is advertised, and we have people complain that they have been refused work unfairly”.

Only 23.4 percent of women are employed

Although the inspectors claim there are no gender differences when it comes to work violations, the simple fact that there are less employed women than men presents a different story.

The data from the Kosovo Statistical Agency shows that the number of employed women compared to employed men is much lower. According to the agency, about 66,719 women are employed in Kosovo, or 23.4 percent, while the number of employed men is 214,735 or 76.6 percent.

Discrimination against women continues, say officials that deal with human rights. Behxhet Shala, leader of the Council for Human Rights in Kosovo, says that discrimination against women starts from the moment a vacancy is announced. “We have seen cases where it says that women who apply should not be older than 30. This happens in many private company vacancies. The women in Kosovo continue to do undignified work, they are repressed in many aspects, and the government has done nothing to fix this”, he says.

5.2 THOUSANDS OF EMPLOYEES WITHOUT CONTRACTS

Prishtina – Thousands of employees in Kosovo do not have working contracts. Many of them are paid under the set minimum wage and are not paid for overtime work. Also, many employers do not declare their employees in order to evade salary contributions, but there are also those that lose their life on the job, especially in the construction sector where working conditions are particularly dangerous, and no one is held responsible for it. These allegations have been confirmed from thousands of identified cases, and employee informality still remains an issue.

The biggest violations happen in the private sector and the most prevalent problem is work without contract, where the employer hides the real number of employees in order to evade taxes on income and other obligations set by the law.

The Kosovo labor inspection, as part of the Ministry of Work and Social Welfare (MPMS), during inspections in the private sector, has identified 3,467 workers without working contracts during 2012, says head inspector Basri Ibrahimidi. We have extracted this number from seven thousand inspections, he says. Among others, the inspector has given other warnings, especially for overtime work. “The biggest violations in the private sector are the extended working hours for employees without financial compensation and work without contract. Other violations come about as a consequence of these”, says Ibrahimidi. The work inspector legalized those 3,467 undeclared employees.

The first course of action for inspectors is to give a warning to the employers, thus granting them an opportunity to avoid paying fines, but not all obeyed the warning. Last year, for various violations, the work inspectors fined different businesses with a total value of 585 thousand euros, where the smallest fine was 500 euros, says Ibrahimidi.

Around 30 thousand illegal employees in Kosovo

Around 30 thousand employees in Kosovo are considered to work without work contracts. This statistic was taken based on the number of citizens that declared themselves as working, and the number of those that pay income taxes. According to the Kosovo Statistical Agency, the number of citizens declared as employed is 280,454. All these people, based on the law should pay pensions and income taxes. However, the statistics taken from the official

publication of the tax administration in Kosovo, state that tax contributors are only 250,890 citizens, roughly 30 thousand less than the total number of declared workers.

Although employees' rights were violated in different ways, the employees never sought help. During 2012, in the work inspection office, only 400 complaints from employees were received, says head inspector Basri Ibrahim. The people who are aware of employee issues say that the reluctance of employees to declare violations comes from the lack of trust in institutions to solve those problems. This is primarily seen as a result of the economic crisis or the lack of alternatives for employees that lose their jobs; as a consequence the employees simply decide not to report violations.

Avni Ajdini, vice-president of the Union of Independent Trade Unions in Kosovo (BSPK), says that employees of Bechtel Enka Company, which was contracted by the government to build the highway between Kosovo and Albania, are paid 0.90 euros per hour, are made to work overtime, and enjoy no rights. "I have information that the employees want to form a union, but the employer always prevents them. This is done because a union would promote and communicate problems more easily. Also, we as BSPK would have direct access to their complaints, and would have an easier time addressing them. As things stand now, we cannot penetrate that organization. This shows that violations are made at the central level, where they make and break the laws themselves", says Ajdini.

Another example according to Ajdini is Mabetex, which also prevents the formation of a labor union. The newspaper contacted both Mabetex and Bechtel Enka for comment, but received no reply. "These companies are not the only ones that violate employee rights. In every company you can find violations", says Ajdini.

According to him, when an inspector does his/her work in Bechtel Enka, they do not report the violations because the company is affiliated with the Government. This phenomenon occurs also in other companies.

