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The Hidden Tax Heaven – Hidden Economy and Tax Evasion in Macedonia, Albania and Kosovo

Policy Brief Nr.39 February 2017

1. Introduction

Hidden economy practices are not always a part of, as its name suggest, low profile activities in the economy. The Panama Papers leaks have revealed a matrix of high profile tax evasion practices which have hidden much needed revenue streams towards the EU economies and towards the quantity and quality of the public services their Governments are supposed to provide. What has become clear is that there is a need for more complete cross-border transparency and international tools to deal with the problem as hidden economy and tax evasion practices are a global phenomenon despite having a local character. However, as certain EU countries (Ireland, Luxemburg) as tax havens are guided by self-interest, the move to immediately seal the cracks within the EU tax system will surely be a bumpy one.

According to 2013 estimates reported by Reuters, the European Union loses around 1 trillion EUR per year in public revenues annually due to tax evasion and fraud.[1] Given that EUs' GDP summed up to 12.7 trillion EUR in 2013, tax evasion and fraud represented an estimated 7.9% of its annual GDP in 2013. Even though replicating the same percentage of tax

Key points

- **Non-issuance of fiscal bills and Tax evasion in Macedonia are the first and second leading reasons for detected irregularities in the period of 2006-2016 (PRO).**
- **The percentage of least frequently taxed services is the largest for Kosovo (74%), second largest in Albania (65%) and third in Macedonia (54%).**
- **Percentage of respondents stating they have not received a fiscal receipt/invoice after purchasing certain goods in the past year in Kosovo is 57.1%, Albania 43%, and a low of 11.8% of respondents in Macedonia (**Error! Reference source not found.**).**
- **Macedonian revenues to GDP are at 29% in 2016, Albanian and Kosovan are at 27%. All are much lower than the EU-28 average of 45% of GDP.**
- **Non-issuance of fiscal receipts for the excise goods alcohol and tobacco (Figure 8) in 2016 sees almost a doubling in non-compliance to 20% in Macedonia. This percentage is worse in Albania (52%) and Kosovo (40%).**

[1] Francois, Lenoir, *EU losing 1 trillion euros a year to tax dodging*. Reuters (21.03.2013). Retrieved from: http://www.reuters.com/article/2013/04/12/us-eu-tax-vanrompuy-idUSBRE93B0KC20130412

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	2006	2007	2008	2009	2010/2016
Pension and disability contributions	21.2%	21.2%	21.2%	19%	18%
Health Insurance contributions	9.2%	9.2%	9.2%	7,5%	7.3%
Unemployment Insurance Contributions	1.6%	1.6%	1.6%	1.4%	1.2%
Additional Health Insurance contributions in case of accidents at work and work related injuries				0.5%	0.5%
Personal Income Tax	15%	12%	10%	10%	10%
Total Tax Burden (Macedonia)	**47%**	**44%**	**42%**	**38,4%**	**37%**

Table 1 - Rates of social security contributions in the period (2006-2016) in Macedonia. Source: KPMG (2012), the Public Revenue Office (PRO) (2014) and Trpeski, Tashevska (2012), http://www.oeconomica.uab.ro/upload/lucrari/1420122/24.pdf

evasion on non–EU countries might give an underestimated estimate it is useful for the scale and contrast that it provides. Assuming that developing countries such as Macedonia, Albania and Kosovo would have a tax evasion problem of at least 7.9% of their GDP it would mean that Macedonia loses on tax evasion around 720 million EUR annually or two times the annual budget of its Health Insurance Fund. Albania potentially loses close to 810 million EUR annually or more than 6 times its annual defense budget. Kosovo loses slightly more than 470 million EUR annually or more than 7 times the annual budget of the Kosovo Security Forces.[2] Even though these figures are just estimates they do portray the scale of non-realized budgetary revenues and the lost potential of directing those revenue to improving quantity and quality of public services.

The government doesn't really have the resources to track down every individual or business that employs different tactics of tax evasion. What the government is keeping track of is lost revenues. According to the Internal Revenue Service in the USA, about $500 billion in taxes were lost last year because of unreported wages, versus $384 billion in 2001. (CNBC, 24.04.2013)

Tackling tax evasion and fraud, being just a part of the policies targeting hidden economic activities, is not just a way to increase government revenues, but also a way to increase the fairness of the tax system, and improve tax acceptance and trust among its citizens and businesses, promote human rights, and enable appropriate protection to the most vulnerable in our societies.

2. Tax Rates, Revenues and Tax Evasion

There are wide regional and country differences in the size, scope and main sectors of operation of the undeclared economy in Europe which, according to Eurofound figures, averages around "18% of EU GDP, ranging from below 8% of GDP (Austria) to over 30% of GDP (Bulgaria). Undeclared work is most prevalent in the building industry, but is also widespread in household services, private security, industrial cleaning, agriculture, and the hotel, restaurant and catering industry."[3] Unavoidably the policy and economic landscape of the country in question creates particular sets of incentives which then produces specific costs and benefits to engage with the hidden economy. Uncovering those specific

[2] The estimates are made by contrasting the 7.9% tax evasions with the 3 countries nominal GDPs for 2015.

[3] European Parliament News (02.02.2016) "European platform to tackle undeclared work." Accessed 19.07.2016 <http://www.europarl.europa.eu/news/en/news-room/20160129IPR11935/European-platform-to-tackle-undeclared-work>

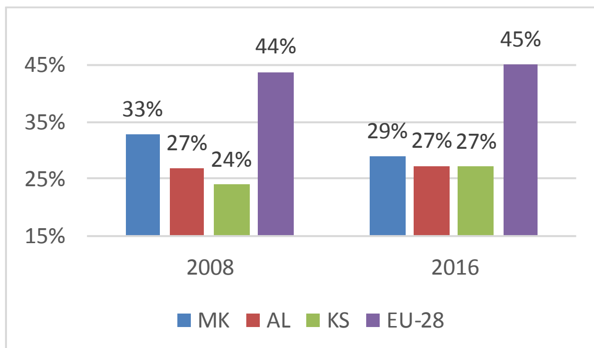
	Albania	Macedonia	Kosovo
Social security contributions (total rate)	27.9% (11.2% employee rate, 16.7% employer rate)	27% (13.5% employee rate and 13.5% employer rate)	10% (5% employee rate and 5% employer rate)
Corporate income tax	15%	10%	10%
VAT	20%	18%	18%
Individual income tax	Progressive rate **0%**, **13%** and **23%**	Flat rate 10%	Progressive rate **0%** (0-80 eur), **4%** (81-250 eur) and **10%** (> 450 eur)

positive and negative incentives inherently leads to policy solutions.

Tax evasion follows this distinctness among countries which is generated, among other factors, by the specific social and healthcare insurance systems, tax rates, efficiency of its tax authorities and adopted compliance measures, awareness, as well as trust in government institutions.

