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# ENVELOPE WAGE PRACTICES: UNDERLYING MOTIVATIONS FROM THE PERSPECTIVE OF WORKERS

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## ABSTRACT

Given the numerous economic and societal consequences of undeclared work, there has been growing interest in understanding its causes so that it can be tackled. This has been particularly the case since the onset of the economic crisis, which has resulted in the fight against tax evasion moving higher up the agenda.

To contribute to advancing understanding of the undeclared economy, this thesis seeks to explain the motivations of workers for participating in quasi-formal employment, which is one of the least discussed types of noncompliance. This practice is based on a formal employer and a formal worker agreeing to declare only one part of the wage, while the rest is given as an undeclared cash payment in order to evade tax liabilities.

Based on quantitative data from approximately 25,000 individuals surveyed during the period 2007-2015 around Europe and 39 qualitative interviews with workers and representatives of relevant institutions in Croatia, this thesis reveals that the phenomenon is more complex than was previously assumed. Although a proportion of workers agree to this illegitimate wage arrangement simply to escape from unemployment and are exploited by employers, the study shows that this cannot be generalised to the whole quasi-formal workforce. It appears that workers are primarily social agents who heavily base their decisions on the behaviour of other taxpayers and the perceived quality of the psychological contract between the state and citizens. Moreover, many workers see take-home pay as the ultimate goal of employment and accordingly voluntarily agree to this wage arrangement if they believe they can earn more when being under-declared.

Apart from its theoretical contribution to understanding workers' motivations for accepting envelope wages, the thesis thus also has a practical significance. It demonstrates that tackling this practice requires an indirect policy approach that not only increases the credibility of the state apparatus but also improves the tax morale of citizens.



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# 1 INTRODUCTION

For over half a century there has been a continuous debate about the causes, nature and trajectory of economic activities that are hidden from the authorities. New forms of unregistered work have been persistently revealed thus providing ever more refined insights into this complex phenomenon.

This thesis explores one of the more recently described types of noncompliance, which is denoted in the research literature as 'under-declared' or 'quasi-formal employment'. These two terms, which will be used interchangeably throughout the thesis, connote a specific form of employment in which an employer conceals from the authorities the actual remuneration of their legally registered employee by declaring only a part of it (OECD, 2008; Williams & Padmore, 2013b). The worker thus receives two different payments for the same job, with one part of the agreed wage paid officially (i.e. the declared wage), while the rest is given 'under the table'. The latter slice of the remuneration, which is commonly denoted as 'envelope wage', remains unreported and therefore is not taxed.

This illegitimate practice reveals that individuals can be involved in both formal and informal realms in parallel not solely by having more than one job, but also within the same job (Williams & Padmore, 2013a). In essence, under-declared jobs highly resemble their formal counterparts, which makes detection and control of this practice a significant challenge for the authorities (OECD, 2008). A firm employing workers on a quasi-formal basis seemingly fulfils its obligations regarding taxes and social contributions, but the problem is that these payments are actually much smaller than what should be paid since the total wage is under-reported. Given that there is no written trace of any agreement between the two parties, it is extremely hard for inspectors to identify possible violators, as well as to prove that the worker audited receives additional cash payments (Meriküll & Staehr, 2010).

In line with this, prevention seems to be a more viable policy solution for tackling this practice. This should be done by the design of effective policy measures to address the rationales behind such evasion. In this regard, one must be aware that despite being commonly initiated by employers, whose motivation is mainly financial (Williams & Padmore, 2013b), under-declaration of the total wage inevitably assumes some sort of consent on the part of an employee (Kriz, Meriküll, Paulus, & Staehr, 2007). Recognising this, one realises that any successful fight against quasi-formal

employment must rely on an understanding of workers' motives for engaging in such an arrangement in spite of the negative consequences of such work to their present and future welfare (e.g. constrained access to loans and credits, lower pension and/or lower benefits in the case of future unemployment).

Yet, not much is known about the nature of this emerging practice. This is partly because it still remains outside the main focus of scholars and international organisations interested in unregistered activities, particularly in western countries where it is not so prevalent in comparison to transition states (Williams, 2009, 2013a). However, an even more important reason can be found in the limited evidence available on this issue. For instance, the applicability of quantitative research methods is usually constrained by the small samples obtained from questionnaire surveys, as under-declared workers represent a subsample of a subsample<sup>1</sup>. On the other hand, qualitative research on the matter usually has to rely on snowball sampling as the only feasible method, which undermines the generalizability of the findings.

In consequence, only a few academic studies explicitly or partially address the issue, and these are mainly focused on post-Soviet countries and several other transition societies of Europe. For instance, country-level research studies on under-declared employment can be found for the case of Lithuania (Woolfson, 2007), Latvia (Hazans, 2005; Sedlenieks, 2003), Estonia (Kriz et al., 2007), Ukraine (Round, Williams, & Rodgers, 2008), Russia (Williams & Round, 2007a), Bulgaria (CSD, 2011) and Hungary (Elek, Köllő, Reizer, & Szabó, 2011). There are also several cross-national comparative studies for the three Baltic countries (Meriküll & Staehr, 2010; OECD, 2003), as well as some recent EU-wide research based on the Special Eurobarometer Survey on undeclared work (Kedir, Fethi, & Williams, 2011; Williams, 2009; Williams & Horodnic, 2015; Williams, Horodnic, & Windebank, 2015; Williams & Padmore, 2013a, 2013b).

Nevertheless, the aforementioned studies are primarily dedicated to determining who is engaged in these activities, while the rationales behind the decision to accept the arrangement are still quite ambiguous and so far unexamined. In order to fill this gap, the main goal of this thesis is to explore the factors influencing workers' decisions to enter employment relations which include under-declaration of income. In addition, the study will explore how the financial gain from such evasion is distributed

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<sup>1</sup> Generally, only a part of the total sample encompasses employed individuals, some of whom are under-declared.



between employers and workers, and how legislation on the minimum wage influences practices of under-declaring. Finally, the study will evaluate what determines the workers' satisfaction with their own positions so as to understand the underlying mechanisms supporting this practice. Apart from making such a theoretical contribution to understanding under-declared employment, this thesis also seeks to help policymakers in addressing the roots of the problem and designing effective measures to reduce quasi-formal employment.

In order to accomplish these objectives, the thesis follows a gradual approach (i.e. from the general to more specific). More precisely, the idea is to scrutinise under-declared employment, which is a hybrid type of work residing between the formal and informal realms, through the lens of contrasting theorisations that seek to explain mechanisms behind unregistered economic activities in general.

To do so, the introductory part of the thesis discusses the main concepts and definitions related to activities that remain concealed from the authorities. Apart from providing an overview of the development in the field, we also discuss problems with the terminology for denoting such activities and provide justification for the framework adopted in this thesis.

In Chapter 2 we introduce six different theories about mechanisms behind unregistered economic activities in general. These theories will be later used as a framework for evaluating how one might explain the nature and causes of under-declared employment. In line with this, the central part of Chapter 2 describes in more detail the issue of quasi-formal employment and gives a summary of the research findings on the matter. After identifying the gaps in the literature, we specify the research objectives and discuss the theoretical and policy contributions of the thesis in more detail.

Chapter 3, which is dedicated to methodological issues, provides a comprehensive explanation of the research methods used to achieve the identified goals, alongside clarification of the philosophical position adopted. In addition, Chapter 3 specifies potential ethical issues and explains the strategies that were applied to avoid any difficulties in this regard.

The research findings are given in Chapters 4 to 8. The elaboration starts with a presentation of the most important results from the quantitative analyses of all EU member states, given in Chapter 4. The main role of this part of the study was to illuminate some interesting peculiarities of quasi-formal employment, which were

then scrutinised in more detail during the remaining phases of the research. Chapter 5 triangulates and further extends these findings using a supplementary data source, namely data from the representative survey on the phenomenon conducted in Croatia, Bulgaria and FYR Macedonia.

To unfold the complex mechanism behind under-declared employment, the rest of the thesis presents the most important findings from two phases of the qualitative research, which were both conducted in Croatia. Being the newest member state and one of the EU countries with the most prevalent and diverse quasi-formal practices, Croatia appeared to be a highly suitable location for exploring this practice.

Explicitly, Chapters 6 and 7 summarise the conclusions from interviews with 30 under-declared workers, which were conducted during spring 2015 in Zagreb, the capital of Croatia<sup>2</sup>. More precisely, Chapter 6 provides an overview of workers' motives for entering the quasi-formal realm, as well as discussion of the role of cash payments in under-declared employment. The discussion is continued in Chapter 7, which examines various other aspects of this practice that have significant effects on the perception of workers of their own position. Apart from dissecting the role of professional and social standards in the workplace in sustaining this practice, it also evaluates the importance of personal and social norms, as well as the influence of deterrence and the potential financial consequences of this practice on the attitudes and behaviour of workers.

Chapter 8 provides a summary of the interviews with nine representatives of relevant institutions in Croatia. This chapter seeks to explain how different stakeholders (i.e. trade unions, employers and the authorities) see the issue of quasi-formal employment and whether some improvement in the fight against the phenomenon can be achieved by enhancing cooperation between these three groups.

Chapter 9 outlines the most important conclusions from the study, with particular emphasis on the most suitable policy strategies to tackle this illegitimate type of employment. Additionally, it also provides a discussion about limitations of the data sources used and research methods applied in this thesis, together with an overview of the challenges that scholars and institutions willing to explore this practice further have to bear in mind.

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<sup>2</sup> Given the comprehensiveness of this phase, findings from it are for practical reasons elaborated in two chapters.

## 1.1 Unregistered economic activities - diversity in terminology and definitions

Despite the vast body of literature developed on the matter, there is no single, broadly accepted term or conceptual definition encompassing all economic activities that remain unregistered with the public authorities. In their overview of terminology and available estimation techniques, Andrews, Caldera Sánchez and Johansson (2011) explain that such diversity is inevitable given the multifaceted character of the phenomenon. For example, researchers and institutions interested in social protection will put the emphasis on employment relations, while tax authorities see personal and corporate income as the focus of attention. On the other hand, if the aim is to estimate the size of GDP more accurately, a broader definition that includes illegal activities and paid community work is required. What is more, definitions are also influenced by the feasibility of data collection, the estimation methods applied and the observation units chosen (Andrews et al., 2011; Schneider, 2000).

To date, more than 40 nouns and adjectives have been introduced in the academic and grey literature to denote this realm (Williams, 2004), whilst each of them represents a slightly different group of activities. Some of the most frequently used terms are: the informal sector (Hart, 1973), the informal economy (ILO, 2002a), the subterranean economy (Gutmann, 1979), the black economy (Dilnot & Morris, 1981), the underground economy (Tanzi, 1983), undeclared work (European Commission, 1998) and the shadow economy (Buehn & Schneider, 2011).

As a consequence of this variety, a range of definitions have also been developed. Although each definition scrutinises 'hidden activities' from a different angle, we can roughly classify them into three contrasting groups based on the central object of interest: enterprise-, job- and activity-based ones (Williams & Round, 2008). While enterprise-based definitions put production units at the centre of research (ILO, 1993), jobs-based definitions are more concerned with workers and their employment status (ILO, 2002a). Activity-based definitions, on the other hand, recognise the possibility for workers and firms to be part of both legitimate and illegitimate realms in parallel, and therefore rather analyse each individual activity separately<sup>3</sup>.

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<sup>3</sup> Further discussion on this matter is provided in the next section.

Yet, the existing diversity of terminology represents a serious obstacle for researchers and institutions in their endeavours to conceptualise unregistered economic activities. Not only must one be cautious when comparing findings from different studies, but also every contributing piece of research must precisely specify which activities are evaluated. In line with this, before any further discussion is commenced, the types of hidden practices to be studied in the thesis should be clarified. For this reason, the rest of this chapter gives a short overview of progress in terminology during the last few decades, followed by an explanation of the adopted framework. The goal is not to discuss in detail all the terms and definitions, but rather to introduce only those that represented important milestones in the field. These fundamental definitions were developed and used by the most relevant institutions in this research area, such as the International Labour Organisation (ILO), the European Commission (EC), the European Foundation for the Improvement of Living and Working Conditions (Eurofound) and the Organisation for Economic Co-operation and Development (OECD).

## **1.2 From the informal sector to undeclared work**

Although there was some earlier research on economic activities concealed from the authorities (Geertz, 1963; Lewis, 1954), it was British anthropologist Keith Hart who sparked broad interest on this issue with his study on unemployment in Ghana (Hart, 1973)<sup>4</sup>. Hart introduced the term 'informal sector', which was later adopted and popularised by the ILO (ILO, 1972). The informal sector was depicted as encompassing all "activities of the working poor who were working very hard but who were not recognized, recorded, protected or regulated by the public authorities" (ILO, 2002a, p. 1). In spite of its vagueness, this descriptive characterisation represented a useful starting point for scholars interested in studying informal practices, which were at that time considered a positive phenomenon, providing shelter for the unemployed and underemployed (ILO, 1972).

Yet, although the praiseworthy pioneering theories of Hart and the ILO were able to explain informal practices in poor African countries, the idea of unemployment as the only cause of 'informality' did not match the situation in other countries around the world (European Commission, 2007b; Gutmann, 1979; Schneider & Williams, 2013). Namely, a significant increase in the tax burden in developed countries during the 1980s

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<sup>4</sup> An earlier version of this article was presented in 1971 to the Conference on urban unemployment in Africa.

and democratisation problems after the fall of socialist regimes in transition economies created a number of incentives for individuals and firms to evade taxes. These economic and political changes entailed new types of hidden activities, not necessarily related to the lack of formal employment opportunities, which therefore raised the need for the focus of attention to be broadened.

A significant step towards a more comprehensive conceptualisation of the phenomenon was taken in 1993 at the 15<sup>th</sup> International Conference of Labour Statisticians. Supported by the ILO, experts in the field agreed on the first international statistical definition of the informal sector. According to the definition, the informal sector embraces “all unregistered (or unincorporated) enterprises below a certain size, including: micro-enterprises owned by informal employers who hire one or more employees on a continuing basis; and own account operations owned by individuals who may employ contributing family workers and employees on an occasional basis” (ILO, 2002c, p. 8). This enterprise-based definition classifies production units as strictly formal or informal, while individuals are categorised in accordance with the type of enterprise in which they are employed. For instance, both registered and unregistered employees are considered as informal if a job is carried out in an informal enterprise. Graphically represented, the informal sector is portrayed as comprising all activities conducted by individuals who fall into cells 3 to 8 in Table 1.

The most noticeable problem with this definition is its failure to recognise the existence of informal employment inside formal enterprises, as well as the role of households in the process. In addition, many critics argued against the term ‘sector’ as it suggested that the formal and informal spheres of economy are discrete and separated. Such a notion was not in line with research studies around the world, which revealed that the two realms are in fact intertwined (Bromley, 1978b; Peattie, 1987). Furthermore, since the same technology, goods and services can be used by both formal and informal agents, the term ‘sector’ failed to describe the real nature of informality (Swaminathan, 1991).