Head inspector Ibrahim denies such allegations. He says that no matter what is said by Bechtel Enka employees, there are no violations in that company. All employees have contracts and safety standards at work, and regarding payment level, it is not the inspector's duty. It is important, according to Ibrahim; no employee is paid less than what the law allows for minimum wage, which is 170 euro.

The small number of inspectors makes the job hard

Head inspector, Basri Ibrahim, says that Kosovo has around 100 thousand businesses; meanwhile, the total number of inspectors for all of Kosovo is 46.

"We have a small number of inspectors, since we follow the labor law, the law on smoking, people with disabilities, and unions; as such this is a heavy burden", says Ibrahim. Although, according to him, compared to the years before the labor law was implemented, the employees' situation is better.

Informality is a concerning issue and it is widespread in Kosovo, says the director of the Kosovo Business Agency, Agim Shahini. "Informality in Kosovo remains a challenge to be dealt with. The labor law is largely violated by employers", he says.

Another problem is that employers do not respect even the minimum wage set by the law, which is 170 euros. There are employees that are paid 100 euros a month, and often even less, says the vice president of BSPK, Avni Ajdini. Many cases in Kosovo show that when employees asked for their rights, they remained jobless.

In October last year, the Turkish company "Uluova", which was sub-contracted from "Bechtel Enka", has fired 50 employees, because they asked for their overtime hours to be paid, and to have a Sunday off, as it was specified in their contract. This situation has passed in silence, but it proves that even when you have a contract, you do not enjoy the rights guaranteed by law.

5.3 DELAY IN COMBATING INFORMALITY

Evasion toward state duties starts at the customs borders and continues through all of Kosovo, where traders use all corruption forms just to evade taxes. An unequal market as it is now, characterizes Kosovo as a country with high informality rate, and as a consequence the budget is deprived of millions of Euros per year.

Prishtina – Starting from customs at the border, through which one enters Kosovo, the trader's corruption begins just to evade state taxes. One of the ways to evade taxes is also to pay customs agents, but then the traders continue with the same mentality even inside Kosovo, thus enabling informality to be high.

Official data on the grey market are missing; however, the World Bank data, although slightly outdated, state that informality in Kosovo is 40 percent of the country's GDP. In monetary value, this is around 2 billion euros. From this number, we see that the state budget loses more than 300 million euros per year (just accounting for VAT).

From 120 thousand businesses registered in the Ministry of Trade and Industry (MTI), only 17 thousand possess a fiscal cash register, which means they are regular tax payers. The most profitable businesses, for example the gas stations, never give the customer a fiscal coupon. The illegal economy in Kosovo has become part of the society and business community, and this is harming the budget and the production industry, claim economy experts. The dimensions of this problem have increased significantly, starting from the border crossings, especially those with Serbia, where many alternative roads are frequented for the black market, and their control is very difficult, state Kosovo customs agents.

Despite this problem, a big issue is the fact that the customs agents receive bribes from traders in order to bring their inventory in without paying taxes, and although this phenomenon is known, it is very difficult to combat.

Corrupt customs agents

During 2012, the Kosovo customs sectors that dealt with combating and preventing corruption inside the customs have registered 46 cases where customs officials have been corrupted, and towards whom disciplinary measures have been taken. These cases have been reported to the police and courts, because they have been caught abusing their official duty.

However, this case was not confirmed by customs officials, who have hesitated to answer when contacted.

These cases have been made public by the Agency Against Corruption, according to which, from the 46 cases of the customs officials, 17 have been reported to the police, 19 disciplinary measures have been taken, 5 cases have been sent to court, and 5 others are under investigation.

There is no data to conclude that these officials were caught taking bribes or making other work violations. Adriatik Stavileci has not answered this question specifically but has talked in general about this case. He says that catching a customs worker taking bribes from a trader is very difficult, if not impossible. He does not deny that this problem exists in Kosovo, and thus Kosovo customs have changed their control system for the goods that enter Kosovo.

From 2007, the control system of goods has been spread, which means that if before you could enter all goods through only one control point, now you must pass from one control to another. "This way of passing from one control to another makes it almost impossible for a trader to corrupt a customs

agent, because they will deal with many agents, not just one", says Stavileci.