Comparing levels of government revenues as a share of GDP or per capita across countries, provides an indication of the importance of the public sector in the economy in terms of available financial resources and is determined by past and current political decisions a government takes. General government revenues can also be used as an indicator undeclared activities in the informal economy or how much of the economic activity escapes government oversight and taxation, especially in developing countries. **Macedonian revenues to GDP are at 29% in 2016, Albanian and Kosovan at 27% which are much lower than the EU-28 average of 45% of GDP (Figure 1).** Even though it is understandable for most of developing countries to have such a low revenues-to-GDP ratio it is a worrying prospect if that ratio does not improve during the course of 8 years. Even more so, Macedonia experiences a worsening of the revenues-to-GDP ratio from 33% in 2008 to 29% in 2016 despite the positive movements in its economy, increased FDIs, increases social security and healthcare contributions, and increased tax revenues. Revenues-to-GDP ratio has remained the same in the past 8 years while the Kosovan experiences a slight improvement from 24% in 2008 to 27% in 2016.

Figure 1 – General Government Revenue as % of GDP. Source: IMF World Economic Outlook https://knoema.com/IMFWEO2014Apr/imf-world-economic-outlook-april-2014?tsId=1025200



Macedonia

Mojsoska-Blazevski's (2011)[4], research on the influence of labour legislation changes over the employment rate and the size of the informal economy showed a marginal effect of the flat tax policy. The author finds that '**the reduction of social security contributions had a positive impact on the employment rate, in contrast with the impact of the flat tax reform**.' She concludes that the social security and tax reforms aimed at reducing labour costs had the following positive

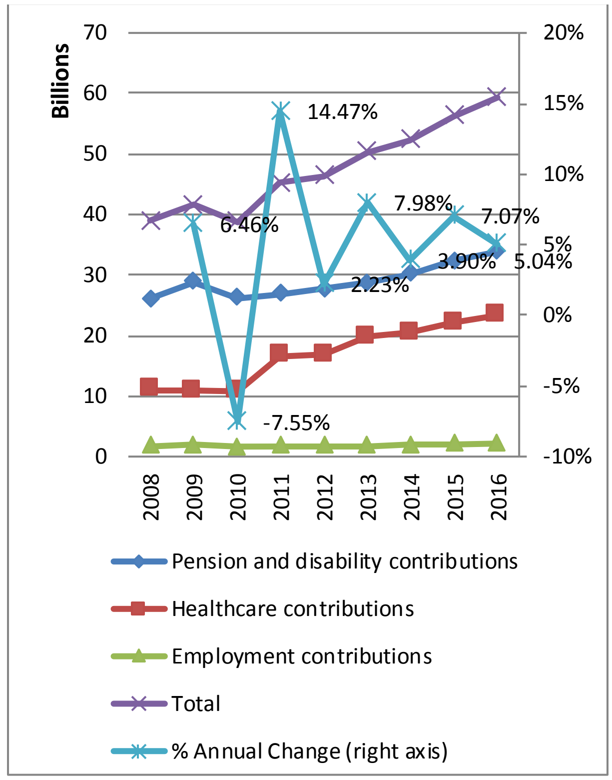
[4] Dzhekova, Franic, Mishkov, C. Williams (2014), "Tackling the Undeclared Economy in FYR Macedonia" GREY Working Paper No. 3, University of Sheffield. Retrieved from: http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf

effects: (a) helped employees during the crisis, (b) had an effect on employment, (c) increased the net wage, (d) diminished the extent of informal economy, (e) improved tax compliance, the and (f) increased the number of individuals insured in the pension system.[5]

The overall tax burden in Macedonia remains low in the period of 2010-2016. However the tax burden remained relatively high in particular for low skilled labour, "caused by the minimum base for payment of social insurance contributions, which was prescribed at 65% of the national average wage rather than on the individual wage and at around 50% for health insurance on average (differentiated by branches, with higher relative burden on branches with lower average wages)"[6].

Looking at the statistical data (Figure 2) coming from the Public Revenue Office (PRO), a **positive trend has been evident in tax revenues from pension and disability, and healthcare contributions,** especially since 2008 with an average annual increase of total contributions by 4.95%. However, revenues from pension and disability contributions and employment contributions have not increased dramatically. In fact, throughout the 2008-2016 period, the annual revenues increased by a total of 29% and 20% respectively since 2008 and remain at average annual values of 29 billion MKD (471 mln. EUR) and 1.8 billion MKD (29.2 mln. EUR) respectively. The positive trend in total tax revenues from social security contributions stems predominantly from the rapid increase in revenues from healthcare contributions, which in 8 years has more than doubled from 11 billion MKD in 2008 to 23 billion MKD in 2016. This could be attributed as a positive effect of the consecutive amendments applied to the *Law on Mandatory and Social Security Contributions* (LMSSC).[7]

Figure 2 - Tax revenues from social security contributions for the period (2008- 2015). Source: Public Revenue Office of Macedonia.



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

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

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

Figure 3 - Tax collection rates of the Public Revenue Office and Customs Administration in Macedonia (In bln. MKD). Source: The PRO http://ujp.gov.mk/mk/statistika/naplata/1/0/0 and Customs http://www.carina.mk/DesktopDefault.aspx?tabindex=0&tabid=57

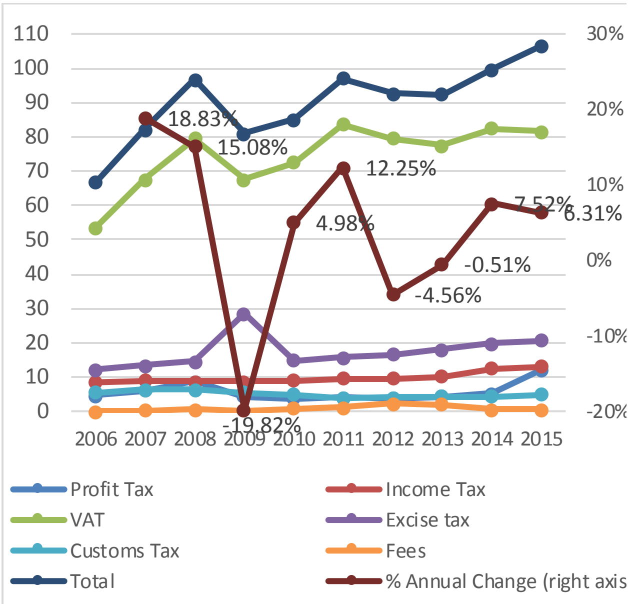
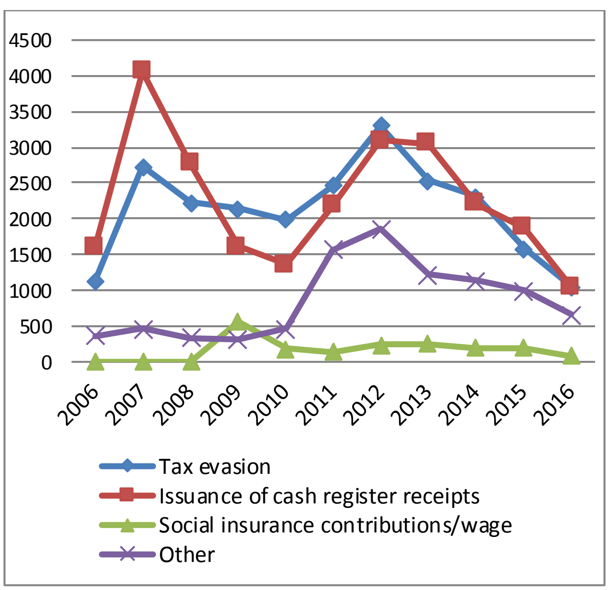