In response to these critiques, and following a suggestion of the Delhi Group on Informal Sector Statistics (Husmanns, 2001), significant changes were introduced at the International Labour Conference in 2002. Firstly, a job-based definition was adopted encompassing “all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements” (ILO, 2002b, p. 5). In this way, the initial definition was extended to include informal employment outside the informal sector (cells 1, 2, 9 and 10 in Table 1).

To reflect this modification, the term 'informal economy' was accepted as a more appropriate and wider designation for this domain.

Nevertheless, all the definitions above classify firms and individuals as being strictly formal or informal, which can be quite misleading. For instance, Williams (2004) points out that formal workers can engage in cash-in-hand activities closely linked to their formal jobs. A typical example is a situation in which individuals use materials and/or equipment from their formal workplace for afternoon moonlighting (e.g. hairdressing after work, small-scale repairs, tutoring, etc.). Similarly, formal enterprises can conduct a part of their activities on an informal basis in order to decrease costs and/or avoid labour regulation (Ram, Jones, Abbas, & Sanghera, 2002). However, the most important drawback from the perspective of this thesis is that both enterprise- and job-based definitions fail to recognise formal employment inside formal enterprises as a potential source of informal practices.

For these reasons, here we use an activity-based definition and the term 'undeclared work', introduced by the European Commission in 1998. Undeclared work embraces "any paid activities that are lawful as regards their nature but not declared to the public authorities, taking into account differences in the regulatory system of Member States" (European Commission, 1998, p. 4). Following this, the only absence or insufficiency in undeclared compared to declared activities is that they remain unreported in order to avoid liabilities concerning taxes, social security contributions and/or labour legislation. Any additional absences or insufficiencies will not result in an activity being classified as undeclared (Williams & Round, 2008). This implies that prohibited activities (for instance drug dealing, prostitution, smuggling, human trafficking, etc.) and activities which do not entail monetary transaction (e.g. unpaid community work and domestic work in one's own household) do not represent undeclared work. If an activity is unpaid, it is denoted as community work or self-provisioning, while prohibited activities are denoted as criminal.

However, by classifying activities rather than individuals or firms, this definition embraces some practices that were not included in any of the previously discussed categorisations. Explicitly, one such occurrence is under-declared employment, which is in the focus of this thesis. Since in this type of employment a formal worker is employed by a formal company, enterprise- and job-based definitions fail to capture it (see Table 1). Therefore, throughout this thesis we use the term undeclared work and the accompanying activity-based definition.

**Table 1 A conceptual framework for the informal economy**

Production units by type	Jobs by status in employment									
	Own-account workers		Employers		Contributing family workers		Employees		Members of producers' cooperatives	
	Informal	Formal	Informal	Formal	Informal	Informal	Formal	Informal	Formal	
<b>Formal sector enterprises</b>					1	2				
<b>Informal sector enterprises<sup>(a)</sup></b>	3		4		5	6		8		
<b>Households<sup>(b)</sup></b>	9					10				

(a) As defined by the Fifteenth International Conference of Labour Statisticians (excluding households employing paid domestic workers).

(b) Households producing goods exclusively for their own final use and households employing paid domestic workers.

Notes: 1) Cells shaded in dark grey refer to jobs, which, by definition, do not exist in the type of production unit in question. Cells shaded in light grey refer to formal jobs. Un-shaded cells represent the various types of informal jobs.

2) Informal employment: Cells 1 to 6 and 8 to 10.

3) Employment in the informal sector: Cells 3 to 8.

4) Informal employment outside the informal sector: Cells 1, 2, 9 and 10.

Source: Hussmanns (2004)





## **2 EXPLAINING UNDER-DECLARED EMPLOYMENT THROUGH THE LENS OF UNDECLARED WORK**

Before moving to the specific issue of under-declared employment, it is useful first to understand the motives behind undeclared work in general. Accordingly, the first part of this chapter provides an overview of the theoretical debates about the nature and causes of undeclared work. These theories will be then used as a framework for a discussion about mechanisms underlying under-declared employment, which is given in the second part of the chapter.

### **2.1 Nature and causes of undeclared work - an overview of the theoretical debates**

Numerous views regarding the nature and causes of undeclared work, its link with the declared economy and the appropriate policy responses to tackle it have emerged over the last sixty years. To bring some clarity to these multifarious perspectives, we here distinguish six different sets of ideas: dualism, structuralism, legalism, voluntarism, quasi-voluntarism and the complementary approach. Each of the six theories has brought yet another view on illicit practices and contributed to the overall development of the research field. This section first briefly describes the most important features of these schools of thought, and then highlights the importance of a holistic approach in efforts to understand the phenomenon.

#### ***2.1.1 Dualism***

The foundations of the dualist school can be traced back to the 1950s, but it reached the peak of its popularity in the 1970s owing to the ILO and a group of associated scholars (Hart, 1973; ILO, 1972; Sethuraman, 1976; Tokman, 1978). Grounded on research results from developing countries, this school subscribes to the notion that the economy is composed of two completely autonomous and not mutually linked realms, denoted as the formal and informal sectors. Dualists perceive the formal sector as a desirable merit of capitalism, while its informal counterpart is nothing more than a marginal residue of the traditional economy. According to their views, the latter is mainly composed of artisans, street traders and other small-scale surviving entrepreneurs (Hart, 1973).

The disparity between these two realms was emphasised by giving them contrasting labels such as: 'firm-centred economy' and 'bazaar economy' (Geertz, 1963), 'modern sector' and 'urban traditional sector' (Hart, 1973), 'dynamic, profit-making modern sector' and 'everything else - a vast sponge of surplus labour' (Peattie, 1987), 'extensive, expansive and progressive' and 'pre-modern, diminishing, existing in margins' (Williams & Round, 2007b). These comparisons underline the central conviction of the dualists, i.e. that informal activities were inherent only in developing countries, not in developed ones. There was a firm belief that the informal sector in developing countries "would disappear once these countries achieved sufficient levels of economic growth or modern industrial development" (Chen, Vanek, & Carr, 2004, p. 16).

Therefore, the dualists saw unregistered activities as a temporary issue caused by the distortions of the labour market. In their view, informal activities were not caused solely by an imbalance between the growth of the urban labour force and the number of newly created jobs, but also by a disparity between the education system and the requirements of the labour market. Besides unemployed and formally employed individuals, the dualists therefore recognise another group of people. These are the so called 'working poor', mainly those who "will accept almost any kind of work after some time even if their job does not correspond to their initial assessment of their prospects" (ILO, 1972, p. 11).

Despite recognising that a certain proportion of employment in the informal sector is economically efficient and profitable, the dualists describe this sector as mainly composed of labour-intensive activities, which are linked to small-scale production and performed by poor self-employed people excluded from formal employment. Yet, even though the proponents of this theory have a positive attitude towards the informal sector given its capability to provide income for the poor, they recognise that "a consideration of income opportunities outside formal employment must include certain kinds of crime" (Hart, 1973, p. 68). More precisely, while presenting unregistered work as an effective temporary solution for pervasive unemployment and poverty, the dualists do not see it as viable and desirable in the long run. Therefore, only the creation of new formal jobs can reduce and eventually completely eradicate such activities from the viewpoint of the dualists.

This school of thought was strongly criticised due to the many shortcomings in defining and explaining the nature of informal activities. As Breman (1976) states, the dualist conceptualisation of the informal sector raised more questions than it really

solved. The major criticism was centred on the idea of there being two independent realms inside the economy. The critics argued that dualism offers “a potential compromise between pressures for the redistribution of income and wealth and the desire for stability on the part of economic and political elites” (Bromley, 1978a, p. 1036). In other words, by asserting that the two sectors of economy are completely independent, the dualist school promotes the idea that the poor can be helped without the position of the rich being harmed. In line with this, Moser (1978) argues that the dualist approach was useful solely for understanding poverty in developing countries, but not particularly helpful for its amelioration within existing political systems.

What is more, studies conducted during the 1970s and 1980s revealed the existence of the informal economy in advanced countries, thus refuting the notion of the residual nature of informality (Chen, 2005). And finally, there was strong evidence for ‘informalisation’<sup>5</sup> in both developed and developing countries (Maloney, 2004). In line with this, the critics argued that the informal economy in fact “represents a novel social trend instead of being a mere ‘lag’ from traditional relationships of production” (Castells & Portes, 1989, p. 13).

Due to its numerous shortcomings, the influence of the dualist school diminished during the 1980s. However, although less popular in recent decades, it has not disappeared completely (Williams & Round, 2007b). For instance, while under-declared employment itself completely refutes the idea of two separate realms inside the economy, the literature on this emerging phenomenon so far has followed the central notion of dualism by pointing at the lack of formal employment opportunities as the main trigger for such practices (Hazans, 2005; Kriz et al., 2007; Woolfson, 2007).

### ***2.1.2 Structuralism***

Based on research in both advanced and less developed countries, the structuralist school represents a significant detachment from the dualist view on informality. In fact, this school of thought evolved primarily from the critiques of the theories introduced by the dualists. The most important novelty brought by the structuralists is the rejection of the idea of there being two distinct and autonomous sectors inside the economy. Unlike the dualists, they see these two realms as intrinsically intertwined.

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<sup>5</sup> Hereafter the term ‘informalisation’ denotes a shift from declared to undeclared work.

Proponents of the structuralist school, mainly anthropologists and sociologists, share a “neo-Marxist ideology which focuses on exposing class conflict, exploitation of labor, and the spread of imperialism through worldwide economic restructuring” (Rakowski, 1994a, p. 503). Contrary to the dualists, they see both declared and undeclared work as features of capitalism. In their view, “it is the demand for informal labour, rather than the lack of demand in formal labour markets, which drives informalization” (Heintz, 2012, p. 12). Given this, the structuralist notion regards undeclared economic activities as affecting countries at different levels of development, not only the developing ones.

According to this school of thought, undeclared labour and production practices have always existed in developed countries, but represented a minor problem until the advent of recession and accelerated processes of globalisation during the mid-1970s. While recession led to a drop in demand and growth of production costs (due to the rise in oil prices), globalisation led to increased competition. Those circumstances forced formal firms to find cheaper methods of production, and the most common strategies were automation, transfer of plants abroad and sub-contracting of work to small undeclared enterprises or self-employed individuals (Castells & Portes, 1989). In consequence, unregistered production arose as an efficient “strategy used by firms - both large and small - to cut costs, improve competitiveness, and guarantee flexibility in firm management and employment” (Rakowski, 1994a, p. 504). Structuralists therefore describe the informal economy as a by-product of the formal economy (Williams & Round, 2007b), consisting of unregistered enterprises and individuals who are exploited by large-scale formal companies.

By denoting the formal part of the economy as a ‘capitalist sector’ and the informal one as ‘petty commodity production’, Moser (1978) clearly depicts the real role of small undeclared units in the modern economy from the perspective of structuralism. The relationship between declared and undeclared economic agents is perceived as “a living museum of human exploitation”, composed of “primitive forms of exploitation that have been given new life by postmodern globalization” (Davis, 2006, p. 186).

However, for the structuralist school the informal economy is not a set of survival activities. Although its proponents recognise that most people inside the informal economy are poor, they argue that informal activities are actually inherent to the whole social structure (Castells & Portes, 1989). In other words, poverty is not a cause of informality; it is rather a consequence, arising primarily from unfair distribution of

wealth between those in power and the subordinated individuals and firms. What is more, the structuralists assert that informal activities are not performed solely by low-skilled individuals; instead, the level of skills required is constantly raised and new means of production are introduced.

Proponents of this school of thought argue that the state is one of the most important stakeholders in this process. By selectively applying regulations, governments support privileged capitalist firms in their efforts to “erode employment relations and subordinate those who work in the informal economy in order to reduce their labour costs and increase their competitiveness” (Carr & Chen, 2001, p. 6). Given this, the structuralists point to “the need for state intervention to reduce inequalities, limit exploitation, and support entrepreneurial endeavors” (Rakowski, 1994a, p. 504). They believe that formalisation is the only route to progress, and the authorities therefore should actively seek effective strategies to eradicate undeclared work (Portes & Sassen-Koob, 1987).

Yet, the main problem with the structuralist approach is related to its narrow view on such a complex phenomenon. Structuralists focused their attention mainly on the relationship between large formal companies and subordinated informal entrepreneurs and workers, while there are many other forms of undeclared work, which do not necessary include exploitative behaviour. Three subsequent schools have tried to fill this gap by unpicking some other aspects of informality.

### ***2.1.3 Legalism***

Grounded in a neo-liberal philosophy and popularised during the 1980s, the legalist school also put enterprises at the focus of its doctrine. However, unlike the structuralists who argue that invasive large firms are the main stakeholders in the process, the proponents of legalism identify the over-intrusive state as the origin of the phenomenon. More precisely, while the structuralists see globalisation as the main problem, the legalists point at burdensome state regulation, primarily high taxes, as well as complicated and time consuming registration procedures (Cook, Heintz, & Kabeer, 2008; Rakowski, 1994b). Moreover, the legalists argue that discriminatory state laws favour powerful interest groups, creating unfair competition and forcing unprotected entrepreneurs to informalise their activities. In that sense, proponents of this school make a dualistic division between privileged formal businesses and non-

privileged informal ones, and accordingly describe declared and undeclared realms as relatively separated.

As de Soto (1989, pp. xiv–xv) argues, undeclared practices are a “spontaneous and creative response to the state’s incapacity to satisfy the basic needs of the impoverished masses”. Legalists thus see noncompliance “as the key to democracy, as popular resistance to an unfair and overly intrusive state” (Rakowski, 1994a, p. 506). Although they do not claim that all people participating in undeclared activities are poor, the legalists frequently use the term ‘the poor’ for unregistered individuals so as to emphasise that informality and poverty are often closely linked. In their view, the poor are “the backbone of a country’s economy, risking all their assets in daily transactions” (Rakowski, 1994a, p. 506).

Contrary to the structuralists, who appeal for greater efforts on the part of the authorities to reduce poverty and inequalities, the legalists think the only solution is market deregulation and the almost complete abolition of state intervention (Gërzhani, 2004). Moreover, while the structuralists point to the need to improve the protection of workers, the legalists argue that such efforts would lead to loss of jobs and even increased poverty (Annis & Franks, 1989). In contrast to the dualists and structuralists, who see formalisation as the only viable path to economic development, proponents of the legalist approach therefore offer “an alternative inverted view of development as a process of informalization” (Williams & Round, 2007b, p. 429). In line with this, they perceive undeclared economic actors as a political force that can bring about social and political changes and undeclared work as the best pathway to those changes (Rakowski, 1994a).

Despite its popularity in neo-liberal spheres, legalism was strongly criticised by scholars around the world. As pointed out by Bromley (1990), the legalists improperly assumed that inefficiency and bureaucratisation problems did not exist in more liberal economies. And more importantly, despite facing these problems, many countries around the world did not witness the path of informalisation described by the legalists. In line with this, the critics argued that the legalist approach was perhaps valid in some countries, but it was overly narrow and of little help in describing this phenomenon at the global level.

Furthermore, Portes and Schauflier (1993) argue that the elimination of state regulation advocated by the legalists would not lead to eradication of the informal

economy, but rather to eradication of the capitalist market. According to them, the removal of protective rules on wages, work conditions and health and social insurance would actually increase exploitation of employees and consequently increase inequalities in society.