The bribes that customs or other public officials could take are very difficult to catch directly, says Agim Shahini, from the Kosovo Business Alliance. Even if traders cannot corrupt a customs agent to bring in their goods illegally, the traders do not stop and they use other forms such as bringing in the goods from uncontrolled zones. "Evasion is the highest in border points, whether in the north of Kosovo or in other points all over Kosovo, through which different products come in and avoid taxes such as customs and VAT", says Shahini. What the country loses from this evasion is hard to determine – he says.

Economics expert, Ibrahim Rexhepi, cites World Bank data, according to which fiscal evasion in Kosovo is close to 40 percent of GDP. "In monetary value this is 2 billion euros. From this value, the state budget loses 300 million euros per year, if we account only the VAT", says Rexhepi.

But, the customs spokesman insists that these data, no matter from which institution they come, are not true. "No one can know how much Kosovo loses from tax evasion. Until they catch the goods, one cannot know how much goods they had and how much the state would have benefited from taxes. Thus the million euro values published from time to time by different institutions are not real", says Stavileci.

1.3 million euro fine, if caught with smuggled goods

During 2012, the customs has caught 1007 cases towards which fines have been given in the total value of 1.3 million euros, while goods in the value of 1 million euros have been seized.

These are cases in which Kosovo customs have caught traders trying to smuggle illegally in different forms, mainly by using illegal roads, says the spokesman for customs Stavileci. If we compare that to 2011, caught cases were 1050, and the seized goods had a similar value close to 1 million euros, while the fines were twice as high, with a total value of 2.8 million euros.

According to customs data, the seized goods in the last few years were mainly gold, cars, petroleum, medications, cigarettes, but other products, such as: clothing, foods stuff, and live cattle. There were also cases where people were caught smuggling in marijuana, says Stavileci. The customs has also continued monitoring the businesses that dealt with illegal products.

This year, customs officials have located and closed a small factory for alcohol forgery, in which case, after prosecutors' request, the operator has been arrested as well. "During 2012 we have started investigating 48 new cases. Additionally, as a result from the investigation we have pressed 40 criminal charges based on fiscal evasion", he says. He also mentioned two types of smuggling that traders use to bring in goods illegally. One, called classical smuggling, is done through unauthorized roads (mountain terrain), but this kind of smuggling is less prevalent now than it was years before, says Stavileci. However, Kosovo has a very long border line with Serbia, where smuggling occurs the most, and the terrain in that border is hilly and easy to pass, says the spokesman for the customs. The second method is called smuggling through undervaluation, or passing the border with falsified documents or double invoices (a very sophisticated form) in order to try and avoid customs payment, he says.

"To fight this phenomenon, Kosovo customs has signed an agreement with customs from countries we mostly import from, to exchange the data. These agreements allow Kosovo to have access to export documents from the country of origin, and as such the cases of undervaluation are discovered easily", says Stavileci. All these activities – according to Stavileci – have enabled the customs to increase the budget. In 2004 the collected incomes from customs were about 400 million euros, while today they are about 850 million euros – he says.

From 120 thousand businesses, 17 thousand have fiscal cash register

Tax evasion towards the country from the traders does not end at customs points, they also continue inside Kosovo. In the Ministry of Trade and Industry, the data show that the total number of businesses registered in Kosovo is 120 thousand, where all public and private, joint-stock, foreign companies, social enterprises and so on, are included.

The data from the Kosovo Tax Administration (TAK) Gazette show the businesses that pay taxes in the state budget in 2012 were around 50 thousand, which means a little less than half the total number of businesses in Kosovo. An initiative to identify the exact number of businesses and to make them pay taxes was undertaken by the Kosovo Government, and this was done by trying to mandate the use of fiscal cash registers from 2010. This project tried to equip 50 percent of businesses with fiscal cash registers in 24 months.

Today, according to the Alliance for Businesses in Kosovo, led by Agim Shahini, the number of those that have fiscal cash registers is 17 thousand. "Today we have roughly 120 thou-

sand registered businesses, and only 17 thousand have fiscal cash registers. This shows how unfair the country is towards businesses", says Shahini. According to him, the country is not fair because there are many businesses, especially big businesses whose interests are tightly connected to institutions, and no one harms them whether they pay taxes or not. He says that today in Kosovo an environment has been created which enables only businesses tied to institutions to succeed. The number of businesses that close in a year, according to the Ministry of Trade and Industry is up to 1 thousand, but new ones register too.