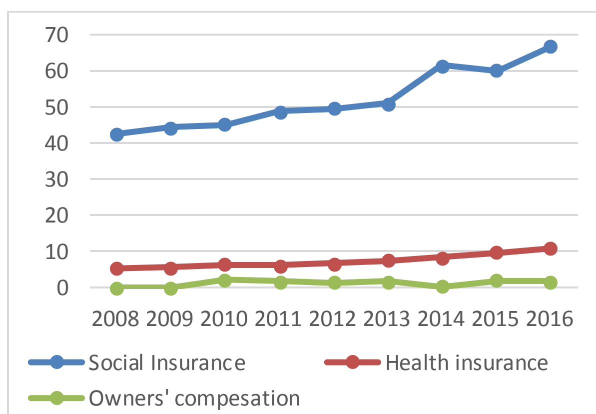
Figure 4 - Reports of irregularities through the Macedonian PRO's hot line (198) and E-report. Source: PRO statistics http://ujp.gov.mk/mk/statistika/naplata/9/0/0



Albania

Since 1997 Albania is making efforts to establish a system of taxes and fees according to EU member countries. A flat tax rate of 10% as well as other fiscal facilities were implemented 2008, which lead to an increasing overall tax revenue at least till 2011. However it must be noted (as in Figure 1) Revenues as a % of GDP have decreased or remained the same since 2008 or at 27% of GDP. In 2013 Albania's new elected government signed a three-year agreement with the International Monetary Fund (IMF), cash securing in exchange for obligation to tighten fiscal discipline[8]. This support helped to reverse the decreasing tax revenues that Albania experienced in the period 2011-2013, mainly through an increase of revenues coming from social contributions and profit tax. Tax rates were enhanced across the board such as corporate taxes, from 10 to 15% as well as the excise taxes. In 2014 the personal income tax was changed from a flat tax rate to a progressive tax rate system. Because 60% of the taxpayers are below the zero-rate threshold, this reform weakened revenue collection.

Figure 5 - Tax revenues in Albania from social security contributions for the period (2006- 2015) in bln. leki. Source: Ministry of Finance of Albania



The increase in excise duty rates for tobacco and gasoline products in 2015, didn't have an

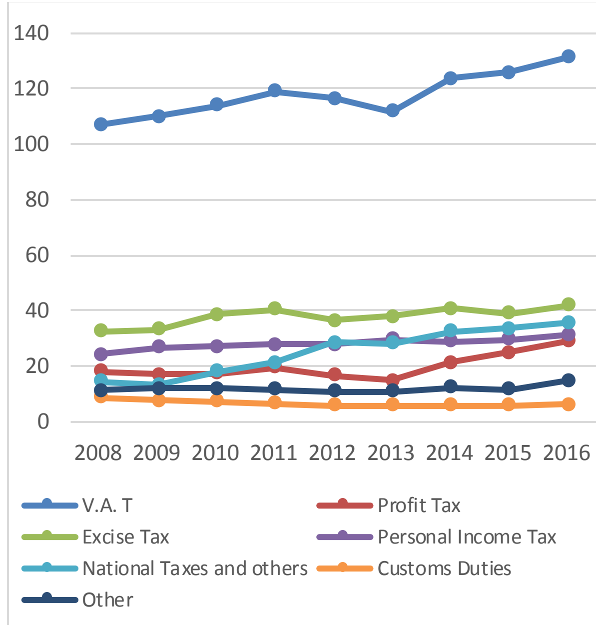
[8] Balkan Insight: [http://www.balkaninsight.com/en/article/albania-government-starts-major-crackdown-against-fiscal-evasion-09-01-2015 - sthash.Y4xeKWdm.dpuf](http://www.balkaninsight.com/en/article/albania-government-starts-major-crackdown-against-fiscal-evasion-09-01-2015)

increasing effect on tax collections. The reason for this might be the anticipation of duty raise and therefore noncompliance of imports and exports or, less likely, simply a decrease in consumption of those goods. The government decided in the 2016 budget law to abrogate the small business tax as well as exempt small and micro businesses from profit taxes, which will likely decrease tax collections but stimulate economic processes.[2] Because of the low tax efficiency, numerous tax exemptions and challenges with tax compliance, tax revenues are expected to slightly increase until 2019.[9]

Tax Evasion

The state of tax evasion in Albania is not clearly identifiable, mainly because there are no accurate statistics or reports of the responsible institutions[10]. Due to the developing bureaucracy and high volume of cash transactions, it is difficult to collect the necessary data.[11] According to the International Monetary Fund, the VAT noncompliance derived from C-efficiency can be taken as approximation to tax evasion. They estimate a compliance gap of 34-39% of the potential VAT[2], which is slightly higher than the regional average and has an increasing trend since 2008. Potential VAT revenues for EU countries is 15 %. This increasing trend seems to be caused by worsening compliance, mostly because of substantial smuggling and fraud in excise duties in Albania such as road fuels and cigarettes.

Figure 6 - Tax collection rates in Albania of the Public Revenue Office (In bln. Leki). Source: Ministry of Finance of Albania.



Albania's black economy is estimated to be at 33% of the GDP[12] in 2014, which is largely above the European average of 18.6%.[13] In September 2015, the government launched a campaign against informality aiming to address the tax evasion issue, particularly through better control, registering employees and small business as well as countering tax compliance. Although it was highly expected from main actors, due to its severity and focus on small businesses it did not have the expected results and contributed to the deterioration of the business climate in the country. Currently the approach of tax office has changed, being more collaborative and focused mainly on risk analyses.

[9] International Monetary Fund, Staff Report Albania 2016, https://www.imf.org/external/pubs/ft/scr/2016/cr16142.pdf

[10] Hysen Muceku, Altin Muca, 'Informal Economy in Albania – Its Costs in the Country Development' (2014) 5(9) Mediterranean Journal of Social Sciences 642, 64

[11] International Monetary Fund, Albania June 2016 https://www.imf.org/external/pubs/ft/scr/2016/cr16143.pdf

[12] Bright Line Law: An insight into tax evasion, money laundering and the Albanian black economy 2016 (https://www.brightlinelaw.co.uk/Latest-News/An-insight-into-tax-evasion-money-laundering-and-the-albanian-black-economy-1.html)

[13] Shadow Economy and Tax Evasion in the EU, Schneider 2014 http://www.econ.jku.at/members/Schneider/files/publications/2015/JournalofMoneyLaunderingControl.pdf

The complexity of the tax system places a substantial burden on business. The number of tax payments and hours needed to pay taxes are 19 and 43%, respectively, higher than the Western Balkan average. General government revenues, both tax and non-tax, are lower in Albania than the ones experiences by its neighbors. Consequently, public spending is rather parsimonious.

The tax burden is lower in Albania than in most other Balkan economies at least up until 2014. Compared with most neighboring countries, the Albanian tax collections are modest for most of the main tax sources. In particular, income taxes, property taxes, and above all social security contributions are substantially lower in Albania. Only revenues raised by VAT and CIT approach levels that are in line with those of comparator countries. Therefore, Albania relies as much on indirect taxes as on direct taxes: the share of VAT and excise tax revenues of total tax revenues is about 49%.

