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Interview with Nand Shani, RCC ESAP Team Leader  
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## Shani: BiH and its institutions do their share of work to tackle informal economy

There are no precise data, but according to the estimates shadow economy's share in Western Balkans (WB) economies' GDP ranges between 20% and 30%, said Nand Shani of Regional Cooperation Council (RCC) in the interview for Radio Free Europe (RFE).

Similar situation is found in Bosnia and Herzegovina (BiH) where the share of shadow economy in GDP is between 25% and 35%. According to the estimates, due to this BiH loses between 50 and 60 million euros of government revenues.

In addition to budgetary implications, countries also lose people over shadow economy because, as Nand Shani said, the lack of opportunities for finding a suitable job has an effect on system's propensity, i.e. forces young people and other workers to seek better life and better jobs abroad.

'Businesses are very sensitive to informal practices'

**RFE:** *To what extent is informal economy present in WB economies and where does Bosnia and Herzegovina stand compared to other economies?*

**Shani:** By definition informal economy is hard to measure; especially considering that it is the part of the country's economic activity that is not accounted by official statistics. There are different estimates that vary widely, depending on the methodology that is used for these estimates. However, most of them are in line and place informal economy share at about 20% to 30% of gross domestic product (GDP) in the Western Balkans economies. Specifically for Bosnia and Herzegovina, estimates range between 25% and 35% of GDP, which is relatively in line with other WB economies in terms of its size and share in GDP.

**RFE:** *To what extent do informal practices in employment impact development of business?*

**Shani:** Businesses and enterprises are very sensitive to informal practices. In order to succeed in a market businesses are competing against each other, but also against informal economy. In order to succeed these businesses require a level playing field and fair competition, favourable environment and equal treatment as well. However, given the magnitude of informality in the markets, which is relatively high, businesses from the region feel the burden of informal practices.

I will refer to a World Bank survey on enterprises which finds that almost half of all the firms in the region are competing against informal firms. One out of four businesses in the region says they feel the competition from informal firms and that this is a major impediment for their business development and does affect their business development.

**RFE:** *Does informal economy have an impact on workers' decision to leave Bosnia and Herzegovina and other WB economies and go to developed economies?*

**Shani:** As for the people who work in informal economy, major group of them use this as a survival strategy because they cannot find formal employment and therefore opt for a temporary and occasional work which will enable them to at least earn certain amount of income to make ends meet. Majority of workers working informally are found in the sectors of construction, agriculture, services, different crafts. There are also those individuals who actually voluntarily decide to participate in the informal work because of avowing to pay taxes and pocketing a larger amount of income.

There are also businesses and entrepreneurs who are knowingly avoiding paying all dues and taxes for their employees so that they can, in this process, maximise their profits. Looking at some of the recent researches in Bosnia and Herzegovina, they indicate that these are mostly young, less educated people, who come from rural areas and families that are economically in more difficult conditions. The lack of a decent job impacts the propensity of the system, forcing young people, and other workers, to look for better life and better jobs, and economic opportunities abroad.

**RFE:** *To what extent can penalties impact combating informal economy?*

**Shani:** The main aim of any policy measure is to transform undeclared work into declared work, i.e. formal economy. And I want to emphasise the word transform. The aim is not to exterminate or destroy all these jobs; these are important jobs that need to be transferred from informal into the formal economy.

The main instrument used to tackle informal work and employment is inspections, so labour inspectorates, tax inspections and other relevant inspections which conduct visits at the business or at the work site to detect informal work, and then impose subsequent sanctions.

There is a lot of research done which shows that tackling informal economy in this way will not eliminate informality completely, i.e. facilitate its transfer into formality. And this is precisely because of penalties. Penalties will only go to a certain level and what is needed are encouraging and incentive measures through relevant policies on employment or relevant bylaws, as combined they will have a more significant impact on the transfer of informality into declared work. We cannot rely on penalties alone or only on incentive measures, but should combine these to reach those working informally, raise their awareness and inform them on the benefits of declared work, to ultimately impact their conscious decision to transfer from informality into declared work.

'Focus on penalties and direct measures'

**RFE:** *How do governments from the region fight informal economy? Which one is most successful in this? Do Bosnia and Herzegovina authorities have a way to fight informal employment?*

**Shani:** There is a range of different tools for tackling informal work and informal economy. Direct tools relate to penalties and inspections focusing on detecting undeclared work. This is a repressive measure while, on the other hand, one should also directly impact the decision of those people not to work informally, showing that conducting work formally is more beneficial than working informally. Indirect tools focus on dealing with institutional failings and repairing social contract between the state and its citizens, working to increase citizens' trust in their government. Citizens who pay taxes do not see nor trust that they will have benefits in terms of services provided by public sector and its institutions which are there to work to the benefit of their citizens.

And if I make a reference to the Nordic countries, where tax levels are very high, however, the compliance is also very high. So the level of informality is very low because individuals have this relationship where there is strong trust between the individuals and the government. Individuals are willing to pay high taxes, because they know that those taxes will contribute to better public goods from which they will all benefit in their everyday lives.

Regional Cooperation Council (RCC) recently conducted 6 diagnostic reports on informal employment in the 6 WB economies where we found that all of these economies focus mainly on penalties, inspections, while less emphasis is placed on indirect measures, dealing with imperfections of formal institutions, as well as on preventive measures, implementation of awareness raising trying to build the trust of citizens in institutions and hence their decision to transform from informal economy into the formal economy. The focus is on the instruments I have mentioned earlier. These are tax administrations, different inspectorates and others that impose sanctions. They try to increase penalties, thus discouraging individuals and businesses from being involved in informal work. The focus should be placed on indirect and preventive measures.

In terms of which WB economy is more successful, I will maybe mention a couple of examples. One is the case of Serbia which has recently adopted the strategic framework for reducing shadow economy and has central coordination body that ensures cohesive and coordinated both infrastructure but also approach and strategic level to tackle informality.

Another example is in North Macedonia where last year the first Strategy for formalising informal economy was adopted, shifting the focus so as to work on formalisation through other measures, including preventive or incentive measures, and not only through punishments and sanctions. The institutions in Bosnia and Herzegovina are also doing their share of work to tackle informal economy, mostly focusing on penalties and direct measures. In recent years BiH institutions shifted a bit more to awareness raising campaigns, trying to make sure that individual workers and business become aware of the downsides of working informally.

**RFE:** *How much does, for example, Bosnia and Herzegovina lose because of undeclared work?*

**Shani:** Undeclared work is difficult to capture and also to analyse. Public budget is at a loss, whether at the level of informal workers or at level of informal companies. Workers have fewer rights, difficult conditions they work in, are exposed to mistreatment by their employers. On the other hand, companies need adequate business environment, level playing field and fair competition which they lack due to a large number of firms operating in informal economy. This leads to macroeconomic instability, because workers and companies operating in shadow economy avoid paying taxes and contributions.

As for BiH, the share of shadow economy in GDP is around 25% to 35% as the different estimates range. If the labour force in BiH is around one million people, and one would estimate between 200 and 300 hundred workers working informally, the government revenue losses would be in a range of 50 to 60 million EUR, based on a minimum salary of around 200 EUR and including the 10% personal income tax.

Likewise, the health and pension funds are at a loss. These are just some rough estimates, but one can easily see that the numbers are high, the magnitude of the problem which goes into all aspects of the economy, and that large funds do not end up where they should, as public revenues, from where they should be redistributed and returned to citizens.