According to Shahini, the number of those closing is higher than 1 thousand even though new ones are opened; this means that the economy is regressing rather than progressing. "One of the reasons why businesses fail is also informality and unfair competition. For example the gas stations do not have fiscal cash registers and no one hinders them. This is an inequality that is harming economic development", says Shahini.

A business that has a fiscal cash register is obligated to pay 16 percent VAT on every cent earned, while the one that does not have a fiscal cash register pays according to their will, as they present them, which is destroying the system, he says.

The analyst for economic issues, Ibrahim Rexhepi, says that tax evasion happens everywhere, but there are state mechanisms that fight it. In the case of Kosovo, the TAK should be more aggressive when it comes to having fiscal cash registers, so that in the future all businesses are equal.

6. CONCLUSIONS AND RECOMMENDATIONS

This study is an analysis of the state of the informal economy in Kosovo. In general it aims to analyze the size and implications that informal economic activities (tax and labor evasion) have on the economic development of a transitioning country such as Kosovo. This analysis is conducted by using primary and secondary data. The primary data was all-encompassing, by incorporating a thorough survey analysis with 600 businesses from different sectors, and also four investigative case studies providing exhaustive field experiences. The survey was conducted only with high rank business managers or company owners, to ensure data credibility. In order to approach this very sensitive topic successfully, the survey was analyzed thoroughly and tested, internally with Riinvest staff and then with 50 businesses, before it was issued to be fully conducted. The survey was comprised of many indirect questions (asking about competitors behavior, which in reality would indicate the respondents behavior as well), and direct questions (about the businesses own behavior).

Informal activities can encompass both *legal* (undeclared but legal business endeavors) and *illegal* (for instance human and drug trafficking) activities. However, for the purpose of this study we focused only on the former, with the aim of trying to see the damage that informal activities cause to the country's economy; including unfair wages, gender discrimination, and evaded taxes that could have contributed to the state budget and ultimately to social wellbeing.

The findings of this research suggest that informality or "unfair competition" still tops the list of barriers to doing business in Kosovo. The survey reveals that 34.4 percent of sales are evaded, which means that state contributions from taxes are more than a third less than they could be. The survey also reveals that small and medium sized enterprises are more prone to tax evasion than larger firms. Additionally, the most evasive sectors in Kosovo are: agriculture, manufacturing, and accommodation and food services; while the most complying sectors are: construction, education, arts/ entertainment and recreation.

Tax evasion also differs between the 7 regions of Kosovo, with the Gjilani region being the most tax evasive region (60 percent), while the least evasive region is the Gjakova region (with only 20 percent of sales evaded). This information may serve as an audit strategy for the Kosovo Tax Administration. Additionally, roughly 62.7 percent of the interviewed businesses believe that they can easily get away with evasion if they decide to do so. These per-

ceptions towards audit and fine rates provide a general picture of perceived deterrence mechanisms of tax inspectorates in Kosovo by businesses. Finally, businesses state that their competitors bribe tax authorities in order to evade tax payments (Mean: 4.48) and that tax officials abuse their duty (Mean 4.35).

Regarding tax morale, 56 percent of respondents state that they do not justify tax evasion, while 9 percent state that they very often justify tax evasion and 16 percent state that they often justify tax evasion. When these results were compared to the World Value Survey, Kosovo ranks very close to Serbia (in terms of tax evasion justification) where 15 percent very often justify evasion, but it is closer in number to India (8.9 percent) and Brazil (8.6 percent). This level of tax evasion justification is reasoned by respondents when they state that for the current level of public goods and services that they receive, they should pay fewer taxes (60 percent), while other respondents (35 percent) believe that they should pay the same amount of taxes for the goods and services received.

Finally, the decision to comply or not by business owners in Kosovo depends largely on traditional factors, namely deterrence factors, and institutional factors such as tax morale, trust or cost of compliance. Our empirical analysis of the tax evasion model showed a positive relationship between tax rate and tax evasion and a negative relationship between audit rate and tax evasion. We find also that tax morale plays a significant role in determining the levels of tax evasion; while the individual business characteristics are also important factors in tax evasion analysis.

Regarding labor informality, respondents believe that on average businesses report about 63 percent of their employees. This means that roughly 37 percent of the labor force in Kosovo is undeclared or unregistered. Labor evasion changes from sector to sector. It is mostly predominant in the agriculture sector, while the least evasive is the education sector. Agriculture has a high labor turnover and is faced with seasonal fluctuations, so this explains the low level of labor declaration.