Albania's lower tax revenues are partly a consequence of the lower efficiency of taxes on wages (Figure 6). Tax efficiency is the ratio between each tax revenues for each tax (in percent of GDP) and the top tax rate. Tax efficiency for social security contributions and personal income tax appears to be lower in Albania than in other Balkan countries. For corporate income and value added taxes, tax efficiency in Albania is roughly in line with neighbors' performance, but there is a broad range of results.[14]

Kosovo

In 2009 Kosovo becomes a member of the International Monetary Fund (IMF) and signed a „Stand-By Arrangement", which will assure the support of Kosovo as well as establish the obligation of meeting numerous quantitative performance criteria. With this arrangement, tax laws for VAT, personal income tax and corporate income taxes were approved and workshops for taxpayers in all regions were implemented which have helped taxpayers to adjust to the amended tax legislation and the derived obligations.[15] Together with the installation of the Electronic Cash Registrars (ECR), which announced an obligation of registering cash money electronically, the overall tax revenues increased strongly and steadily. A big share is due to VAT which was increased in 2009 from 15% to 16% and in 2016 to 18%.[16]

Because Kosovo relies heavily on indirect taxes collected at the border and has only a share of 14% of direct taxes, the Tax Administration Office recommended in 2011 to increase direct taxes. This included broadening tax bases for corporate income tax (otherwise a flat corporate income tax CIT) and an increase of the progressivity of personal income taxes (PIT), which could explain the changes in this year. [17] Both were set at 10% in 2013 from where the revenues remained increasing and had to compensate a minor decline in revenue collection from adverse price developments which affected the value of imports and thus lowered customs receipts.[18]

The Revenue in 2016 should have benefit from higher excises taxes (tobacco, alcohol and road fuels) and increase in V.A.T. from 16 to 18% of this year,[19] as well as a new approach of mobilization of non-tax revenues. Due to the relatively positive growth performance of Kosovo's economy – even though not optimal for a developing country, tax

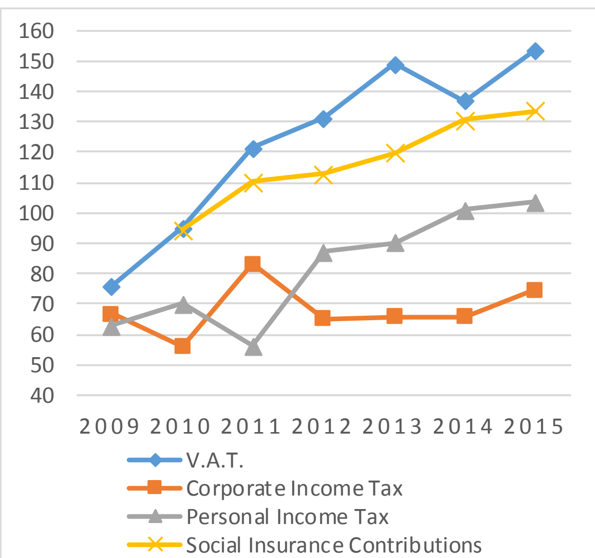
[14] IMF-Albania taxation
[15] Tax Administration of Kosovo, Annual Report 2010, http://www.atk-ks.org/wp-content/uploads/2010/09/Raporti-Vjetor-2010_v_fundit_shtyp_ENG.pdf p. 18
[16] Vat Live, VAT news (16.09.2015) http://www.vatlive.com/vat-news/kosovo-raises-vat-to-18/
[17] International Money Fund, Staff Report 2011 http://www.imf.org/external/pubs/ft/scr/2011/cr11374.pdf
[18] International Money Fund, Staff Report 2013 http://www.imf.org/external/pubs/ft/scr/2013/cr13379.pdf
[19] International Money Fund, Staff Report 2016, http://www.imf.org/external/pubs/ft/scr/2016/cr1622.pdf

revenues are expected to be maintained at stable rates of increase until 2020.[20]

Social Contribution and Tax Evasion

In 2012 there was a growing recognition that the social and pension support system needs to be reformed. The costs of certified and new war veterans together would exceed the affordable. These pension schemes were also discouraging employees from keeping their jobs, looking for jobs or truthfully declaring their income.[21] The year of 2017 will be the first time that health insurance contributions and not only pension contributions will be mandatory. The health insurance contribution will be in the amount of 7% of the gross income, equally shared by employer and employee of 3.5% and this is expected to strongly enhance the revenues.[22]

Figure 7 - Tax and social security contributions revenues in Kosovo for the period (2009 - 2015). Source: Kosovo Agency of Statistics, Tax Administration of Kosovo, Ministry of Finance of Kosovo.



Data about tax evasion is so far not clearly detected, mainly because of the still developing bureaucracy system, high volume of cash transactions and citizens fearing to report noncompliance and lose their current jobs. The authorities though are advancing in developing a centralized procurement system to detect corruption, and to improve governance by making public expenditures and revenues more efficient.

Social insurance system bares its own local marks and it is somewhat complicated. Just as is the case with Macedonia, Kosovo pension system consists of 3 pillars which differ mostly by the model of funding and the population strata that it is designed to cover:

- **The First Pillar** - is a means-tested basic social assistance scheme which is also applicable to the elderly. This pillar is integrated into the Central Government and its financing and functioning resembles the most pay-as-you-go (PAYG) one pillar state funded pension funds. Pension expenditures under this scheme are considered to be social benefits.

- **The Second Pillar** - is a mandatory pension funded scheme. This scheme was implemented from August 2002, when big employers and national agencies were mandatory for contribution. Since 2003 the mandatory saving scheme is expanded in order to cover all the employers of Kosovo and the self-employed. Unlike Macedonia, where these funds are managed and matured through conservative investment strategies two private insurance companies, in Kosovo the Mandatory pension savings are administrated and managed by the Kosovo Pension Saving Trust. KPST handles pension contributions amounting to 10% of

20 Policy Report Pension System Kosovo 2012 http://legalpoliticalstudies.org/download/Policy Report 06 2012 eng.pdf

21 KPMG Tax News Kosovo (21.12.2016): https://home.kpmg.com/al/en/home/insights/2016/12/tax-news-kosovo--new-administrative-instruction-on-the-implement.html

22 Loxha Arberesha, Group for Legal and Political Studies (06/2012) "Pension System in Kosovo: review of current state, main challenges and gaps" http://legalpoliticalstudies.org/download/Policy Report 06 2012 eng.pdf

gross wages from both, **employers and employees (5% + 5%),** as well as the self-employed: 10% of the earned income. KPST also invests these assets in long term and stable financial instruments.