Yet, in spite of strong criticism, the legalist school has had a significant role in the popularisation of this phenomenon, not only among politicians but also among the broader public. Its influence on academic, political and public debates is indisputable. Legalists have changed the public image of unregistered activities, depicting 'informals' as survivors rather than victims, heroes rather than parasites and the main force in the fight against unfair state regulation (Bromley, 1990). This has led to the development of two further schools of thought, which also put the relationship between the state and taxpayers at the centre of their philosophy.

#### ***2.1.4 Voluntarism***

Unlike all previous schools, which described the process of entry into the undeclared sphere as an undesirable outcome or necessity, the voluntarist school recognises that a certain portion of unregistered economic agents enter this realm by choice (Maloney, 2004). Proponents of this viewpoint also identify burdensome state regulation as the central driver of undeclared practices, thus sharing some basic concepts with the legalist school. However, unlike the legalists who see defiance as the main trigger for noncompliant behaviour, the voluntarists explain a decision to engage in such practices as a rational choice "after weighing the costs-benefits of informality relative to formality" (Chen, 2012, p. 5).

The voluntarists subscribe to the notion that people are in a continuous transition between open unemployment, formal employment and informal employment. While new entrants to the labour market would accept informal jobs if they did not succeed in finding formal ones, there are also people who shift voluntarily from the formal to the informal realm if the assessed gain of such change outweighs the potential consequences (Maloney, 2004). Accordingly, the voluntarists recognise two different currents within the informal sphere: one that is relatively easy to enter and embracing individuals who are temporarily excluded from the formal economy, and another composed of experienced individuals who voluntarily move from the formal to the informal domain. By distinguishing 'an easy-entry' and 'an upper-tier' informal economy, the voluntarists therefore developed the idea of dualism within the informal economy (Fields, 1990).

According to this school of thought, some people choose to work undeclared because “they find more autonomy, flexibility and freedom in this sector than in the formal one” (Gërzhani, 2004, p. 274). Still, the voluntarists do not claim that such undeclared workers are making enough money to stay outside poverty, only that they would not be in a better position if working formally (Maloney, 2004). In other words, the voluntarists recognise that this voluntarism is not a completely desirable option, but rather a rational choice inside the specified framework. Therefore, “given the constrained choices open to them, a great many of informal sector workers are in that sector voluntarily” (Fields, 1990, p. 67).

Alongside the tax burden and complicated administrative procedures, the voluntarists also identify poor pension and social welfare systems as additional drivers of noncompliance. However, unlike the legalists, they do recognise that unregistered enterprises “create unfair competition for formal enterprises because they avoid formal regulations, taxes, and other costs of production” (Chen, 2012, p. 6). Following this, the voluntarists advocate stronger government efforts to reduce undeclared work, primarily through deterrence (Allingham & Sandmo, 1972).

Still, although a certain proportion of undeclared workers and firms indeed conceal their activities out of choice (Eurofound, 2008), the greatest problem with this view on informality is the notion that people base their decision about (non)compliance solely on an assessment of costs and benefits. Given that in practice the probability of being audited (which is the key contributing factor to the cost side of the equation) is quite small, many critics argue that the voluntarist approach overestimates the real share of undeclared work (Frey, 2003).

### ***2.1.5 Quasi-voluntarism and conditional cooperation - the role of personal and social norms***

The inability of the voluntarist school to approximate the real extent of tax evasion accurately led some scholars to scrutinise undeclared work from both psychological and sociological perspectives in parallel, i.e. to supplement the idea of a rational agent with that of an ‘emotional agent’. Long and Swingen (1991, p. 130) for instance argue that some people never search for evasion strategies because they are “simply predisposed NOT to evade”. On the other hand, some will tend to cheat even if the expected benefits are lower than the assessed costs. This implies that personal and



cultural peculiarities should not be neglected when discussing the causes of noncompliance (Cummings, Martinez-Vazquez, McKee, & Torgler, 2006).

There are two groups of intertwined socio-psychological factors that are of particular importance here, and these are denoted as personal and social norms (Wenzel, 2004). Personal norms stand for moral and ethical values ascribed to each individual, and social norms for those ascribed to other taxpayers (Song & Yarbrough, 1978). These two sets of norms jointly shape 'tax morale', a latent factor which can be defined as the "individual's willingness to pay taxes, in other words, the moral obligation to pay taxes or the belief that paying taxes contributes to society" (Frey & Torgler, 2007, p. 140). Scholars interested in the socio-psychological dimension of undeclared work describe tax morale as a complex attribute determined by the trust between the state and taxpayers (vertical trust) and trust among taxpayers (horizontal trust), as well as by some personal characteristics (Frey & Torgler, 2007).

Levi (1988) for instance defines tax compliance as a quasi-voluntary process, explaining that taxpayers feel an obligation to obey as long as they believe that the authorities respect an invisible psychological contract existing between the state and its citizens. As paid taxes represent a direct and tangible loss for each individual, willingness to comply is heavily influenced by the perception of the justifiability of the process. Given this, if people believe that paid taxes and contributions are not spent fairly and efficiently, they will prefer to keep the money for themselves (Barone & Mocetti, 2011). This implies that prevalent corruption among public officials, non-transparent public expenditure and disrespect for citizens undermines the psychological contract and consequently reduces citizens' tax morale (Torgler, 2011).

Similarly, some research studies found a positive link between tax morale and the way the tax administration treats taxpayers (see Feld & Frey, 2002). If the tax authorities pursue cooperation rather than coercion, citizens will reward them with a higher level of compliance (Eurofound, 2008). On the contrary, if they are penalised for every little mistake, taxpayers will tend to express their dissatisfaction through increased evasion.

When it comes to social norms, Song and Yarbrough (1978) argue that each individual is a social actor and their attitude towards (non)compliance will thus be influenced by the behaviour of other people in their surroundings. In that light, Frey and Torgler (2007, p. 137) explain that "the more other taxpayers are perceived to be honest, the more willing individuals are to pay their own taxes". This feature is known as

'conditional cooperation', implying that people will tend to obey as long as they believe that others also obey (Torgler, 2004). On the other hand, if they realise that others are cheating, honest taxpayers can shift to the undeclared realm for two reasons. Firstly, they feel deceived, because their contribution to society is not recognised and supported by others. And secondly, the prevalent evasion sends a message that this practice is tacitly approved in society, which decreases the moral cost of noncompliance (Torgler, 2004). The importance of social norms is particularly pronounced in societies with large economic inequalities, as individuals with lower income levels often see the unfair distribution of wealth as justification for their noncompliance (Rosser, Rosser, & Ahmed, 2000).

In addition, research studies on the matter have also revealed that tax morale is significantly determined by age, marital status, employment status and the level of religiosity (Frey & Torgler, 2007; Lago-Peñas & Lago-Peñas, 2010). Older people tend to have higher tax morale than the young population, while married individuals usually find evasion less justifiable than those who are single. Similarly, more religious members of society generally express a lower level of tolerance towards evasion. On the other hand, the link between gender and tax morale is not yet sufficiently understood (Daude, Gutiérrez, & Melguizo, 2012).

### ***2.1.6 The complementary approach***

The complementary approach is a significantly different view on undeclared work in comparison with the perspectives described previously. Despite sharing an interest in sociological aspects of the phenomenon with quasi-voluntarism, the complementary approach is focused primarily on prosocial behaviour (Round, 2009). Accentuating community-oriented aspects of the undeclared domain, the proponents of this school of thought assert that many individuals carry out unregistered activities first and foremost in order to help other people and reinforce social ties (Williams, 2005).

As they usually have a formal job, such individuals use small-scale undeclared work as a strategy to establish or improve their position in society and thus financial gain is not the principal rationale. Therefore, this school subscribes to the notion that the informal and formal realms of the economy are intricately intertwined and complementary (Round, 2009). Proponents of the complementary approach perceive undeclared community-oriented activities as positive and harmless, often describing them as “a

good part of the informal economy“ which “forms a nexus of social glue that makes the formation and maintenance of social life possible” (Gaughan & Ferman, 1987, p. 25).

Although it does not enjoy wide recognition yet, this approach has broadened the horizons of the understanding of the complex nature of undeclared work by switching the focus from economic to social causes. Moreover, alongside offering new social and cultural perspectives, this school undermines widely accepted policy approaches to tackling this phenomenon. As Williams (2005) states, due to the belief that market-like and money-oriented incentives are the main drivers of hidden activities, the predominant policy response is still focused on improving detection and increasing fines. However, applying repression to community-oriented informal practices can destroy “the active citizenship that other realms of public policy are seeking to develop” (Williams, 2005, p. 144). In this context, policy measures that aim at facilitating the legalisation of these activities seem to be more appropriate.

### ***2.1.7 A holistic approach***

Each of the six presented schools of thought illuminates different aspects of undeclared work and therefore enables social researchers to analyse this complex phenomenon from different angles (Chen, 2012). For instance, while some economic agents are indeed forced to operate on an undeclared basis due to lack of formal employment opportunities (dualism), increased competitiveness (structuralism) and/or an over-intrusive state (legalism), some choose it voluntarily after weighing costs and benefits (voluntarism) or deliberately as a response to the poor performance of the psychological contract with the state (quasi-voluntarism). Similarly, while many people carry out both declared and undeclared activities in parallel (complementary approach), there are also some engaged in unregistered work for the sake of survival, thus having no link with the formal realm (dualism). Finally, some undeclared units and individuals might formalise their work if administrative burdens are reduced (legalism, voluntarism) or if faced with increased moral costs of tax evasion (conditional cooperation).

Thus, these schools should not be seen as being in opposition to each other but rather as providing different insights that can be integrated so as to produce a more nuanced analysis of undeclared work (Williams & Round, 2007b). Even though undeclared work is a more complex and heterogeneous phenomenon than the sum of all these perspectives would suggest, nowadays there is recognition among scholars that a

holistic approach should be pursued to broaden horizons and widen our understanding of mechanisms behind unregistered economic activities (Chen, 2012).

And this is exactly what will be done in this thesis. Explicitly, the focus of the study is on quasi-formal employment, and the idea is to evaluate to what extent the enumerated theories can help in explaining factors behind this relatively under-researched subtype of undeclared work. The goal of the inquiry into this practice through the lens of the holistic theory will be twofold: alongside offering a more profound depiction of quasi-formal employment, the thesis also seeks to provide information of value to the authorities in their efforts to tackle this phenomenon.

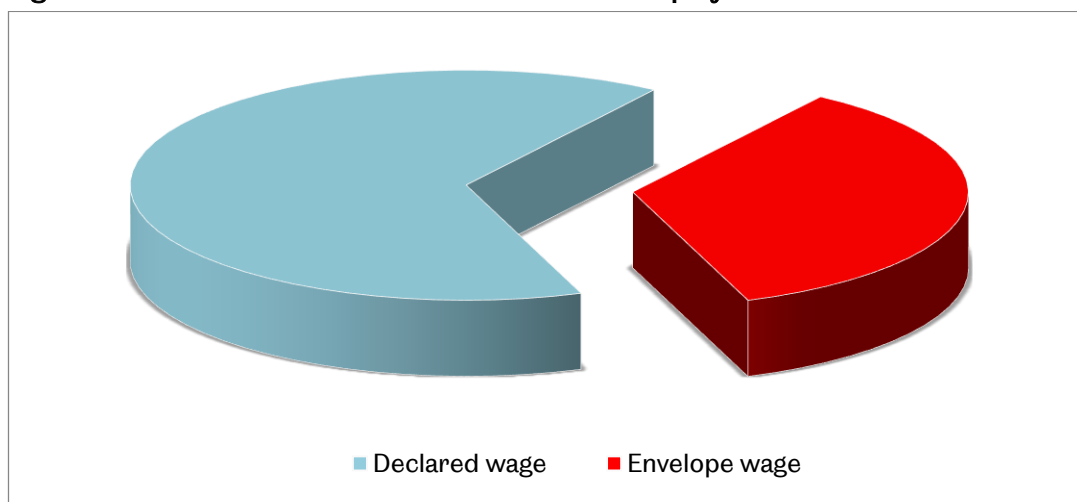
Yet, it is first essential to recapitulate what is known about quasi-formal employment. Therefore, in the next section we first describe this type of employment in more detail and give an overview of the findings on the matter. After identifying gaps in the literature, the last part of this chapter specifies the research objectives and elucidates the theoretical and policy contributions of the thesis.

## **2.2 Under-declared employment as a sophisticated type of noncompliance**

As already mentioned, under-declared employment can be best described as a hybrid type of work, residing between the formal and informal realms (Meriküll & Staehr, 2010). This is because both the company and worker are officially declared, but a hidden wage arrangement is in place so as to evade taxes and social security contributions. The worker is registered with the authorities and their legitimate employer (seemingly) complies with the legislation, which places them both in the formal sphere of the economy. However, the state remains deprived of a certain amount of taxes and social security contributions, given that the declared wage is lower than the actual remuneration. The work conducted is thus partially undeclared. As a result, whilst neither the employer nor the worker belongs to the informal sphere, their activities do belong there.

By denoting the undeclared part of the total wage as an 'envelope wage', scholars interested in the matter clearly denote the character of this illicit practice (Hazans, 2005; Meriküll & Staehr, 2010; Woolfson, 2007). The whole arrangement is based solely on a verbal agreement between an employer and an employee, and money is therefore given confidentially, without any written traces.

**Figure 1 Total remuneration for under-declared employment, an illustration**



*Source: Author's own illustration*

Yet, it should be stressed at this point that the term 'envelope wage' can sometimes be quite misleading because some researchers use it to denote any type of illegitimate payment. For instance, Kriz et al. (2007) label remuneration of both under-declared and completely undeclared jobs as an envelope wage. Similarly, Sedlenieks (2003) uses the term 'cash in an envelope' for both under-declared employment and bribery. Nonetheless, hereafter the term 'envelope wage' refers explicitly to the undeclared part of the remuneration for formal employment. Therefore, for the purpose of this thesis, the total remuneration of under-declared employment is the sum of the declared wage and the envelope wage, as illustrated in Figure 1.

