

**THE CHALLENGES OF THE
INFORMAL ECONOMY IN THE
WESTERN BALKANS**

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INFORMAL ECONOMY: CONCEPT AND EFFECTS

According to the International Labour Organization (ILO), the informal economy—often referred to as the grey, shadow, or hidden economy — “refers to all economic activities by workers and economic units that are – in law or practice – not covered or insufficiently covered by formal arrangements”. It's important to clarify that it does not encompass any illegal activities. Specifically, it excludes the provision of services or the production, sale, possession, or use of goods prohibited by law. This includes the illegal production and trafficking of drugs, the illicit manufacturing and trafficking of firearms, human trafficking, and money laundering. The informal economy includes domestic work, day labour, undeclared work, and temporary or part-time employment. The ILO indicates that the informal economy accounts for more than half of the global workforce and over 90% of micro and small enterprises. Furthermore, the International Monetary Fund (IMF) estimates that more than 60% of the global adult workforce is engaged in the informal economy.

The negative effects of the hidden economy are numerous and affect both the individuals engaged in these jobs and society as a whole. For employees in the informal economy, the consequences can include a lack of healthcare and pension coverage, unsafe working conditions, irregular incomes, long working hours, and no maternity or annual leave. From a societal perspective, the negative impacts manifest as low productivity, reduced tax revenues, inadequate funding, and poor quality of public services. Additionally, informal practices can foster unfair competition and corruption. Empirical studies indicate that these issues are interconnected; for instance, a one-point increase in the corruption index is associated with a 0.253% rise in the level of the hidden economy (as a percentage of GDP). The significant presence of a large informal economy can deter reputable investors and attract those with questionable backgrounds. Additionally, the informal economy is often associated with poverty and income inequality.

While the informal economy often has a negative reputation, it also offers several positive aspects. One of the main benefits is that it creates employment opportunities for individuals who struggle to find jobs in the formal economy, especially in developing countries. This type of work provides flexibility and supports vulnerable groups, allowing them to earn an income. Additionally, working in the informal economy enables individuals to acquire essential knowledge and skills, which can lead to future opportunities in the formal job market. Moreover, during crises, the

informal economy can serve as a valuable buffer, maintaining business activity and providing goods and services.

INFORMAL ECONOMY IN THE WESTERN BALKANS

The economies of the Western Balkans have one of the highest rates of informal employment in Europe. The informal employment rate across these economies ranges from 20% to 30%, except for Albania, which exceeds 40%. Comparatively, the size of Croatia's informal economy is estimated at 29.8%. One challenge in accurately determining the proportion of those employed in the informal economy is that labour force surveys often do not include the necessary questions to effectively identify informal employment based on the International Labour Organization (ILO) definition.

The structure of informal employment significantly varies between the Western Balkans and the European Union (EU). In most Western Balkan economies, unpaid family employment represents a significant portion of informal work. In contrast, this form of informal employment is the least common in the EU. Across all economies, informal employment is most widespread in agriculture, as unpaid family workers—who are categorised as informal workers—are predominantly found in this sector.

Informal employment contracts are primarily held by vulnerable groups, such as young people, women, and the elderly. In this subregion, the research conducted by Krstić and Gashi indicates that both young people entering the labour market and the elderly, who are leaving the workforce after meeting pension requirements, are particularly impacted. Regarding the role of women in the informal economy, it is important to note that, in this subregion, women's participation in the labour market is lower than that of men. Traditional reasons, such as cultural and religious beliefs, as well as responsibilities related to home, children, and elderly family members, contribute to this disparity. Additionally, the presence of an informal economy reduces the incentives for women to enter the labour market. In Albania and Serbia, women are more likely to be informally employed. Conversely, in Bosnia and Herzegovina and North Macedonia, men comprise nearly two-thirds of those in informal employment. This trend is largely due to the higher proportion of men working in agriculture. Also, the restrictive measures linked to COVID-19 have primarily resulted in decreased revenues for informal workers in the short term. The pandemic significantly impacted the informal economy in the Western Balkans, as most individuals in this sector lacked formal employment and were thus eligible only for limited assistance during the crisis.

RECOMMENDATIONS

The most common recommendations for reducing the informal economy are:

- To improve access and quality of education because acquiring additional knowledge and improving skills can promote decent work and enhance transition to formality
- To enhance financial inclusion by promoting and expanding access to financial services. Limited access to these services often fuels the growth of the informal economy
- To reform the tax system to discourage participation in the informal economy. Implementing a simple value-added tax and corporate tax system with minimal exemptions, as well as lowering tax rates, helps to reduce informality
- To enhance the capability of tax administrations to monitor and address tax evasion
- To simplify labour market regulations, enabling greater flexibility and a smoother transition to the formal economy
- To simplify registration procedures
- To employ people from low-income households, investing in them through on-the-job training along with practical exposure to working systems.

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