- **The Third Pillar** – Is a voluntary scheme funded for those who wish to invest more in their social security. This scheme is optional for business and other financial institutions and can be funded either from employers' contributions or employees.[23]

Even though tax rates and the way the social insurance system is set up is important in determining the incentives that define the hidden economy, and more so tax evasion practices, without proper enforcement and awareness raising mechanisms the incentives to evade taxes unavoidably prevail as economic subjects seek ways to be more competitive. Without doubt market competition is a positive and a desirable condition in our economies as long as the economic entities play by the same established rules and laws and respect the principles of fair competition. A study in Kosovo (2013) on informality of businesses, found that almost 62.7% of companies are certain that if they decide to evade taxes they can easily do so without getting caught. Surprisingly however, in terms of tax audit intensity, 37.3% of the respondents believe that there is a high or very high chance of getting caught evading taxes.[24] Presumably they are relying on the well-established hidden economy practice of bribing the tax inspector. The situation is much alike other SEE countries.[25]

The lack of human resources prevents SEE governments from effectively monitoring tax and customs officers' operations. The absence of monitoring, interconnectedness and automated information sharing among relating government agencies increases the likelihood of tax and customs officers being involved in corrupt practices. These in turn frequently relate to hidden economic practices of business entities. While Bulgaria (currently and in the past), Croatia and Macedonia (recently) and Albania (planned) focus on technology, Montenegro and Kosovo focus on raising awareness about public finance and tax compliance through various campaigns. These campaigns have aimed at involving the general public in a larger scale, and promote soft enforcement of integrity rules. The public, however, seems to be sufficiently aware and sensitive when it comes to corruption among tax officials: a quarter of the respondents in SELDI's survey believed that almost all tax officers were involved in corruption and 37% thought that most of them were involved.[26] The only available, tax gap estimate (for the fiscal years 2011 and 2012), is based on Schneider's Shadow Economy estimates for the Western Balkan countries, and was produced by Harremi. A subsequent consultancy report by AL-Tax Centre from Albania, which resembles the former in methodology, but with no direct reference to it, presented its second tax gap assessments in the region for the fiscal year 2013. Macedonia tops the group with a gross tax gap of 29.2% of GDP, but due to differences in the cost of enforcement and possibly the tax refund system, three countries are at the top in terms of net tax gaps – Macedonia, Montenegro and Kosovo, with 25.9 % of GDP.[27]

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[23] Balkan tax report http://www.norway-kosovo.no/NR/Balkan%20Taxation%20report.pdf

[24] RIINVEST Institute (2013) "To pay or not to pay – A business perspective of informality in Kosovo". http://www.riinvestinstitute.org/uploads/files/2016/October/17/BUSINESS_INFORMALITY_5mm_bleed_no_inside_ENG_FINALV_313964385731476693005.pdf

[25] SELDI (2016) "Shadow Power – Assessment of Corruption and Hidden Economy in Southeast Europe" http://seldi.net/publications/publications/shadow-power-assessment-of-corruption-and-hidden-economy-in-southeast-europe/

[26] Ibid

[27] Hidden economy assessment report, CSD. Also available at SELDI's hidden economy country fact

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).[28]

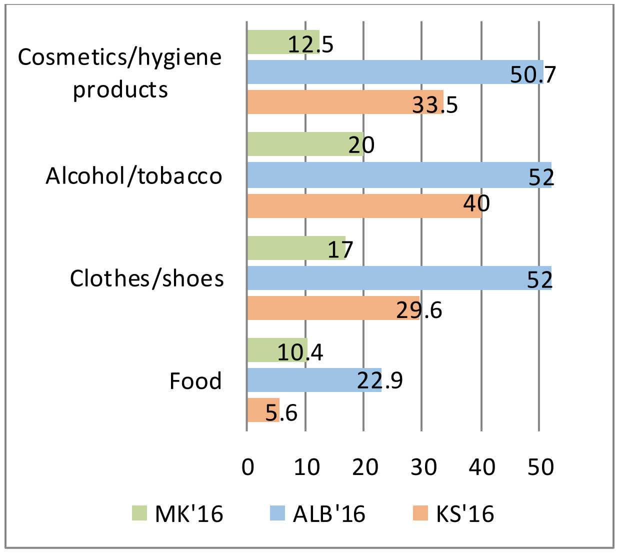
However, low taxes do not by default imply a small informal sector, as there are many other factors that help determine whether firms choose to operate informally. In this regard, strengthening of the tax administration is necessary to broaden the tax base and ensure consistent tax collection.

Simplifying procedures respectively shortening of the time and cost to start a business, especially at the municipal level; Outlining of procedures and strengthening of administrative capacity that relates to the regulatory regime of doing business, especially with regard to business licensing and construction permits as well as a range of measures are issues that require a quick government response. This is something that is foreseen in the SME Development Strategy for Kosovo 2013-2017 compiled by the Ministry of Trade and Industry (MTI).[29]

3. Survey Results

There are vast differences within the three countries when it comes to issuing fiscal receipts for purchased basic products/groceries. In particular, the non-issuance of such receipts is especially prevailing in Albania, somewhat less in Kosovo, and the least frequent in Macedonia. Apparently, cosmetics/hygiene products, alcohol/tobacco and clothes/shoes are the most likely products to be sold without being taxed, while food is most likely to be taxed, especially in Macedonia and Kosovo (See Figure 8).

Figure 8 - % of respondents stating they've rarely or never been issued fiscal receipts for purchased products during the past month. Source: Population survey CRPM/IDM/D4D 2016 Q.25 (population).



Macedonia in 2016 in terms of non-issuance of fiscal receipts for the excise goods alcohol and tobacco (Figure 8) sees almost a doubling in noncompliance from 12% in 2014 to 20% in 2016. This is important as it can indicate lost revenues, inefficient inspections (especially in the Customs Administration), and consequent profilferation of contraband and smuggling of these types of highly taxed goods. The situation in Albania however seems more grave and worse than the other two countries with more than 50% of the repspondents stating that they have rarely or never received fiscal receipts for **a)** cosmetics/hygene products, **b)** alcohol/tobacco, **c)** clothes/shoes.

However, when it comes to issuing receipts for received services, the situation is rather grave in all three countries. Figure 9 shows the average percentage of respondents stating that they have

sheets (2016) http://seldi.net/publications/publications/hidden-economy-fact-sheets-2016/

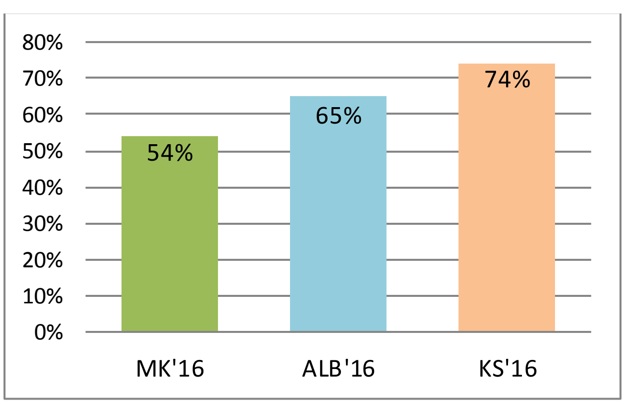
[28] RIINVEST Institute (2013) "To pay or not to pay – A business perspective of informality in Kosovo". http://www.riinvestinstitute.org/uploads/files/2016/October/17/BUSINESS_INFORMALITY_5mm_bleed_no_inside_ENG_FINALV_3139643857314766930 05.pdf

[29] Ministry of Trade and Industry of Kosovo "Private Sector Development Strategy 2013-2017" (2013) http://www.kryeministri-ks.net/repository/docs/PRIVATE_SECTOR_DEVELOPMENT_STRATEGY_2013-2017.pdf

not received fiscal receipts for (some of) the 13 outlined services in the questionnaire. The percentage of least frequently taxed services is the largest for Kosovo (74%), second largest in Albania (65%) and third in Macedonia (54%).