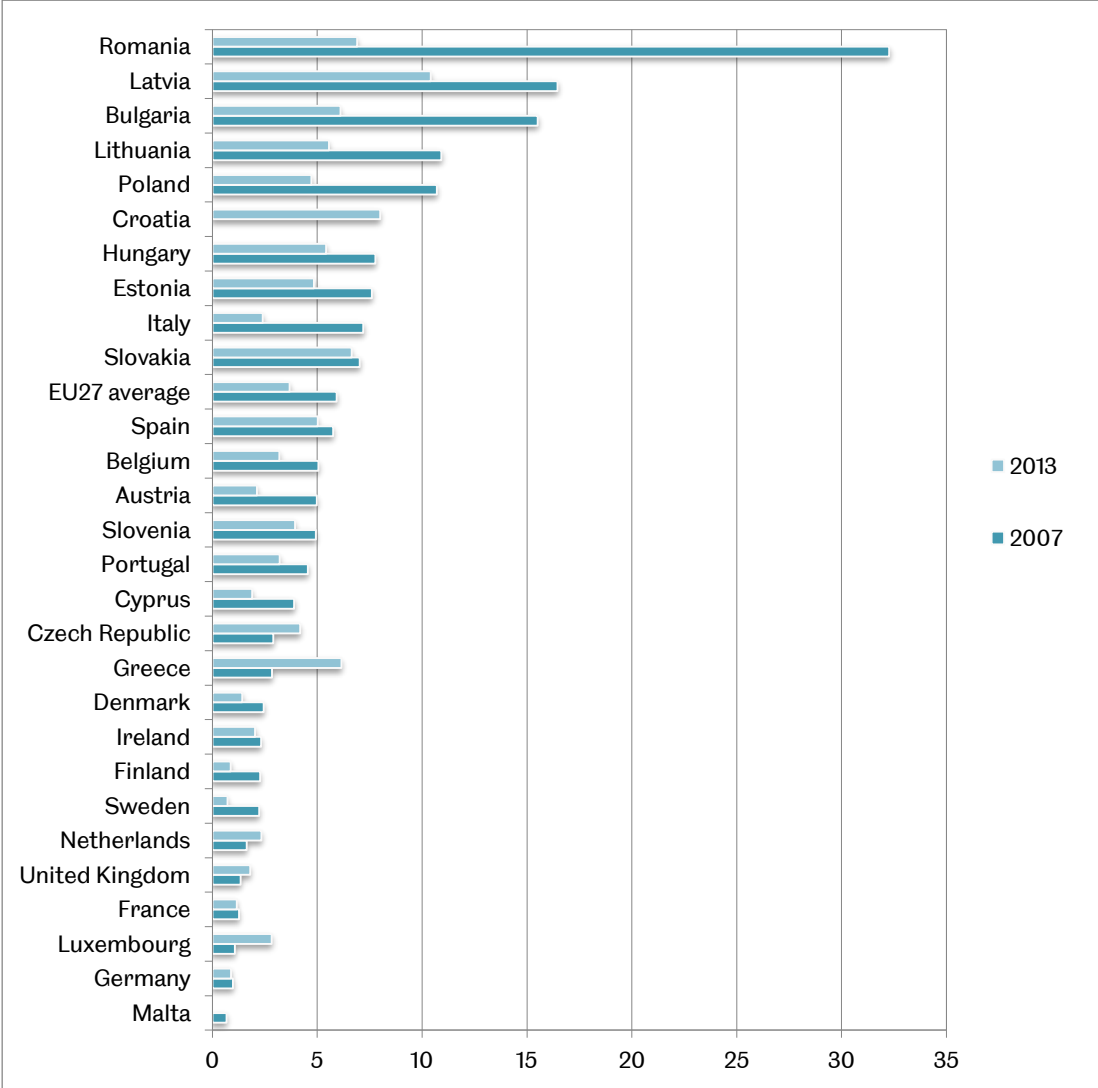
### ***2.2.1 Prevalence and characteristics of under-declared employment in the EU***

The only comprehensive source of cross-national data on quasi-formal employment in Europe so far is the Special Eurobarometer Survey on undeclared work in the EU<sup>6</sup>. This survey, first conducted in 2007 and then repeated in 2013 in all member states, reveals that approximately one in 20 workers in the EU is working on an under-declared basis (Figure 2). If extrapolated to the whole population, this would suggest that more than 11 million people in the EU are engaged in this type of employment (Williams, 2013b).

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<sup>6</sup> The survey follows the definition adopted in this thesis.

**Figure 2 Envelope wage practices in the EU, % of formal employees in 2007 and 2013**



Notes: 1) The 2007 dataset includes 11,135 individuals, while for 2013 this number accounts for 11,025  
 2) Both average values are calculated for 27 member states (without Croatia which was not included in the first wave)

Source: Author's calculations based on the Special Eurobarometer 284/Wave 67.3 and the Special Eurobarometer 402/Wave 79.2

Yet, because a significant proportion of respondents in the survey refused to answer<sup>7</sup> or simply stated they did not know whether they were receiving envelope wages, the given estimates should be perceived only as a lower boundary. Due to its illicit nature, there is a reasonable assumption that many of those who refused to answer were actually involved in this type of work (Fegatilli, 2009).

Taking these individuals into consideration, one can argue that the average share of under-declared workers in the total workforce was between 5.9% and 12.6% in 2007

<sup>7</sup> This is a common drawback of questionnaire surveys that deal with delicate issues, such as tax evasion. More detailed discussion on this matter is provided in Chapter 3.

and between 3.7% and 8.3% in 2013 (Table 2). The findings presented therefore clearly suggest that, despite still not being widely recognised by the academic community and relevant international institutions, this hybrid type of employment is already a constituent part of labour markets all around Europe

Another noticeable feature is the difference in the prevalence of envelope wage practices between countries. As presented in Figure 2 and Table 2, under-declaration of income is most common in transition economies. Quasi-formal workers in those countries accounted on average for between 10.2% and 19.3% of the total formal workforce in 2007 and between 6% and 12.2% in 2013, which is significantly higher than in developed states.

**Table 2 Envelope wage practices in the EU, % of formal employees in 2007 and 2013**

	2007			2013		
	YES	NO	REFUSAL /DK	YES	NO	REFUSAL /DK
<b>Post-socialist countries</b>	10.16	80.67	9.17	5.99	87.77	6.24
<b>Mediterranean countries</b>	4.35	87.73	7.92	3.32	91.08	5.60
<b>Continental countries</b>	2.20	92.03	5.77	1.92	94.81	3.27
<b>Nordic countries</b>	2.30	97.02	0.68	1.02	97.63	1.35
<b>Total</b>	5.93	87.36	6.71	3.68	91.70	4.62

*Notes: 1) Sample sizes for 2007 and 2013 are 11,135 and 11,025 respectively*

*2) Post-socialist countries: Bulgaria, Croatia (included only in the second wave), Romania, Estonia, Lithuania, Latvia, Hungary, Slovenia, Slovakia, Czech Republic and Poland*

*3) Mediterranean countries: Spain, Portugal, Italy, Greece, Malta and Cyprus*

*4) Continental countries: Belgium, Netherlands, Luxembourg, Germany, Austria, France, United Kingdom and Ireland*

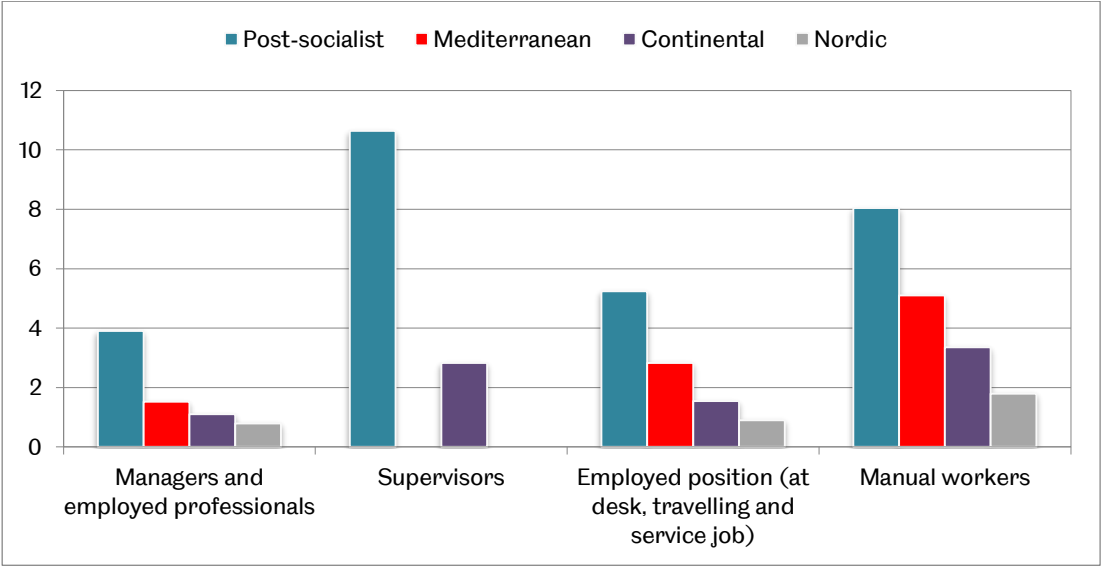
*5) Nordic countries: Denmark, Finland and Sweden*

*Source: Author's calculations based on datasets from the Special Eurobarometer 284/Wave 67.3 and the Special Eurobarometer 402/Wave 79.2*

However, the most important discrepancy between these two groups of countries can be found in the occupational structure of under-declared workers. While in the rest of the EU these practices are inherent mainly for manual workers and other low-paid employees, in post-socialist states they are widespread across all types of occupation. For instance, almost 4% of managers and professionals (engineers, lawyers, doctors, etc.) in transition countries receive envelope wages, alongside 10.6% of individuals whose jobs include supervision<sup>8</sup> (Figure 3).

<sup>8</sup> Yet, such discrepancies could be caused by differences in employment structure across countries (for instance, in some member states professionals may be predominantly working on a self-employed basis). However, official statistics on employment and labour market in the

**Figure 3 Prevalence of under-declared employment according to the type of occupation, % of formal employees in 2013**



*Note: The sample includes 11,025 individuals*

*Source: Author's calculations based on the Special Eurobarometer 402/Wave 79.2*

According to other available studies on the matter, envelope wages are particularly prevalent in post-Soviet economies. For instance, a survey of 313 respondents conducted during 2005 and 2006 in Moscow revealed that three out of four workers in full-time formal employment received additional remuneration in cash (Williams & Round, 2007a). Accordingly, under-declared employment represented some 80% of all illegitimate employment in Moscow, with the remaining 20% being completely undeclared jobs. Slightly better results were found in the case of the Ukraine, where almost every third formal employee was receiving envelope wages (Round et al., 2008), while in Lithuania and Latvia this share during the late 1990s was estimated at about 20% (OECD, 2003).

Scholars generally agree on several key reasons for quasi-formal employment to be more prevalent in post-socialist countries. Woolfson (2007) for instance argues that alongside the weak culture of tax compliance inherited from the socialist period, the key foundation of this phenomenon can be found in the transformation problems during the 1990s. As he explains, the privatisation process stimulated a rapid increase in the number of private companies, which easily developed various illegitimate practices due to weak enforcement bodies and poor regulation in the initial phase of transformation. Additionally enhanced by pervasive unemployment and augmented

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EU show that no significant variation between transition and developed countries exists in this respect (Eurostat, 2016b, 2016j).



income inequalities, under-declaration of income has become a common practice in these countries (Meriküll & Staehr, 2010). This is in line with Abbott and Wallace (2009) who argue that the prevalent informality in transition economies has resulted from the endeavours of individuals and households to survive in difficult financial circumstances. While some had to find an additional informal job in order to supplement low formal incomes, others found undeclared and under-declared employment to be the only sources of revenue.

The issue of quasi-formal employment has been emphasised since the onset of the economic crisis, when significant budget deficits forced the authorities to increase their effectiveness in combating unregistered economic activities (Eurofound, 2013). Yet it should be stressed that apart from short-term financial consequences for the public budget, envelope wage practices can also have a deeply negative effect on economic growth in the long run. For instance, under-declaration of real income undermines estimates of the GDP and various labour market statistics (e.g. average wage), which makes it difficult for governments to develop efficient long-term investment plans and optimal social and economic policies (OECD, 2003).

However, the authorities are not the only stakeholders interested in the eradication of this phenomenon. From the perspective of compliant enterprises, informal practices represent one of the key drivers of unfair competition on the market (Gërkhani, 2004; Sepulveda & Syrett, 2007). Explicitly, illegitimate reduction of labour costs enables a decrease in the final price of produced goods and services, which gives noncompliant firms an advantage over their completely formal counterparts. This can consequently force compliant firms to completely or partially informalise their activities in order to be able to survive in the market.

When it comes to under-declared workers, they can face constrained access to loans and credits because they have a low official wage. In addition, quasi-formal employment decreases future income from the pension system and reduces entitlement for social welfare benefits, as those revenues are commonly conditional upon the declared wage (Round et al., 2008; Sedlenieks, 2003).

All these negative features of envelope wage practices refute the *laissez-faire* approach<sup>9</sup> as a viable option (Williams, 2009; Williams & Padmore, 2013b). In line with this,

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<sup>9</sup> A *laissez-faire* approach connotes the absence of intervention on the part of the authorities (Berend, 2006).

governments rather choose to apply various reduction strategies (Kedir et al., 2011). While some of these reduction strategies can be focused on encouraging individuals and firms already working on an under-declared basis to transfer their activities into the completely formal realm (curative measures), others rely on detection and punishment of violators (repressive measures). There is also a group of strategies that seek to intercept noncompliance before it occurs by providing incentives to start activities inside the formal economy from the outset (preventative measures) and a group of those concentrated on improvement of tax morale through public campaigns and normative appeals (commitment measures)<sup>10</sup>. Nonetheless, whichever approach is chosen, the crucial precondition for a successful fight against quasi-formal employment is to understand why people and firms engage in these activities and how such practices are pursued. In line with this, the next section summarises findings on the nature and causes of the phenomenon and identifies gaps in the literature.

### ***2.2.2 Underlying rationales behind under-declared employment - gaps in the literature***

Researchers interested in this phenomenon point to financial gain as the most important motivation for employers to engage in envelope wage practices (Sedlenieks, 2003; Williams & Padmore, 2013b). Given that liabilities concerning taxes and social security contributions are conditional upon the gross wage, under-declaration of total payment automatically shrinks the tax base. This gives some room to achieve an advantage in the market by offering cheaper goods and services, as explained in the previous section (Gërxfhani, 2004; Sepulveda & Syrett, 2007). Such an approach reflects the standpoint of the structuralist school, which marked ruthless capitalism as the main cause of illicit activities (Castells & Portes, 1989; Davis, 2006; Rakowski, 1994a). Still, by choosing under-declared rather than completely undeclared work, these noncompliant firms retain all the benefits of the formal realm (access to finance, access to open market, legal protection, etc.).

Yet another link with the structuralist school can be found in the practice of envelope wages being used to exploit and oppress employees, as described in some studies (Hazans, 2005; Woolfson, 2007). Employers can for instance manipulate their workers by reducing the envelope wage after every little mistake or inappropriate behaviour. Given that the initial agreement on cash payments was informal, a decrease in an envelope

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<sup>10</sup> For a detailed overview of policy approaches to tackle informal activities see Eurofound (2008).

wage by the employer (or even a complete failure to pay it) does not actually represent a legal offence. Workers remain completely unprotected in such a situation, faced with uncertainty and “fully subject to the manager or owner” (Woolfson, 2007, p. 555).

A similar strategy that can be used by employers is to attract new workers by promising a relatively high overall income. They can offer to declare a worker on a low amount and deceptively promise to pay the rest in cash (Williams & Round, 2007a). When employees realise that the given assurance will not be completed, all they can do is either retain the job with much smaller remuneration than was initially agreed or voluntarily quit the job. Yet, it usually takes a few months for a worker to realise the initial plan of the employer, which gives enough time for the latter to abuse their cheap workforce. Given this, one can understand why quasi-formal employment is often described as “the ‘dark side’ of employers’ illicit wage practices” (Williams, 2013a, p. 1).