The survey reveals that roughly 41.2 percent of the interviewed businesses are not aware of the labor law or its requirements. On a positive note, 73.3 percent of the interviewed businesses are aware of the minimum wage requirements in Kosovo. The new labor law, according to respondents, has mainly affected the cost of operations for businesses, especially the long maternity

leave. This has resulted in short term contracts for the women labor force at best, or shifting them into the informal sector at worst. As such, most respondents recommend changing maternity leave payment scheme, by shifting the burden more towards the government (37 percent), and to reduce the number of days that are allowed as paid absences (24 percent).

Finally, the four journalistic case studies investigate real life experiences of individuals that were faced with informality. The first case is about maternity leave and the discrimination that women are faced with at work. The second case study presents the fact that numerous employees are working without contracts, which puts them at a disadvantage legally. The third case talks about bribes and blackmailing to win governmental tenders. The last case, presents the level of tax evasion and bribing at the Kosovo border and how that affects the overall economic stability in Kosovo.

In line with general discussion and the findings provided in this study, we provide the following policy recommendations:

ON TAX BURDEN:

- Reduce tax burden, not necessarily through reducing tax rates, but through reducing compliance costs related to tax payments. Low tax rates do not necessarily reduce all tax burdens. As seen from the case of Kosovo, despite the average tax rate being amongst the lowest in all TEs (around 10%), the level of tax evasion is amongst the highest (39.5%). Other sources of burden include reporting costs, bureaucratic costs or even treatment costs. Some of these costs become transaction points, which are preserved solely for corruptive requirements of officials.
- Pay a special attention to the simplicity of laws related to reimbursable taxes, such as Value Added Tax. If the amount of time required for VAT reimbursement is sufficient to discourage taxpayers' compliant behavior, then regardless of the tax rate (low or high) evasive behavior becomes highly likely.

ON AUDIT STRATEGY:

- Audit rates should not be random; rather, they should be oriented according to the firm characteristics. Kosovo is currently directing its audit strategy towards its largest firms, in order to maximize revenue collected in the context of limited human resources. Such strategy could mean that the real evaders are unobserved.
- Focus audit rates on sectors that include higher rates of cash transactions. In such sectors, legal obligations for possession of receipts by consumers would facilitate the engagement and efficiency of tax inspections.
- Optimize audit rates as to treat competitors equally within

same clusters, i.e. competitors with same characteristics (size, sector, or region). Equal auditing, or perceived non-discrimination from equal treatment, will increase perceptions related to the fairness of tax administration

ON TAX MORALE:

- Morality, beliefs, social norms and other ethical values lie at the heart of every fiscal system. A healthy relationship between those that raise taxes and those that spend taxes creates a synergy for a non-tax evasive environment which, in turn, enforces an even healthier relationship.
- Adopt and enforce serious anti-corruption policies. This could reduce tax evasion both by increasing voluntary compliance and by better performance of enforcement mechanisms.
- Beyond improving transparency and accountability, governments should also improve the link between revenues collected and revenues spent. This will drive positive responses of taxpayers towards the governments and other relevant institutions.
- Use moral obloquy as a tool to improve collection rates. Tax evaders, cheaters and corrupted officials should be treated publicly in order to discourage shameful acts in the future. Moreover, institutions should use public campaigns and public awareness tools that stress the importance of tax payments for the same taxpayers, while tax compliance should be established as a patriotic act.
- Improve the efficiency and modernize significantly public administration; especially that part of administration that is in day-to-day contact with businesses

ON LABOR INFORMALITY:

- Increase the pressure within businesses through campaigns that promote benefits from social and pension contributions in the long run. This could increase the demand of workers for more rights.
- Work intensively on collective contracts, where certain labor rights are enforced.
- Reduce the financial burden of the current law, with a special focus on maternity leave, so that the women do not suffer from short term contracting and job discrimination.
- Enable targeted action against more vulnerable industries where employee under-declaration is more prevalent. In this case, the action should be fair and balanced towards all industries to ensure that industrial productivity does not fall as a consequence.
- Increasing the growth potential through higher earnings for informal employees. This could be executed through targeted vocational training.

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