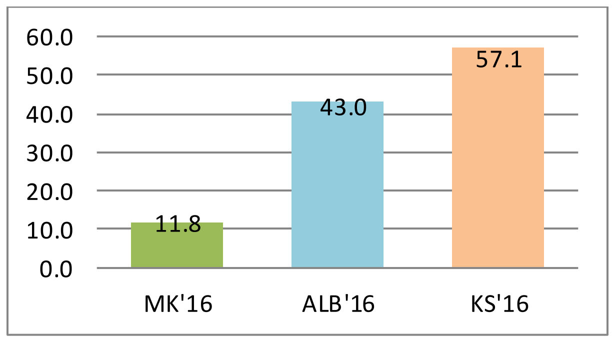
However, there are vast differences with regards to the type of service. Specifically in Macedonia receipts are most frequently given (85%) for **a)** professional services (accountants, psychologists, architects, etc.) and **b)** transportation services (75%); while least frequently given for: **a)** repairmen/auto mechanic services; **b)** household maintenance (17%); **c)** renting assets/premises (30%); **d)** craftsmen services 36% (hairdressers, tailors/seamstresses, beauticians). In Albania fiscal receipts are most frequently given for **a)** Catering and restaurant services (84%) and **b)** transportation services (66%) while least frequently given are for: **a)** household maintenance (6%); **b)** home repair (8%); **c)** renting assets and premises (11%); **d)** senior and child care services (15%). It is similar in Kosovo with most frequently issued receipts being for **a)** catering and restaurant (77%) and **b)** transportation services (47%). The least frequently given receipts for services on Kosovo are for: **a)** vehicle and electronics repair (6%); **b)** home repair (11%); **c)** renting assets and property (14%); **d)** senior and child care services (15%).

Figure 9 - % of respondents stating they haven't received receipt for purchased services during the last three months. Source: Population survey CRPM/IDM/D4D 2016 Q.26B (population).



Finally, when it comes to purchasing larger goods (such as cars, furniture, technical equipment etc.), the frequency of issuing of fiscal receipts/invoices is the lowest in Kosovo with 57.1% of respondents, somewhat better in Albania with 43% of respondents and rather good in Macedonia with just 11.8% of respondents (**Error! Reference source not found.**).

Figure 10 - % of respondents stating to have not received a fiscal receipt/invoice after purchasing certain goods in the past 2 years. Population survey CRPM/IDM/D4D 2016 Q.24 (population).



It seems as if the continuous fiscal reform in Macedonia since 2007, has resulted in strengthened control over sellers of goods and services, and increased awareness of the importance of issuing fiscal receipts and their connection to quantity and quality of public services.

Regardless of the differences in issuing receipts and paying taxes for goods and services, the perceptions regarding the usefulness of taxes do not differ to the same extent. Specifically, the vast majority of respondents (especially in Albania) agree with the statement that "Unpaid taxes negatively influence the local economy", showing understanding of the importance of taxes (Figure 11). However, somewhat contradictory (Figure 12), 16% of respondents from Macedonia and Albania also stated that "Not paying taxes should be tolerated" (more frequently selected by respondents with lower household income), indicating that although considered important for the local economy, the tax morale is still relatively low in all three countries.

Figure 11 - (Dis)agreement with the statement "Unpaid taxes negatively influence the local economy." Population survey CRPM/IDM/D4D 2016 Q.MK11B (population).

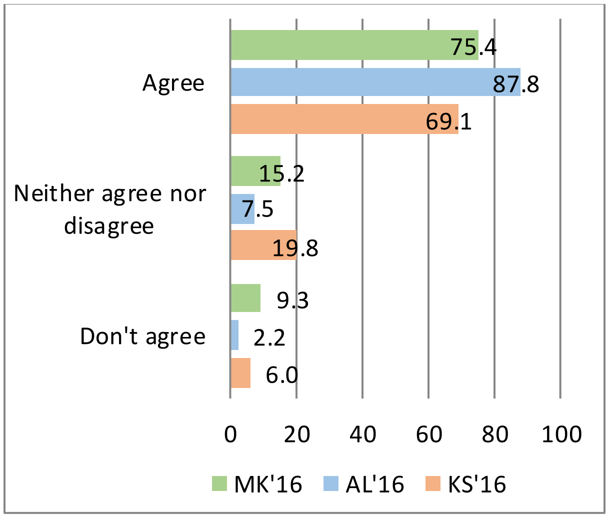
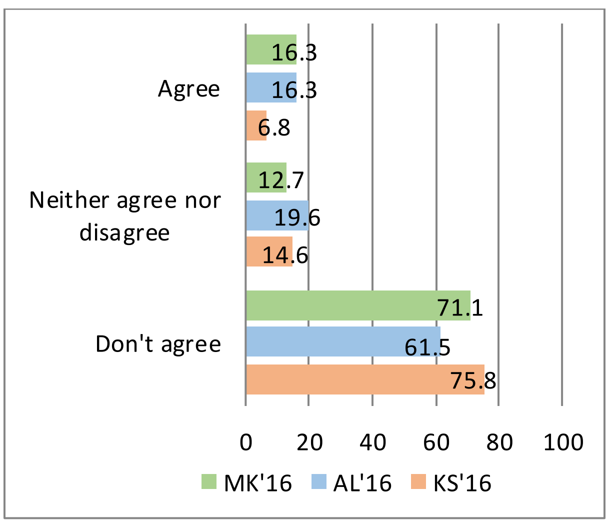


Figure 12 - Dis(agreement with the statement "Not paying taxes should be tolerated." Population survey CRPM/IDM/D4D 2016 Q.MK11G (population).



4. Conclusion

The tax burden, one of the many factors that contribute to tax evasion, is the first front where public policies should, and very often are, targeted in order to change a system that gives incentives for engaging in tax evasion and fraud. The tax burden relates not only to the amount paid but also to the ease of, and difficulties involved in, paying such tax and social security contributions.

Non-issuance of fiscal bills and Tax evasion in Macedonia are the first and second leading reasons for detected irregularities in the period of 2006-2015 (PRO). The percentage of least frequently taxed services is the largest for Kosovo (74%), second largest in Albania (65%) and third in Macedonia (54%).

Percentage of respondents stating they have not received a fiscal receipt/invoice after purchasing certain goods in the past year in Kosovo is 57.1%, Albania 43%, and a low of 11.8% of respondents in Macedonia (**Error! Reference source not found.**). As far as awareness goes and the importance of taxes being paid the results show that on average more than 3 quarters of the respondents in Macedonia, Albania and Kosovo agree that unpaid taxes negatively influence the local economy and disagree with the statement that not paying taxes should be tolerated.

The governments of Macedonia, Albania, and Kosovo have to continue reforming and investing in the operational capacities of the main institutions responsible for curbing tax evasion and undeclared labor such as Public Revenue Office, the Financial Police, the State Market Surveillance Inspectorate and State Labor Inspectorate especially in the fields of performance assessment, electronic interconnectedness, data sharing, and electronic services for individuals and businesses. As the available research shows it is not just the level of tax rates that affect the spread and scope of tax evasion and undeclared labor but also the ease of doing/formalizing business and the ease of fulfilling administrative procedures. These depend greatly on the government efforts of simplifying, reducing and streamlining procedures, especially the ones that provide unintended incentives for informality.