As well as supporting the structuralist school of thought, findings on envelope wages suggest that the ideas of the legalist school are also valid to a certain extent. As found in some field studies, under-declaration of the total payment “represents a useful device when a formal employer wants to make redundant formal employees” (Williams & Padmore, 2013b, p. 75). This can be done by paying only the official amount, without an envelope wage, in order to provoke a worker’s dissatisfaction and voluntary termination of the contract (Hazans, 2005; Round et al., 2008). If the worker decides to quit the job, the employer avoids the problems of giving a termination period and/or severance pay. This therefore shows that quasi-formal employment can be used as a valuable tool in efforts to circumvent complex firing procedures. Burdensome labour legislation is the main trigger for disobedience in this case, which corresponds with the ideas of the legalists (Cook et al., 2008; de Soto, 1989; Rakowski, 1994b).

However, quasi-formal employment can for the similar reasons be used as a response to a temporary increase in demand (Meriküll & Staehr, 2010). If faced with growth in labour demand, companies sometimes tend to expand the volume of work for existing personnel and pay that overtime work in cash. Envelope wage practices in that situation serve as a cushion for altered circumstances, and rescue the management from difficulties with firing procedures in the case when a potential new workforce is not necessary anymore. Yet, an opposite direction is also possible. As Williams and Padmore (2013a) suggest, sometimes quasi-formal employment is a pure survival strategy: if faced with business decline, employers can opt to under-declare their employees in order to decrease the overall cost and save the number of jobs.

Nonetheless, under-declared employment is a result of mutual agreement between the employer and the worker. Although these two stakeholders are not necessarily in an equal starting position in terms of negotiating power, the arrangement can be accomplished only if the worker gives consent (Elek et al., 2011; Kriz et al., 2007). This would suggest that complete understanding of the phenomenon is not possible without knowing the rationales behind workers' willingness to engage in this type of employment, in spite of all the negative consequences it entails.

Several research studies have tried to determine which socio-economic groups are more likely to engage in these activities. Results indicate that men are more likely to work in an under-declared fashion than women, and the same applies to young workers in comparison to older ones (Kedir et al., 2011). Furthermore, such practices appear to be more prevalent among workers in small firms (Meriküll & Staehr, 2010; Williams & Padmore, 2013a, 2013b). On the other hand, no significant link between occupation and under-declared employment has been found, suggesting that these practices are not confined to manual workers, but rather are widespread across all types of jobs<sup>11</sup>. Finally, and most importantly, although the phenomenon is more common for some population and demographic groups, research findings confirm that it "is ubiquitous – few, if any, social groups are exempt" (Williams & Padmore, 2013a, p. 421).

Nevertheless, things are much less clear when it comes to the question of why people choose to work on an under-declared basis. No systematic research on this matter exists and theories developed so far have been largely based on anecdotal evidence. It is mainly believed that the lack of formal employment opportunities lies behind individuals' decisions to engage in such an arrangement (Hazans, 2005; Kriz et al., 2007; Williams, 2013b; Woolfson, 2007). Given that a quasi-formal job provides at least minimum social protection and access to the financial loans market, those who are in danger of being excluded from formal employment tend to accept it rather than remain unemployed or work on a completely undeclared basis.

In line with what has been presented above, under-reporting of wages is believed to be offered and imposed by employers (Williams, 2009, 2013b). It is generally assumed that in most cases only the minimum, or slightly above the minimum wage is offered to be paid formally, and no discussion about the arrangement or negotiation about

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<sup>11</sup> One should not forget that these findings are based on studies in post-socialist societies, which does not necessary mean that the same is applicable to western countries.

the amount paid in cash is possible (Elek et al., 2011; OECD, 2003; Williams, 2013b). Workers therefore have only two options: accept the offer or find another job. Following this, and reflecting the structuralist ideology, workers are deemed to be hapless victims trapped inside this practice, with modest or even non-existent financial gain (Hazans, 2005; Round et al., 2008). They are often “forced to accept or even typically collude in the receipt of envelope wages for fear of jeopardizing their employment” (Woolfson, 2007, p. 555). On the other hand, employers are usually portrayed as abusers who retain the greatest part of the benefits from under-declaration (Round et al., 2008; Williams, 2009). Given this, one can conclude that theoretical debate about the causes of this phenomenon from the perspective of labour supply follows the same pattern as was the case with completely undeclared work. By marking quasi-formal employment as exploitive in nature and driven by the fear of exclusion from formal employment, the literature so far supports the ideas of the dualists and structuralists.

However, although these depictions are probably true for a certain proportion of envelope wage receivers, it is questionable whether such a classification can be generalised. Certainly the salient problem with these theories lies in the presumption that under-declared workers are a homogeneous group. For instance, if all workers receiving envelope wages are indeed mistreated, then one would expect them to be dissatisfied with their situation. Yet, the results of the 2007 Eurobarometer Survey on undeclared work suggest that this is not the case<sup>12</sup>. When asked about attitudes towards their position, 41% of under-declared workers stated that they are happy with receiving envelope wages. Only 29% were completely dissatisfied, while the remaining 30% were either hesitant or refused to answer. It should be stressed that other available studies on this issue provide similar findings (see Kriz et al., 2007).

A possible explanation for such a high figure for those who are content with receiving two wages for one job can be provided by a qualitative study of 15 respondents conducted in Riga during 2000 (Sedlenieks, 2003). Some informants, who, alongside employees of various private companies, also included highly positioned individuals (businesswomen, doctors, lawyers), pointed to the prevalent corruption among state officials as the main trigger for under-declaration of their official wage. It was believed that a certain amount of public money ends up in the pockets of those in power, so paying taxes was regarded as “money thrown into a garbage-bin” (Sedlenieks, 2003,

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<sup>12</sup> This matter was not evaluated in 2013.

p. 45). For that reason, envelope wages in Latvia were perceived as a victimless crime, a way of “depriving the state (i.e. the corrupt officials) from their illegitimate income” (Sedlenieks, 2003, p. 45). Given that both corruption and under-declared employment appear to be far more prevalent in post-Soviet countries than in other transition economies, which at the same time face larger problems with both practices than western societies (Transparency International, 2014), the role of corruption in the process should not be neglected.

In addition to these findings, which support defiance as another possible rationale, some envelope wage earners in the above-mentioned Latvian study explained their noncompliance as resulting from distrust in the long-term viability of the pension system. Since they believed that their pension would not be proportionate to current liabilities, those individuals preferred more money now, instead of expecting the state to return a much smaller amount in the distant future. The deficiencies of pension systems, which have been neglected in other studies on the matter, could certainly help in explaining why workers in transition countries are more prone to engaging in under-declaration than their counterparts in developed countries. Even though all European societies face the same challenges regarding the ageing of the population, pension systems in transition economies are additionally encumbered by the legacy of the early stage of transformation: most post-socialist countries relied on early retirement as a strategy to solve the problem with decreasing employment during the 1990s (Svejnar, 2002). This resulted in an adverse ratio of employed-to-retired persons, and consequently in a substantial reduction in retirement benefits during the later phases of transformation (Mladen, 2012).

In any case, the findings from Latvia indicate that the notion of envelope wages as being imposed by employers cannot completely explain this phenomenon, and that further differentiation is required. For instance, it is hard to expect that the same motives are applicable across all occupation and income groups. Even if dualism and structuralism are able completely to explain the phenomenon for low-skilled workers, their validity in the case of high positioned individuals is debateable. That is to say, it is questionable whether well-off individuals are also driven by the lack of alternative formal employment opportunities, as well as whether they are abused by their employers. In order to understand the rationales of these individuals, it is essential to analyse the role of other potential drivers, such as the tax burden, trust in institutions, tax morale, and expected future benefits from pension and social welfare systems.

However, this does not exclude the possibility that some low-income earners are also motivated by factors that do not necessarily include the fear of unemployment. For instance, given that in some countries certain welfare benefits are also available for employed individuals, but dependent on overall income (e.g. child allowance), some low-income individuals might prefer to conceal a certain part of their wage. Similarly, the decision of low-income workers to under-declare their total wage might be a response to the perceived large inequalities in society and unfair distribution of wealth (Rosser et al., 2000).

### **2.3 Research objectives and contribution**

Given the identified gaps in the literature, the main theoretical goal of this thesis is to explore to what extent legalism, voluntarism, quasi-voluntarism and conditional cooperation can explain under-declared employment from the perspective of workers<sup>13</sup>. This applies both to understanding the rationales for joining the under-declared realm in the first place, as well to understanding why some quasi-formal workers keep working under this arrangement in spite of all the negative consequences it entails, while others seek escape opportunities.

Although accepting the notion that some workers are engaged in these practices out of necessity, and are indeed exploited, we hypothesise that those individuals are just one subgroup of workers inside the under-declared realm. The main focus is thus on exploring the motives of those others who do it partially or wholly by choice.

Following the discussion in the previous section, of particular interest here are the underlying factors that can be ascribed to the structural differences between transition and western countries. In their debate about transition countries, Ferrer-i-Carbonell and Gërkhani (2011) for instance point to the existence of two tiers inside the informal economy in these societies, which is not the case in developed countries. The lower-tier realm encompasses individuals excluded from the formal economy, mainly manual workers whose incomes are much lower than those of their formal counterparts. On the other hand, the upper tier is comprised solely of affluent individuals who evade taxes in order to increase their overall income. Therefore, Ferrer-i-Carbonell and Gërkhani (2011) argue that undeclared work in post-socialist countries engenders an inequality gap in society, i.e. it serves to impoverish the poor

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<sup>13</sup> Due to its community-oriented character, the complementary approach appears not applicable in this case.

additionally, while at the same time it enriches well-off individuals. Accordingly, the intention here is to explore whether the same conclusion can be applied in the case of quasi-formal employment.

However, it is also possible that tax morale plays a key role in the decision to enter this realm by choice<sup>14</sup>. For instance, if inefficient and non-transparent public budget expenditures blur the link between citizens' liabilities and received public goods and services, it is reasonable to expect that taxpayers will be more willing to engage in quasi-formal employment, regardless of their occupation and level of income. The same explanation would be applicable in cases when people think that their contribution to the public budget is not supported by the contributions of other members of society.

If this proves to be valid, i.e. if low levels of vertical trust (trust between the state and taxpayers) and horizontal trust (trust among taxpayers) indeed encourage a certain proportion of workers to voluntarily or deliberately under-declare their wages, it may imply the possibility of a future expansion of the phenomenon in many countries. This is because of the vicious circle in which prevalent tax evasion triggers further evasion thus eventually forcing governments to increase tax rates, which then in turn can induce additional evasion, etc. (Pedersen, 2003).

Another important empirical goal of this thesis closely linked to the previous ones, and not researched so far, is to explore how the financial gain from such evasion is distributed between employers and workers. In the case of workers who would prefer full declaration, one would expect their employers to retain all financial benefits. This would imply that the total net income from such jobs is at most equal to that from their completely formal equivalents. On the other hand, it is reasonable to expect that workers in better-paid jobs probably benefit from such practices. If this proves to be true, it would confirm the suspicions raised earlier that some more affluent under-declared workers are willing participants in this practice, rather than victims.

The last goal, which is more policy-oriented, is to explore the link between the legislation on the minimum wage and the formal part of remuneration within under-declared employment. Contrary to the prevalent understanding, it is hypothesised here that a

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<sup>14</sup> Akin to the case of corruption, tax morale is also much lower in transition countries, with citizens from post-Soviet societies having the most permissive attitude towards tax evasion (Torgler, 2003).



significant proportion of employers will tend to declare more than just the minimum in order to decrease the probability of being audited. This particularly applies to those employing high income earners, whose declared wages are probably significantly above the minimum required amount. This question is important as the activities of individuals with a higher income are usually not considered by the authorities as susceptible to envelope wage practices. This in turn facilitates the readiness of the latter group, as they face a lower risk of being audited in this matter than those who work at low-paid jobs.

To summarise, this study seeks to explore the following four research questions:

- 1) What factors shape workers' decisions to enter employment relations based on under-declaration of income?
- 2) What affects the willingness of under-declared workers to keep obeying the unwritten agreement?
- 3) How is the financial gain from under-declaration distributed between employers and workers?
- 4) How does the legislation on the minimum wage affect the agreement regarding the formal part of remuneration within under-declared employment?

As can be realised from these research questions, the thesis aims to provide both a theoretical and a practical contribution. Theoretically, it seeks to widen our understanding of the phenomenon by approaching it from quite a different perspective than that of the previous studies. Since this is the very first attempt comprehensively to scrutinise the phenomenon through the lens of employees, the thesis is thus expected to reveal essential information on the workers' side of the story.

First and foremost, the intention is to show that workers are not passive figures in this respect (as suggested by previous studies), but that they are rather active players who can significantly influence the dynamics and nature of the practice. Accordingly, by recognising that some individuals possibly enter under-declared employment out of choice, this thesis intends to show that quasi-formal employment is not all involuntary and totally employer-driven. In line with this, the study also aims to give a nuanced elaboration on different groups of workers within the quasi-formal realm.

From a practical standpoint, answers to these research questions will provide valuable information for the authorities in their efforts to tackle the phenomenon. This firstly applies to the link between minimum wage legislation and the declared part of

remuneration. By determining how employers (and employees) really establish their strategy in this respect, the thesis intends to provide guidelines for more successful detection of possible violators. In addition, if the hypothesis that tax morale plays an important role in under-declaration of income proves to be true, it would indicate a necessity to put more emphasis on 'soft' measures, which seek to repair the psychological contract between the state and its citizens.

It is important to realise that it would be hard (or even impossible) to address each research question separately owing to a substantial level of interdependency among them. For instance, it is reasonable to assume that the entrance rationale would exert significant influence on an individual's behaviour during the employment. As a matter of fact, workers who recognise under-declaration as an opportunity to increase their earnings will presumably be more willing to stay inside this realm than those who have accepted an under-declared job simply to escape unemployment. In other words, for answering the second research question, one must first dissect the first one.

On the other hand, while fair distribution of financial gain between the two stakeholders can be a sufficient rationale for some workers to enter this realm, this issue can also be a reason for a worker to quit their job if the agreement changes during the course of employment. This implies that the first two research questions cannot be answered separately from the third. At the same time, one's perception regarding fairness in the distribution of financial gain is expected to be significantly determined by the size of the declared wage, which thus indicates an interrelation between the answers to the last two research questions. Likewise, the size of the declared wage also presumably plays an important role in workers' deliberations about entering this realm, as well as in the readiness of those already involved in it to continue in this condition.

An additional problem in this respect resides in the non-stationarity of quasi-formal employment. Every employment is a dynamic process in which the relationship between an employer and employee (as well as among employees themselves) constantly changes. Yet, this feature is particularly emphasised in quasi-formal employment, as there is an informal agreement between the two parties regarding the payment of wages. If an employer for instance decides to change the agreed conditions unilaterally or fails to fulfil the obligations, this can significantly affect the attitudes and behaviour of workers. Quasi-formal employees can also alter their views following changes in their social or professional life (if they for instance get married, obtain a

higher education degree, etc.). This stochastic nature of quasi-formal employment therefore adds an additional dimension to the interdependence of the research questions analysed in this thesis. To grasp the multifaceted nature of under-declared employment, it is thus necessary to examine the phenomenon from several angles.