Increase tax compliance readiness: Social security currently does not pay off in the eyes of private employers and employees and this is a decisive factor for evasion. Simultaneous reduction of the cap and rates of social security with increase of the base of those paying could be helpful. Data from Macedonia already suggests that reducing rates for social insurance might actually increase revenues through higher compliance.[30]

It is also necessary **to increase the capacity of the administration** to detect non-compliers and to collect its debts. This could include introduction of **risk management system** (selectively inspecting those with the highest potential negative impact), but the most important measure would be to unify the tax administration with that responsible for social security contributions collection. Additionally, the level of enforcement of regulations in all three countries needs to be strengthened in order for effects to take place.

All three countries must improve the way **remittances are measured and assessed** by the state authorities, as the official transfers (accounted through the International Transaction Reporting System) represent only a small fraction of all remittances.

It is necessary **to simplify and reduce transaction costs associated with remittances** to reduce their hiding. Sending remittances home officially is usually extremely expensive and regressive. But, still, whatever way people find to send money home it still could be optimized through a modern financial system and the cost differential to be used for socially productive purposes.

[30] **Shurkov, E, Mickovska R.A.**, (2014) "Hunting the Shadows – Tax Evasion Dynamics in Macedonia" Policy Brief Nr. 33, Dec. 2014. Retrieved from: http://www.crpm.org.mk/wp-content/uploads/2015/03/PolicyBrief33_ENG.pdf

5. Tables with macroeconomic indicators on Macedonia, Albania and Kosovo

MACEDONIA	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Indicator (MKD million unless otherwise stated)	**FY 2006**	**FY 2007**	**FY 2008**	**FY 2009**	**FY 2010**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015***
Labor Market										
Unemployment Rate (%)	36.0	34.9	33.8	32.2	32.0	31.4	31.0	28.6	28.0	26.1
Youth Unemployment Rate (%)	59.8	57.7	56.4	55.1	53.7	55.3	53.9	51.9	53.1	47.3
Long-term Unemployment Rate (>12 months)	86.3	84.9	84.9	81.9	83.3	82.6	82.1	82.5	83.4	81.6
Productivity				-3.6	2.1	1.0	-1.3	-1.6	2.0	
Labor Force	891,680	907,141	919,425	928,774	938,294	940,048	943,055	956,058	958,997	954,924
Labor Force Activity Rate	55.1%	55.7%	56.3%	56.7%	56.9%	56.8%	56.5%	57.2%	57.3%	57.0%
Average Net wages (MKD)	13,518	14,586	16,095	19,958	20,554	20,848	20,903	21,146	21,394	21,904
Average Gross wages (MKD)	23,037	24,140	26,228	29,923	30,226	30,603	30,670	31,026	31,325	32,171
Nominal net wages (annual % change)		7.3	9.4	19.4	2.9	1.4	0.3	1.2	1.2	2.3
Real net wages (annual % change)		4.6	8.0	12.4	1.0	1.2	0.2	1.1	1.0	2.6
GDP, Trade and Revenues										
GDP (Current Prices Mln MKD)	334,840	372,889	414,890	414,622	437,296	464,186	466,703	501,891	525,620	560,148
Export Total (Mln USD)	2,415	3,398	3,991	2,708	3,351	4,478	4,015	4,298	4,964	4,490
Import Total (Mln USD)	3,752	5,281	6,883	5,073	5,474	7,027	6,522	6,620	7,301	6,400
Final Consumption Expenditure	319,975	351,065	403,225	397,304	410,328	427,192	431,883	447,970	456,372	472,845
Household Final Consumption Expenditure	264,690	288,408	326,125	318,213	330,344	343,080	344,852	360,115	367,729	379,290
Public Final Consumption Expenditure	55,285	62,657	77,100	79,092	79,984	84,112	87,031	87,855	88,643	93,555

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Gross Fixed Capital Formation	71,683	88,421	115,890	106,734	106,999	124,926	135,003	144,584	160,081	178,492
FDI Total (mln MKD)	21,207	31,117	25,178	8,419	9,649	21,193	8,063	14,108	12,140	10,498
FDI Total (mln EUR)	344.8	506.0	409.4	136.9	156.9	344.6	131.1	229.4	197.4	170.7
Profit Tax	4,710	5,896	8,579	4,435	3,691	3,888	3,655	4,419	5,060	12,024
Income Tax	8,414	8,891	8,696	8,707	8,872	9,513	9,553	10,255	12,321	12,909
VAT (The PRO)	27,240	32,962	36,174	35,178	37,694	42,223	38,468	39,835	43,859	41,694
VAT (Customs)	26,400	34,500	43,400	32,511	34,814	41,322	41,041	37,741	38,513	44,492
Excises	680	890	1,000	14,730	14,670	15,559	16,630	18,064	19,695	20,721
Customs Tax	5,600	6,400	6,400	5,409	4,760	3,779	4,066	4,255	4,222	4,843
Credit and Deposit Market										
Credit Growth Rate (%)					7.1	8.5	5.4	6.4	10.0	9.5
Household Credit Growth Rate (%)					5.1	8.1	6.5	10.2	11.8	12.9
Enterprises Credit Growth Rate (%)					8.4	8.6	4.5	3.8	8.6	7.1
Bad Loans Rate (%)	12.9	9.3	6.8	8.1	9.9	9.5	10.3	11.7	11.5	11.3
Deposit Growth Rate (%)					13.7	9.2	4.9	6.1	10.4	6.3
Household deposits (%)					17.4	12.0	7.2	6.7	8.9	4.1
Enterprises deposits (%)					6.4	6.1	-2.0	4.1	15.0	10.2
Debt, Deficit and Inflation										
Public Debt	30.6	23.5	20.5	23.6	24.1	27.7	33.7	34.0	38.2	38.0
Public Debt (incl. other debt)	33.2	25.8	23	26.2	27.2	32.0	38.3	40.3	46	46.5
Budget Deficit (%)	-0.5	0.6	-0.9	-2.6	-2.4	-2.5	-3.8	-3.8	-4.2	-3.5
Inflation Rate CPI (%)	3.2	2.3	8.3	-0.8	1.6	3.9	3.3	2.8	-0.3	-0.3
NBRM FX reserves (mln EUR)	1,416.7	1,524.4	1,494.9	1,597.5	1,714.5	2,068.9	2,193.3	1,993.0	2,436.5	2,261.8
Non-Observed Economy NOE (as % adjustment of GDP)			20.1	21.0	19.6	20.0	19.2			
* Latest Data is available to December 2015 only										

ALBANIA											
Indicator (ALL million unless otherwise stated)	**FY 2006**	**FY 2007**	**FY 2008**	**FY 2009**	**FY 2010**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**	**Q2 2016**
Labor Market											
Unemployment Rate (%)	13.78	13.37	13.05	13.76	14.04	13.98	13.35	15.93	17.50	17.10	15.5
Youth Unemployment Rate (%) 15-29 yar old	n/a	19.8	24.7	21.9	22.5	21.9	26.0	27.2	32.5	33.2	29.9
Long-term Unemployment Rate (>12 months)	n/a	71.1	63.2	67.4	70.2	73.9	77.1	72.4	64.3	66.0	
Productivity	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Labor Force	**1,084,000**	**1,082,000**	**1,041,708**	**1,052,324**	**1,064,000**	**1,089,798**	**1,101,349**	**1,059,915**	**1,067,338**	**1,122,000**	
Labor Force Activity Rate (%)	65.2	58.0	53.3	55.1	55.2	60.3	57.3	52.4	53.7	55.7	
Average Net wages (ALL)							51,500	52,600	53,800	54,270	54,500
Average Gross wages-state sector (ALL)	23,037	24,140	26,228	29,923	30,226	30,603	30,670	31,026	31,325	32,171	32,369
Nominal net wages (annual % change)	7.5	17.1	8.3	11.9	6.7	6.9	7.3	4.1	1.7	1.8	
Real net wages (annual % change)	4.9	13.8	6	8.1	3	3.4	5.2	2	0.1	0	
GDP, Trade and Revenues											
GDP (Current Prices mln ALL)	882,200	966,600	1,089,300	1,143,900	1,239,600	1,300,600	1,332,800	1,350,600	1,400,500	1,444,700	
Export Total	77,405	97,171	112,572	104,515	161,548	196,897	213,030	246,397	255,759	243,183	
Import Total	299,147	376,194	439,894	428,839	477,768	544,004	528,490	517,378	552,281	544,606	
Final Consumption Expenditure	769,319	890,645	1,010,137	1,052,102	1,106,590	1,161,114	1,183,692	1,229,289	1,297,286	1,304,879	
Household Final Consumption Expenditure	673,236	784,867	892,776	918,651	961,912	1,011,826	1,032,478	1,073,609	1,129,915	1,141,148	
Public Final Consumption Expenditure	91,875	101,163	112,163	127,085	138,312	142,733	144,541	148,850	159,788	155,941	

Gross Fixed Capital Formation	332,252	351,305	366,882	374,169	352,412	381,944	353,044	352,088	342,844	390,721	
FDI Total (mln EUR)	250.0	470.0	665.0	717.0	793.0	746	746	923	812	871	
Profit Tax	22,258	21,077	18,108	17,149	17,606	19,712	16,853	15,119	21,483	24,968	
Income Tax	8,580	14,850	24,498	26,820	27,058	27,967	27,989	29,570	28,852	29,661	
VAT, total	74,268	87,771	107,094	110,062	113,998	119,189	116,533	111,940	123,847	125,783	
Excises	22,997	28,731	32,510	33,504	38,788	40,403	36,421	38,151	40,894	39,027	
Customs Tax	13,991	9,848	8,660	7,929	7,274	6,850	6,118	5,797	5,852	5,796	
Credit and Deposit Market											
Credit Growth Rate (%)	56.46	50.12	34.85	11.14	9.70	12.16	2.37	-1.23	2.20	-2.42	0.44*
Household Credit Growth Rate (%)	65.91	57.53	30.75	4.18	1.54	-0.15	0.50	-0.01	1.24	7.40	.-0.19*
Enterprises Credit Growth Rate (%)	52.90	43.25	32.96	13.81	14.66	15.35	1.82	-2.01	2.37	-6.97	2.63*
Bad Loans Rate (%)	3.1	3.3	6.5	10.3	13.6	18.9	22.8	23.2	22.8	17.7	21.2*
Deposit Growth Rate (%)		19.76	2.84	6.88	18.54	11.46	6.34	2.08	2.88	1.01	
Household deposits (%)		19.76	2.86	6.86	18.54	11.46	6.34	2.08	2.88	0.83	0.92*
Enterprises deposits (%)		31.25	1.30	-14.51	24.53	-5.35	-3.78	4.71	20.36	7.00	5.35*
Debt, Deficit and Inflation											
Public Debt (% of GDP)			51.3	55.3	54	55.7	58.2	61.7	65.9	67.4	65.9**
Public Debt (incl. other debt)	56.1	53.5	54.7	59.7	57.7	59.4	62.2	70.4	71.8	72.5	70.9**
Budget Deficit (%)	-3.3	-3.5	-5.5	-7.1	-3.1	-3.5	-3.4	-5.0	-5.2	-4.0	.-2.8**
Inflation Rate CPI (%) year end	2.5	3.1	2.2	3.7	3.4	1.7	2.7	1.9	0.7	2.0	
BoA FX reserves (mln EUR)	1,364.9	1,455.5	1,675.0	1,646.2	1,904.8	1,912.5	1972.0	2015.0	2,192	2880.0	

KOSOVO	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Indicator (EUR million unless otherwise stated)	**FY 2006**	**FY 2007**	**FY 2008**	**FY 2009**	**FY 2010**	**FY 2011**	**FY 2012**	**FY 2013**	**2014**	**2015**
GDP (Current Mln EUR)	3,120	3,461	3,883	4,070	4,402	4,815	5,059	5,327	5,568	5,727
Export Total (Mln EUR)	441	547	609	695	878	943	922	927	1,092	
Import Total (Mln EUR)	1,586	1,790	2,107	2,114	2,443	2,737	2,649	2,611	2,814	
Final Consumption Expenditure	3,332	3,661	4,172	4,222	4,517	4,976	5,320	5,539	5,855	
Household Final Consumption Expenditure	2,676	3,033	3,513	3,554	3,794	4,173	4,478	4,675	4,945	
Public Final Consumption Expenditure	656	628	660	668	722	802	842	864	910	
Gross Fixed Capital Formation	738	835	1,053	1,130	1,301	1,476	1,317	1322.6	1293.8	
FDI Total (mln EUR)		440.7	369.9	295.5	368.5	384.4	229.1	280.2	151.2	324.4
Profit Tax (1,000 EUR)	9,380	3,441	4,425	8,407	583	1,798	116	162	15	1
Income Tax	29	34	44	39	44	56	60	61	67	71,716
VAT (non-Customs)	48	59	59	76	95	121	130	147	136	154
VAT (Customs)	211	255	305	328	361	419	419	412	424	457
Excises	115.268*	129.395*	132.498*	150.69449*	157.94*	200.131*	303	301	315	361
Customs Tax	124	143	164	155	179	206	117.721**	120.128**	126.323**	131.391**
Credit Growth Rate (%)			32.7	8.9	13.2	16.4	3.8	2.4	4.2	
Household Credit Growth Rate (%)			40.1	22.3	25.5	17.7	6.2	3.9	12.7	
Enterprises Credit Growth Rate (%)			30.4	4.6	8.7	12.3	3.9	2.0	2.1	
Bad Loans Rate (%)		4.1	3.3	4.3	5.9	5.7	7.5	8.7	8.3	

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Deposit Growth Rate (%)	10.47	23.67	26.4	20.82	11.0	8.6	8.3	7.5	3.6	
Household deposits (Mln EUR)	515.7	676.8	843	1039.7	1299.4	1490.5	1640.1	1774.4	1843.3	1964.5
Enterprises deposits			477.4	388.02	526.6	509.3	528.0	555.9	559.8	
Public Debt				6.4	6.2	5.5	8.4	9.1	10.6	13.0
Public Debt (incl other debt)										
Budget Deficit (%)			-0.2	-0.7	-2.6	-1.9	-2.4	-3.0	-2.2	
Inflation Rate - CPI (%)	0.6	4.4	9.4	-0.2	3.5	7.3	2.5	1.8	0.4	-0.5
CBK FX reserves (mln EUR)	14.6	13.7	11.2	11.2	14.9	18.0	19.4	19.5	19.6	
Non-Observed Economy NOE (as % adjustment of GDP)										

* Does not included data on internal excises.

** Missing data on certain import taxes, like cigarettes.