In line with this, this study relied on four different data sources in order to address the identified research questions. This brings us to the issue of research design, whose detailed description is hence given in the next chapter.



### 3 RESEARCH DESIGN

Most attempts to conceptualise under-declared employment so far have been purely quantitative, with only a few notable exceptions of purely qualitative research (see Hazans, 2005; Sedlenieks, 2003; Williams & Round, 2007a; Woolfson, 2007). Yet, even though the strategy of applying only one of the research perspectives is understandable given the problems of constrained access to data on the matter, the ability of such an approach to provide a comprehensive picture of the practice is thereby limited. For instance, while statistical analyses on data from questionnaire surveys can help in illuminating which economic agents are more likely to participate in quasi-formal employment, they are not particularly useful when it comes to more profound insights into the dynamics of this practice. This is not only due to the numerous drawbacks of questionnaire surveys<sup>15</sup>, but also due to the inability of statistical tools to grasp longitudinal changes in behaviour and the decision-making-process of individuals. Qualitative inquiry, on the other hand, is potent in explaining complex mechanisms that underlie the decision-making process of a worker, but cannot provide generalizable findings. In line with this, there is a substantial risk of bias in drawing conclusions when qualitative research is pursued.

Given the presented research objectives on the one hand, and the enumerated limitations of the two contrasting inquiry strategies on the other, the decision was made to utilise both in this thesis so as to reduce bias and obtain as realistic a picture of the phenomenon as possible. In other words, this thesis will rely on a mixed-methods approach (Greene, 2008; R. B. Johnson, Onwuegbuzie, & Turner, 2007; Teddlie & Tashakkori, 2006). Before describing the data sources and exact research methods used, it is therefore essential first to briefly discuss the most important advantages and difficulties with academic inquiries that apply both quantitative and qualitative methods in parallel. Apart from this, the following section also outlines and justifies the philosophical perspective pursued throughout the study.

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<sup>15</sup> For instance, quantitative researchers commonly have to work with incomplete sets of predictors owing to the limited size of questionnaires, sensitivity of research topics and/or problems with quantifying various social phenomena. This was exactly the case with the datasets used in this thesis, as will be described later.

### 3.1 Mixed-methods approach

According to Rossman and Wilson (1985), the mixed-methods approach is usually applied for three different, not mutually exclusive purposes. Firstly, by scrutinising a research problem from both qualitative and quantitative perspectives, researchers can get a more comprehensive depiction of the nature and underlying mechanisms of the matter of interest. Secondly, scholars sometimes address the same question with qualitative and quantitative methods simultaneously in order to verify the findings from one approach by those of the other and thus increase the validity of the research<sup>16</sup>. And finally, the mixed-methods approach can be a valuable tool for discovering unusual patterns (which can for instance arise from discrepancies between qualitative and quantitative findings) and is hence sometimes used to shed new light on certain aspects of the matter under examination or to raise new research questions (Greene, Caracelli, & Graham, 1989).

Johnson et al. (2007, p. 113) argue that the greatest advantage of the mixed-methods approach in comparison to single-method ones lies in its ability “to respect fully the wisdom of both of these viewpoints while also seeking a workable middle solution for many (research) problems of interest”. Not only does the mixed-methods approach reduce bias introduced by single-method strategies, but it also provides an opportunity to identify various facts and latent mechanisms, which can remain undiscovered if only one strategy is applied. In addition, mixing methods enables researchers to take up different positions towards the subject of interest (Bergman, 2011). While detachment from the research subject(s) in the quantitative approach enables more neutral findings, qualitative insights allow in-depth understanding of the problem due to direct social contact between the researcher and the researched.

However, mixing qualitative and quantitative methods may involve various problems from a philosophical perspective. Some scholars argue that these two sets of methods entail completely different ideas about the nature of knowledge (epistemology) which makes it completely inappropriate to combine them (see Guba & Lincoln, 1994). They maintain that the positivist concepts of knowledge, which advocate the possibility of detecting value-free and universal truths and thus tend to be inherent in quantitative inquiry, cannot be reconciled with the interpretivist stance of qualitative research, which presupposes the subjective role of the researcher. Nevertheless, the proponents

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<sup>16</sup> This strategy is in the research literature known as ‘triangulation’ (Bergman, 2011).

of mixing methods argue that no philosophical position implies which research tools should be used in efforts to grasp new knowledge and therefore “differences in epistemological beliefs (such as a difference in beliefs about the appropriate logic of justification) should not prevent a qualitative researcher from utilizing data collection methods more typically associated with quantitative research, and vice versa” (R. B. Johnson & Onwuegbuzie, 2004, p. 15). This viewpoint implies that it is the research question that determines which methods should be used, not ontological and epistemological beliefs.

Following this, many authors advocate pragmatism as the most appropriate philosophy for the mixed-methods research. Pragmatists argue that researchers “should use whatever methods are needed to obtain the optimum results, even if this involves ‘switching between’ alternative paradigms” (McEvoy & Richards, 2006, p. 68). Thus, they place quality and the practical validity of the research in front of the epistemological issues. As such, pragmatism can be perceived as an a-epistemic philosophy (Scott, 2007), which “allows the researcher to be free of mental and practical constraints” (Feilzer, 2010, p. 8) and enables utilisation of all available tools in order to find the most valid answer for research questions.

Nevertheless, the author of this thesis argues against the idea that research methods are independent of philosophical stance, and therefore rejects pragmatism as a feasible position for this study. The author believes that not only should the choice of methods be guided by ontological and epistemological assumptions, but also that interpretation of the research findings cannot be free of the philosophical position taken. For those reasons, this thesis will follow the concepts of critical realism, which is another set of ideas supporting both qualitative and quantitative inquiries (Ackroyd, 2004; McEvoy & Richards, 2006; Mingers, 2004; Scott, 2007; Zachariadis, Scott, & Barrett, 2013).

From the ontological perspective, critical realism recognises the existence of a unique reality that is independent of our constructions, perceptions and theories (Bhaskar, 2011). However, at the same time it denies the possibility for humans to fully understand that reality. By describing absolute truth as a “God’s eye view”, Putnam (1999, p. 16) suggests that complete knowledge remains outside our reach. Given this, critical realism acknowledges “the existence of a real, though not an ‘objectively’ knowable, world” (Maxwell, 2012, p. 10). As there is one reality but numerous interpretations of that reality, the aim of social research is thus to offer theories that are always open to critiques and revision (McEvoy & Richards, 2006).

In that way, despite not being able to reach the absolute truth, we can approach it through criticism and improvement of existing knowledge.

Critical realism resides half way between positivism and interpretivism; its ultimate goal is not to find generalizable laws (as is the case with positivism) or to describe the beliefs and experience of social actors (as interpretivism does), but to develop a greater level of understanding and provide more comprehensive explanation of a research matter (McEvoy & Richards, 2006; Zachariadis et al., 2013). In that light, one must be cautious when applying quantitative methods. As Mingers (2004) explains, the role of quantitative methods in research under the assumptions of critical realism is to assist in finding regularities and mechanisms, not to predict the future or establish universal truths. In line with this, quantitative methods are particularly useful when applied in the exploratory phase of the study to identify associations and patterns which may otherwise remain undetected by qualitative inquiry (McEvoy & Richards, 2006; Mingers, 2004).

This is exactly the approach pursued in this thesis. Namely, this comprehensive study on the causes and nature of under-declared employment starts with quantitative analyses, whose role is solely to identify existing associations between quasi-formal employment and various micro- and macroeconomic indicators. The findings from the quantitative research will then be used to develop the list of topics and questions for the qualitative phase.

After introducing the mixed-methods approach and clarifying the chosen philosophical position we move back to the other aspects of research design. The following sections first define the exact scope of the research before moving to the description of data sources and methods used to accomplish the research objectives. The last part of this chapter is dedicated to ethical issues and the strategies applied in this respect.

### **3.2 Scope of the research**

As already pointed out, there are significant discrepancies between transition and developed countries in the nature and prevalence of under-declared employment. Since the particular interest is in detecting reasons for such differences, we start with



quantitative analyses on data from all 28 EU member states<sup>17</sup>. Besides providing a sufficiently large sample (and thus increasing the robustness of the applied statistical methods), using data on individuals from 28 different countries simultaneously also gives an opportunity to analyse the role of country-specific factors that can significantly influence the dynamics of under-declared employment<sup>18</sup>. By applying two-level modelling, which acknowledges the existence of both individual- and country-level determinants of envelope wage practices, one can gather better information on economic and cultural determinants of this practice.

After identifying factors that can help in explaining differences between EU member states in this respect, we shift our focus solely to the dynamics of envelope wage practices in a transition setting. Again, this is done for two reasons. Firstly, since quasi-formal employment is far more prevalent in post-socialist economies, it is much easier to identify potential research participants for qualitative interviewing in such countries. Secondly and more importantly, since the focus is on understanding how individuals' decisions are shaped by the economic and social environment in which they operate, respondents from transition countries appear more suitable for in-depth insight into the determinants of this practice that can be ascribed to inherent differences between western and post-socialist economies.

Yet, the inquiry into quasi-formal employment in a transition setting starts with quantitative analyses on data from representative surveys in three South-East European countries: Croatia, Bulgaria and FYR Macedonia. Not only are these three countries at the top of lists when it comes to the prevalence of undeclared and under-declared employment, but also they are among the countries facing the most profound problems with unemployment, the efficiency of the state apparatus, the quality of judicial systems, prevalence of corruption and (dis)trust in the institutions<sup>19</sup>. In line with this, the three chosen countries appear highly suitable for evaluation of envelope wage practices in transition economies.

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<sup>17</sup> Although the inclusion of other European countries (for instance non-EU post-Soviet economies) would yield more reliable findings, this was not possible as those countries were not encompassed by available cross-country surveys. However, since the principal role of the quantitative inquiry in this study is to open different horizons that will be further explored during the qualitative research, focusing solely on the EU member states should not represent a serious limitation in this respect.

<sup>18</sup> Some of these country-specific factors are for instance employment rate, tax burden, corruption perception index, average level of trust in institutions, etc.

<sup>19</sup> For more detailed elaboration on the similarities and differences between these three countries see Williams, Dzhekova, Baric, Franic and Mishkov (2014).

Bulgaria and Croatia are already EU member states, and as such will be embraced in the first wave of the quantitative study. FYR Macedonia, on the other hand, is not a member state yet (it is a candidate country), but it shares many features and problems with the remaining two economies<sup>20</sup>. Apart from triangulating the findings from the analyses on EU-28, quantitative insight into quasi-formal employment in South-East Europe also serves as a source of additional information on the matter, which could not be grasped from the EU-28 dataset (as discussed below).

To gain an in-depth understanding of the phenomenon, the central part of the thesis presents the findings from qualitative interviews with workers and representatives of relevant institutions in Croatia. The exact reasons why this newest member state was chosen for the fieldwork will become apparent after presenting the research findings from the quantitative inquiry. Following that, a more detailed discussion on this matter is given in Chapter 5.

Overall, four different data sources were used to address the given research questions, with three of them covering solely countries in transition. The following sections describe each of these four sources, together with the research methods that will be applied to analyse them.

### **3.3 Quantitative inquiry - datasets and research methods**

#### ***3.3.1 Special Eurobarometer Survey on undeclared work***

The insight into the nature and causes of quasi-formal practices starts with quantitative analyses on data from the Special Eurobarometer Survey on undeclared work in the EU. First conducted in 2007 and then repeated in 2013, this study provides information about unregistered practices in all 28 member states. It also contains data on the demographic and socio-economic characteristics of each respondent (gender, age, marital status, occupation, size of the company they work for, etc.), their personal attitudes towards different types of violating behaviour, as well as on their perceptions about the potential legal consequences of illegitimate practices. Identical analyses will be applied separately on data from both time periods so as to check the robustness of the applied statistical methods, as well as to get some insight into

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<sup>20</sup> For instance, Croatia and FYR Macedonia were parts of Yugoslavia until the early 1990s, thus sharing numerous economic and cultural peculiarities.

possible changes in this practice during the observed period<sup>21</sup>. This is feasible due to the fact that both surveys followed similar sampling procedures and contained identical questions<sup>22</sup>.

Approximately one thousand persons per country were surveyed following a multi-stage random sampling procedure (European Commission, 2007a, 2014). In the first phase, administrative units were stratified according to the type of area (metropolitan, urban, rural). Sampling points were then drawn systematically from each of these stratified units with probability proportional to population size. In the next phase, a starting address in each sampling point was chosen at random, while each subsequent one was selected by the 'random route' procedure. Finally, an individual respondent (aged 15 years or more) in each household was sampled by the 'closest birthday rule'.

For the purpose of this study, only a subsample of individuals who identified themselves as dependent employees will be considered. This restriction arises from the very nature of the research objectives; even though under-declaration of income is also inherent to self-employed individuals, they are not the focus of this research. This is because the self-employed are in fact employers (employing themselves) and therefore their motivations for under-declaration of income should be investigated primarily from the employer side. Since we are essentially interested in a complex relationship between under-declared workers and their employers, dependent employees are the focus of this study.

The total sample for 2007 includes 11,135 dependent employees from 27 member states (European Commission, 2007a), while for 2013 there are 11,025 dependent employees from 28 member states (European Commission, 2014). It should be stressed that Croatia was not included in 2007, as it was not a member state at that time.

Data from the two waves of the Special Eurobarometer Survey are publicly available<sup>23</sup>, as is an overall analysis (European Commission, 2007a, 2014), but all analyses presented in this thesis were done by the author using raw data. In addition to the descriptive analysis that was presented in Chapter 2, data from this survey will be further used in statistical modelling in order to explore which factors influence the

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<sup>21</sup> It is important to note that these two waves encompassed different sets of individuals and therefore only changes on a macro-level can be grasped.

<sup>22</sup> It should be, however, admitted that some questions asked in 2007 were omitted from the 2013 questionnaire. More on this issue is given later in this section.

<sup>23</sup> See <http://www.gesis.org/eurobarometer-data-service/data-access/>

decision of a worker to enter the under-declared realm, as well as to understand what determines their level of satisfaction with own position. That is to say, the Special Eurobarometer Survey is utilised to evaluate the first two research questions. Accordingly, two different types of models are applied in this case, reflecting the existence of two dependent variables of interest.

### ***3.3.1.1 Exploring factors behind the decision to engage in under-declared employment***

The first dependent variable is based on the central question regarding quasi-formal employment, which every respondent in the Special Eurobarometer Survey who classified themselves as a dependent employee was asked. The question, which was asked in both waves, was formulated as follows:

*Sometimes employers prefer to pay all or part of the salary or the remuneration (for extra work, overtime hours or the part above a legal minimum) in cash and without declaring it to tax or social security authorities. Has your employer paid you any of your income in the last 12 months in this way?*

Four possible answers were offered:

- 1) Yes;
- 2) No;
- 3) Refusal and;
- 4) Do not know

In 2007 there were 616 individuals who admitted receiving envelope wages, while 9,772 stated their wage was completely declared and the remaining 747 hesitated or refused to answer. In 2013, 418 dependent employees stated they had worked on an under-declared basis during the 12 months preceding the survey, a further 10,095 denied engagement in this practice, while 512 either refused to answer or were not certain.

Since the focus is on the factors that shape individuals' decisions to enter the under-declared realm, the main intention here is to explore personal and country-level characteristics that distinguish under-declared workers (i.e. persons who answered 'Yes' to the above question) from those who denied participation in such activities. In other words, the goal is to get a quantitative insight into socio-economic and demographic particulars of quasi-formal individuals, as well as into economic and

cultural differences among EU member states that exert influence on the likelihood of working quasi-formally for dependent employees.

It should be stressed, however, that analyses based on the above dependent variable have been conducted previously (see Kedir et al., 2011; Williams et al., 2015). Nonetheless, the main focus of these two papers was on evaluating the prevalence and distribution of quasi-formal employment, and in particular on individual-level determinants of this practice. Since we are interested here in both individual- and country-level determinants, the analyses conducted in this thesis represent extensions of earlier research on the matter.

If only those respondents who answered either 'Yes' or 'No' on the above question are taken into consideration<sup>24</sup>, then our variable of interest becomes binary. Since there are only two outcomes (i.e. a person either participates in this illegitimate practice or does not), linear regression is not an appropriate tool for modelling this variable. This is because linear regression assumes a normal distribution of random errors, which in turn implies normality of the dependent variable (Hosmer, Lemeshow, & Sturdivant, 2013; Verbeek, 2012; Weisberg, 2005). In other words, as linear regression does not place restrictions on the possible values of the explanatory variables, the values of the dependent variable are free to range from negative infinity to positive infinity (Menard, 2002).

A tempting solution for this issue would be to apply linear probability analysis, which models the probability of an event occurring rather than the real outcome (Agresti, 2007; Cramer, 2003). More precisely, if we define the probability of working on a quasi-formal basis for an individual '*i*' as  $E(y_i) = P(y_i=1) = \pi_i$ , then the related linear probability model is given by:

$$\pi_i = \beta_0 + \sum_{k=1}^K \beta_k X_{ik} + \varepsilon_i, \quad i = 1, 2, \dots, N \quad (1)$$

where  $X_k$  denote explanatory variables,  $\beta_k$  are accompanying coefficients and  $\varepsilon_i$  are normally distributed random errors.

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<sup>24</sup> This is just a provisional selection used to justify the chosen statistical method. We will return later to the problems caused by the answers 'Refusal' and 'Do not know' and the strategies to resolve them.

Yet, although this approach yields a continuous dependent variable, it does not solve all the issues. For instance, this specification still allows one to obtain predicted response probabilities that would be less than zero or greater than one, which are in fact nonsensical values given that any probability must lie between zero and one. What is more, the model assumes a linear relationship between the explanatory variables and the response probability, which is not necessarily valid in reality (Cramer, 2003). As a matter of fact, in many social phenomena this relationship is actually nonlinear with a flatter slope for values of  $\pi$  near 0 and 1 (Menard, 2002). In addition, the assumption about the normal distribution of random errors is violated since residuals can take only two possible values<sup>25</sup>. These are just some of the most important reasons why linear probability modelling is not suitable for modelling dichotomous outcomes<sup>26</sup>.

To address all these issues, a range of so-called generalised linear techniques has been developed over the years. Such techniques assume a nonlinear transformation of the right hand side in equation (1), which ensures that the predicted probabilities are always between 0 and 1. The general form of a generalised linear model for a binary dependent variable is given as:

$$\pi_i = F\left(\beta_0 + \sum_{k=1}^K \beta_k X_{ik}\right) \quad (2)$$

where  $F$  is the cumulative distribution function of a statistical distribution with a known mathematical form.

Following increased interest in studying economic and psychological determinants of human behaviour, as well as due to growing reliance on experiments in medicine, generalised linear methods have become widely popular among scholars during the last few decades (Guo & Zhao, 2000). Their usage has been additionally enhanced by advances in computing power and the development of specialised statistical software. The most common choices for function  $F$  in equation (2) are the logistic distribution and normal distribution (Hosmer et al., 2013; Snijders & Bosker, 1999). The family of methods relying on logistic distribution are known as logit models, while those based on normal distribution are known as probit models. A discussion about similarities and differences between logit and probit models is beyond the scope of this thesis,

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<sup>25</sup> To see this, note that  $y_i = \pi_i + \varepsilon_i$ , which implies that  $\varepsilon_i = y_i - \pi_i$ . Yet, since  $y_i$  is either 1 or 0, the only two possible values for each residual are  $\varepsilon_i = 1 - \pi_i$  and  $\varepsilon_i = -\pi_i$ .

<sup>26</sup> For more detailed elaboration on the matter see for instance Menard (2002).

and thus it is not presented here<sup>27</sup>. It suffices to say that coefficients obtained from the two models are proportional in the case of single-level analysis, i.e.

$$\beta_{probit} \approx 1.8 \cdot \beta_{logit}.$$

Yet, while in typical circumstances decisions about which of the two to use is arbitrary, the logit link is far preferable when multi-level modelling is pursued<sup>28</sup>. Namely, given the complex structure of the normal cumulative distribution function, multi-level logit models are computationally far more efficient. The issue is additionally emphasised when a multiple imputation technique is applied. Since in this thesis both multi-level modelling and multiple imputation strategy are applied (see below), the logit link appears to be a more convenient option.

Generally speaking, the role of logit modelling is to determine how well responses to a categorical outcome variable can be predicted by responses to the set of explanatory (interval or categorical) variables (Gelman & Hill, 2007; Hosmer et al., 2013). In its most general form, the logit model is defined as:

$$\pi_i = \frac{e^{\beta_0 + \sum_{k=1}^K \beta_k X_{ik}}}{1 + e^{\beta_0 + \sum_{k=1}^K \beta_k X_{ik}}} \quad (3)$$

After applying a simple mathematical manipulation, a more intuitive representation of the model (3) can be obtained:

$$\ln\left(\frac{\pi_i}{1 - \pi_i}\right) = \beta_0 + \sum_{k=1}^K \beta_k X_{ik} \quad (4)$$

As the left-hand side of equation (4) illuminates, logit analysis applied to the case of quasi-formal employment in fact models the natural logarithm of odds that a person is working quasi-formally. It is also important to note that the right-hand side of equation (4) looks quite similar to that in equation (1). The only difference is the absence of the error terms in logit model (4). This is because a standard logistic distribution of errors is assumed, which implies constant  $\sigma_e^2 \approx 3.29$  (Hosmer et al., 2013).

<sup>27</sup> A curious reader is advised to consult for instance Cramer (2003).

<sup>28</sup> Some scholars prefer logit even in single-level modelling due to the straightforward interpretation of the coefficients, which is not the case with the probit link (Agresti, 2007; Hox, 2010).

However, given that our datasets contain individuals from all EU member states, the model defined by equation (4) is still not satisfactory. Explicitly, in situations where individuals come from different clusters/groups, it is reasonable to expect that two randomly selected individuals from the same cluster/group will be more similar than individuals selected from different clusters/groups (J. de Leeuw & Meijer, 2008; Heck & Thomas, 2000; Hox, 2010). In our case, the logical assumption is that the behaviour and decisions of individuals depend on the macroeconomic peculiarities of their countries. For instance, given the difference in labour market conditions between Germany and Greece, it is expected that the decision-making process of a Greek worker will be more similar to that of another Greek worker than to a randomly chosen German worker.

This state of affairs violates the assumption about the independence of measured units, which is a basic precondition for logit modelling (Hosmer et al., 2013). If clustering is ignored, one risks having biased estimates (Heck & Thomas, 2000; Snijders & Bosker, 1999). In other words, there is a substantial risk of obtaining too small standard errors for some predictors (and consequently too small p-values). This in turn can lead to an inference that a predictor has a significant effect on the variable of interest when in fact there is no real effect (Hox, 2010).

It is therefore crucial to address variation among countries in order to get correct standard errors. There are several available approaches for this, the most convenient among them being multi-level modelling (Hosmer et al., 2013). Unlike other approaches, which only correct random errors by taking into account the existence of variability between clusters/groups, multi-level modelling can also give an insight into the exact nature and scope of between-group variability (Hosmer et al., 2013). In other words, multi-level modelling provides a framework for analysing effects of group-level predictors on individual outcomes by including them in the model of interest alongside individual-level explanatory variables. This is exactly the main reason why multi-level modelling is preferred in this study, since we are particularly interested in country-specific determinants of under-declared employment.

Explicitly, we utilise two-level random intercept logit models, with individuals (level\_1 units) nested within countries (level\_2 units). In its general form, the two-level random intercept logit model is defined as:



$$\ln\left(\frac{\pi_{ij}}{1-\pi_{ij}}\right) = \beta_{0j} + \sum_{k=1}^K \beta_k X_{ijk} + \sum_{s=1}^S \gamma_s Z_{js} \quad (5a)$$

$$\beta_{0j} = \beta_0 + u_j \quad (5b)$$

where  $u_j \sim N(0, \sigma_u^2)$ .

As can be seen from equations (5a) and (5b), a new index 'j' has been introduced to denote each of the level\_2 units (i.e. 28 EU member states). The central difference between equations (4) and (5a) is in the intercept term, which is now country-specific. In other words, instead of one universal intercept term, as was the case in a single-level model (4), now there are 28 different intercept terms. This is clarified in equation (5b), which defines each country-specific intercept as a sum of the average intercept  $\beta_0$  and a group-specific effect  $u_j$ . The intercept for a particular country will thus be lower or higher than the average intercept depending on whether  $u_j$  is greater or less than zero. That is to say, countries with an above average share of under-declared employment will have larger values of the overall residual.

It is also important to note that the right-hand side of the equation (5a) now contains two sets of variables. Alongside individual-level predictors  $X_{ijk}$ , there are also country-level explanatory variables ( $Z_{js}$ ), which can be compiled from other data sources. This will allow us to examine how the specific economic and social climate in which an individual lives and operates can help in explaining their propensity to work on an under-declared basis. Such an approach is particularly effective in testing the relevance of the five contrasting theories introduced in Chapter 2.

Another important merit of multi-level modelling is the possibility for estimating between-group residual variance  $\sigma_u^2$ . It provides an insight into variation that can be attributed to each of the two levels (i.e. individual-level and country-level). This is done by using the variance partition coefficient, which is defined as:

$$VPC = \frac{\sigma_u^2}{\sigma_u^2 + 3.29} \quad (6)$$

In our case, the variance partition coefficient will indicate the exact proportion of the total variability in the propensity to work on an under-declared basis that is due to differences between countries.

It should be stressed here that multi-level logit modelling gives yet another potent tool for analysing the complex mechanisms behind social phenomena. Namely, if there is a reasonable presumption that the effect of level\_1 predictor(s) differs between level\_2 units, then the so-called random slope models can be utilised (Gelman & Hill, 2007; Hox, 2010; Snijders & Bosker, 1999). This is done by adding random coefficients to level\_1 predictor(s), as was done with respect to the intercept in equation (5b). Putting it in the contexts of under-declared employment, one can for instance let the effect of age, gender, tax morale (or any other individual-level predictor) vary across countries. Yet, since there is no theoretical reason to assume a variable effect for any of the possible predictors in the case of quasi-formal employment, random slope models are not used here. In other words, the analyses conducted in this thesis follow the assumption that the effect of all demographic and socio-economic characteristics of an individual on their propensity to work on an under-declared basis is fixed across all member states.

The last issue to outline is the list of predictors used in the search for potential drivers of under-declared employment. Yet, since this task requires a detailed justification of the chosen explanatory variables in the light of the defined research questions, it is deferred until Chapter 4. Instead, we now move to the second outcome variable from the Special Eurobarometer Survey that will be modelled in this study.

### ***3.3.1.2 Understanding worker's satisfaction with envelope wage payments – multi-level cumulative logit model***

In the second step, the idea is to explore why some workers are more satisfied with receiving envelope wages than others. Since there are no previous studies on factors affecting the willingness of quasi-formal workers to keep obeying the unwritten contract between them and the employer, this thesis is therefore the very first attempt to explore the issue. Akin to all other quantitative analyses presented in this thesis, and in line with the standpoints of critical realism, this part of the study also serves solely as a tool to identify associations and patterns, which will then be scrutinised in more detail during the qualitative inquiry.

The main variable of interest is constructed from the following question, which only those respondents in the Special Eurobarometer Survey who admitted receiving envelope wages were asked:

*Were you happy getting part of your salary without having it declared to the tax or social security authorities or would you have preferred to have had your total gross salary declared?*

Every quasi-formal worker was offered five options:

- 1) I would rather have preferred full declaration;
- 2) It depends,
- 3) I am happy with this;
- 4) Refusal and;
- 5) Do not know

There are two problems with this variable that should be discussed at the outset. First, this question was asked only in 2007 and therefore only one analysis will be conducted. Even though this does not represent an important structural problem from the statistical side, the nonexistence of data for 2013 disables any discussion of changes in attitudes of workers and in determinants of these attitudes during the given period. Another problem, which is quite significant from a statistical aspect, is the rather small size of the sample. As stated, only under-declared workers were asked the above question, which gives an overall sample of 616 respondents. While 616 individuals in the sample is a satisfactory number for a single-level analysis, things are much more complicated in the case of a multi-level inquiry, for a closer inspection of data reveals that several countries have only a few individuals answering the above question<sup>29</sup>. Using country-level predictors in such a situation can yield incorrect findings as there is not enough variability within each country, due to the small sample size at the country-level (Gelman & Hill, 2007).

One solution would be to omit countries with a low number of respondents, but this is not recommended here for two reasons. Besides additionally decreasing the number of level\_1 units (i.e. individuals), such an approach would also significantly reduce the number of level\_2 units (i.e. countries), thus undermining both the validity and generalisability of findings. The risk of limited validity is additionally salient

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<sup>29</sup> The problem is exacerbated by 83 individuals having refused to answer or having stated they did not know the exact answer. The strategy to address this issue is explained later in the text.

because all countries that would be excluded due to the small sample size can be classified as developed economies.

Since the issue of sample size in multi-level analysis is particularly delicate for higher levels (see Hox, 2010) the decision was made not to omit any country from the sample. However, this comes at the cost of not being able to use country-level predictors. Accordingly, this stage of quantitative inquiry will also rely on multi-level analysis, but solely individual-level predictors will be used.

Before defining the model of interest, it is important to note that the modelled variable can be perceived as an ordered categorical variable. Taking into account only individuals who chose one of the first three answers to the above question, we can classify them in three groups according to the level of satisfaction. Those who answered 'I would rather have preferred full declaration' can be designated as 'dissatisfied', those responding 'It depends' as 'neutral', and those stating 'I am happy with this' as 'satisfied'. Even though such reasoning can be criticised, it will fulfil its role having in mind that the aim of this quantitative inquiry is to assist in finding regularities and mechanisms, not to establish universal truths. We now turn to the definition of the exact model used in the analysis.

For a variable  $y$  whose values can be ordered so as that each value  $1, 2, \dots, C$  represents one category in a sequence, the response probability for a category  $m$  is defined as:

$$P(y_i = m) = \pi_m \quad (7)$$

where  $\pi_1 + \pi_2 + \dots + \pi_C = 1$

Next, we define the cumulative probability of being in category  $m$  or lower:

$$y_m = P(y \leq m) = \pi_1 + \pi_2 + \dots + \pi_m \quad (8)$$

From (7) and (8) it follows that  $y_1 = \pi_1$  and  $y_C = 1$

A single-level cumulative logit model for an ordinal response variable, which is sometimes also referred to as an ordered logit model, is defined as:

$$\ln \left( \frac{P(y_i \leq m)}{P(y_i > m)} \right) = \alpha_m + \sum_{k=1}^K \beta_k X_{ik}, m = 1, 2, C-1 \quad (9)$$

where  $X_k$  designate explanatory variables,  $\beta_k$  are accompanying coefficients and  $\alpha_m$  represent threshold parameters.

In order to understand the interpretation of the coefficients, it is first essential to realise that the model (9) is just a generalisation of a single-level logit model for a binary response given by (4). Namely, in the case of a binary variable  $y_i$  (coded 0 and 1), where  $P(y_i = 1) = \pi_i$ , equations (9) are reduced to a single equation:

$$\ln\left(\frac{P(y_i \leq 0)}{P(y_i > 0)}\right) = \ln\left(\frac{P(y_i = 0)}{P(y_i = 1)}\right) = \ln\left(\frac{1 - \pi_i}{\pi_i}\right) = -\ln\left(\frac{\pi_i}{1 - \pi_i}\right) = \alpha + \sum_{k=1}^K \beta_k X_{ik} \quad (10)$$

Multiplying the last two factors of equation (10) by -1 gives

$$\ln\left(\frac{\pi_i}{1 - \pi_i}\right) = -\alpha + \sum_{k=1}^K -\beta_k X_{ik} \quad (11)$$

which is a binary logit model (4), but with the signs of the coefficients reversed<sup>30</sup>.

Following this, one can see that coefficients  $\beta_k$  in cumulative logit modelling actually represent the effect of a 1-unit change in each of the covariates on the log-odds of being in a lower category of the modelled variable (not in a higher category, as is the case with binary logit models).

It is also important to stress that the proportional odds assumption is applied here. To be exact, it is assumed that the effect of a predictor on the log-odds of being in category  $k$  or lower is the same for all values of  $k$ . Following this, the log-odds of a response being in any category  $k$  or lower increase by  $\beta_k$  for every 1-unit increase in  $X_k$ . Putting it in the context of our dependent variable, the assumption is that a one-unit increase in a particular covariate has the same effect on the propensity to be indifferent towards under-declaration rather than being dissatisfied as it has on the propensity to be satisfied rather than indifferent. In other words, the three categories of satisfaction are perceived as equidistant. This assumption, while not necessary always the best solution, reduces the number of regression coefficients to estimate.

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<sup>30</sup> Note that there is also difference in the names of intercept terms between the two models, but this is just a matter of notation.

Given the small size of the sample in our case, it would not be possible to obtain robust results without this assumption<sup>31</sup>.

However, since our data are on two levels (individuals within countries), we need to extend model (9) to take this into account. In the same manner as was done with the binary dependent variable earlier, a single-level cumulative logit model (9) is extended to a random intercept cumulative logit model by adding a country specific effect:

$$\ln\left(\frac{P(y_i \leq m)}{P(y_i > m)}\right) = \alpha_{mj} + \sum_{k=1}^K \beta_k X_{ijk}, m = 1, 2, C-1 \quad (12a)$$

$$\alpha_{mj} = \alpha_m + u_j \quad (12b)$$

where  $u_j \sim N(0, \sigma_u^2)$  is the level\_2 random effect or residual.

The thresholds  $\alpha_m$  in (12b) are interpreted as the log-odds that an individual with  $X = 0$  and  $u = 0$  has a response in category  $m$  or lower. Yet the addition of the group-level residual  $u_j$  allows these intercepts to vary from group to group, according to a normal distribution. Parameters  $\beta_k$  measure the effects of a 1-unit change in each of the explanatory variables on the log-odds that a response is in category  $m$  or lower, when the country effect  $u$  is held constant. Each  $\beta_k$  can be perceived as the effect of the accompanying predictor for individuals in the same country.

Like the analysis of the factors behind a decision to enter the under-declared realm, the discussion about the exact predictors used here is to be found in Chapter 4. Yet, before moving to the next source of data, it is important to enumerate the limitations of the Special Eurobarometer Survey on undeclared work and the related analyses.

### ***3.3.1.3 Limitations of the Special Eurobarometer Survey and chosen statistical methods***

Apart from the drawbacks that are common to all questionnaire surveys, and which were mentioned earlier, there are also some other problems that are specific to this particular survey. First of all, the questions about participation in under-declared

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<sup>31</sup> In the absence of the proportional odds assumption, C-1 coefficients for each of the covariates need to be estimated. This reduces to only one under this assumption.

employment were asked only to respondents who declared themselves explicitly as dependent employees working under standard employment relations. In this way, false self-employment is neglected as a potentially important source of under-declared employment<sup>32</sup>. In addition, some important questions asked in the first wave were omitted from the second one. One such example is the question about satisfaction with envelope wages, which is in the focus of this study. As already pointed out, this question was asked in 2007, but not in 2013.

Moreover, the survey does not contain all the individual-level variables essential for understanding the phenomenon. For instance, some important topics such as trust in institutions, experience with corruption in the public sector or the exact size of an individual's wage were not elaborated in the survey. Even though some information on these matters will be obtained owing to the inclusion of country-level indicators, certainly much better insight would be acquired if there were such data for each individual. And finally, this survey is useful only for addressing the first two research questions, as there is no information which would enable insight into the link between minimum wage and the official part of remuneration, or about the distribution of gain from this arrangement.

All these issues further justify the reliance on the mixed-methods approach. Having in mind the enumerated deficiencies, one can understand why the main role of analyses on the Special Eurobarometer Survey on undeclared work in this thesis is solely to provide guidance for the qualitative part of the research. Yet, in spite of all limitations, this survey will certainly reveal some useful information about the link between envelope wage practices and various micro- and macroeconomic factors. In line with this, the greatest merit of the Special Eurobarometer Survey from the perspective of this thesis is in its multi-layer nature (i.e. individuals nested within countries), which enables inclusion of numerous country-level indicators from other data sources (see Chapter 4).

### ***3.3.2 Population survey: Bulgaria, Croatia and FYR Macedonia***

To further explore the nature of under-declared employment from the quantitative perspective, the thesis also discusses the most important findings from a survey of 6,019 respondents in Croatia, Bulgaria and FYR Macedonia (approximately 2,000 per country). This survey was conducted for the purpose of the European Commission's

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<sup>32</sup> 'False self-employed individuals' are those who are in practice working under standard employment relations, but "choose or are forced by their employer to operate as self-employed to bypass the legal requirements of a normal employer-employee relationship or reduce their tax liability" (OECD, 2008, p. 4).

Framework 7 Industry-Academia Partnerships Programme (IAPP) research project entitled 'Out of the shadows: developing capacities and capabilities for tackling undeclared work in Bulgaria, Croatia and FYR Macedonia' (GREY), through which this thesis was funded<sup>33</sup>.

The fieldwork, conducted during the period July-October 2015, followed identical sampling procedures and covered a range of questions similar to those of the Special Eurobarometer Survey<sup>34</sup>. Most importantly, the questions on participation and satisfaction were identical to those in the Special Eurobarometer Survey, which enables triangulation of findings. However, as the author of this thesis was involved in questionnaire design for the GREY Survey<sup>35</sup>, the part of the Survey dedicated to under-declared employment was extended to address other research questions, as well as to further explore findings from the analyses on EU-28.

The biggest merit of the GREY survey from the standpoints of this thesis can be found in the inclusion of three supplementary questions, which were not asked in the Special Eurobarometer Survey on undeclared work but are of vital importance for our research problems. The first of them will for instance certainly help in revealing the role of the minimum wage in the process, as all respondents that admitted receiving envelope wages were asked to state how the exact size of their declared income related to the minimum wage (i.e. was it equal to, larger than or smaller than the minimum wage). Additionally, every quasi-formal worker was asked to state who actually initiated under-declaration of wages (employer, worker or whether it was a joint decision), as well as whether they verbally agreed with their employer to any other condition besides those stated in the work contract. An insight into these three matters will undoubtedly extend our understanding of this complex practice, which further justifies the reliance on the GREY Survey for the purpose of this thesis.

However, alongside the typical shortcomings of questionnaire surveys on undeclared work, which were explained earlier, an additional problem with this survey can be found in the small sample of interest. There were only 2,545 dependent employees in

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<sup>33</sup> Hereafter this survey will be denoted as the GREY Survey. It covers undeclared work in general, but one part was dedicated strictly to under-declared employment.

<sup>34</sup> The questionnaire for the GREY Survey is given in Appendix 1.

<sup>35</sup> The researcher was in charge of preparing the questions on under-declared employment, while all other parts of the questionnaire were developed in collaboration with colleagues from the GREY project. The fieldwork was subcontracted to market research agencies, but all other parts of the process (including cleaning the data and analysing the data presented here) were the author's own work.



all three countries, and only 291 of them admitted receiving envelope wages. This significantly reduces the robustness of regression models, particularly in the case of satisfaction with envelope wages (since only those who confirmed receiving cash-in-hand payments were asked the question about their attitudes towards this practice).

For that reason, the statistical modelling is only appropriate for exploring determinants of participation, while the issue of satisfaction (as well as all other topics of interest) has to be analysed solely from the descriptive angle. Nevertheless, even in the case of participation there is one considerable problem that has to be addressed with caution, and it relates to the fact the survey encompassed only three countries. Since there are only three level\_2 units, multi-level modelling is not applicable at this stage. In line with that, individual-level logit modelling is the only appropriate choice in endeavours to determine which socio-economic and demographic characteristics of workers in South-East Europe can explain their decision to engage in under-declared employment.

Following this, even though our dependent variable is identical to the one described in section 3.3.1.1, the model of interest is much simpler than before. Explicitly, we rely on the model defined by equation (4) above. Yet, to control for the difference between the three countries, the model is extended by including country indicators (i.e. dummy variables). Although being quite limited, such a strategy still fulfils its purpose. In line with the discussed role of the quantitative inquiry in this thesis, the adopted statistical approach at least enables a check on whether the findings from analyses at the EU-level regarding individual-level determinants of this practice also hold true when this specific group of countries is scrutinised separately. The full list and an explanation of the predictor variables used in this single-level logit model is given in Chapter 5.

Finally, the reader should be aware of yet another problem with the GREY Survey which, while common to all other questionnaire surveys, is particularly prominent in this case. Namely, the problems related to the small sample of under-declared workers in the GREY Survey are exacerbated by the quite high number of faulty answers. For instance, out of 2,545 dependent employees encompassed by the survey in all three countries, 117 individuals did not provide a clear answer to the question regarding participation in under-declared employment. This is almost 50% of the total number of those who admitted receiving envelope wages (one might recall that 291 people acknowledged themselves as being under-declared). Although it might seem an efficient strategy, omitting such individuals from further statistical analysis is not recommended for the reasons explained below.

### ***3.3.3 Handling missing values***

As already discussed, there is a reasonable assumption that the proportion of people involved in under-declared employment is much higher than suggested by the aforementioned surveys on the matter. One reason for this can be found in the illegitimate nature of this arrangement, which probably prompted some people to refuse to answer the question or falsely deny involvement in such activities out of fear of being prosecuted. On the other hand, some people possibly failed to give a correct response because they did not understand the question, which could for instance have happened if the interviewer did not clearly explain the definition and scope of under-declared employment. Finally, in some occasions it could be that survey respondents were not willing to cooperate any longer, and therefore they chose to refuse to answer all remaining questions or simply stated they did not know the exact answer to some of them so as to speed up the process.

While not much can be done in the case of respondents who falsely or accidentally denied involvement in envelope wage practices, there are effective strategies to utilise data from those who refused to answer or did not know the exact answer (Collins, Schafer, & Kam, 2001; Newman, 2014; Schafer & Graham, 2002). First of all, it is important to realise that in our case there indeed exists a 'true' value for each modelled variable. That is, every dependent employee either had been or had not been working on an under-declared basis, and therefore the answers 'Yes' and 'No' are the only real choices. A similar reasoning can be applied to the question on satisfaction, since it is certain that every quasi-formal worker has some attitude towards their own position.

Even though researchers using secondary data sources usually cannot know the exact reason why a person failed to give a 'true' answer, this does not mean that such individuals can be ignored (D. R. Johnson & Young, 2011; Little & Rubin, 2002). Consider for instance the question on participation in envelope wage practices: if it is indeed the case that many of those who failed to provide the 'true' answer did it on purpose owing to some underlying reason(s), omitting such individuals from statistical analyses would certainly yield biased inferences (Collins et al., 2001; Enders, 2010; van Buuren, 2007). This is not only because incorrect information about the prevalence and distribution of this practice will be obtained (as the real extent would be under-estimated), but because there is a risk of drawing false conclusions regarding the effect of individual-level characteristics on decisions to enter this realm. If there are one or more underlying factors that can explain why a person failed to give

the 'true' answer, then excluding individuals with missing values would result in a loss of information about the relevance of that particular factor(s). For instance, married individuals might be less likely to admit this practice due to a rather large moral cost or fear of prosecution in comparison to those who are single. Similarly, the propensity to give a faulty answer might also be dependent on a person's age, the size of the company they work for or some other factors.

For that reason, even though the exact motivation for people to give faulty answers is often outside the reach of a researcher, this issue should be addressed so as to obtain valid inferences (Enders, 2010; D. R. Johnson & Young, 2011; Rubin, 1987). There are several methods by which this can be done, each of them with its own strengths and weaknesses (Enders, 2010; Schafer & Graham, 2002). In this thesis we use the multiple imputation technique, which is recognised as the most efficient method for handling missing values (Newman, 2014; van Buuren, 2007). Developed by Rubin (1987), the multiple imputation technique is based on drawing inferences from a likelihood function that utilises the available information in order to predict the true values. In other words, a missing answer for each single respondent is replaced by a set of plausible values using available information (on this individual, as well as on all other individuals in the sample) and controlling for probabilistic uncertainty (Little & Rubin, 2002; Rubin, 1987; van Buuren, 2007).

This is done through the set of simultaneous imputations which yield  $n$  complete datasets ( $n$  stands for the exact number of parallel datasets produced, which has to be determined in advance by the researcher). These parallel datasets differ solely in the values that were previously missing (i.e. that are imputed by the procedure), while all existing original values are simply copied to each of the datasets. In the next phase each individual dataset is analysed separately using the statistical model of interest (Enders, 2010; van Buuren, 2007). The final results are then combined following the procedure defined by Rubin (1987), which yields statistically valid inferences. Since the exact assumptions and technical details of the multiple imputation technique are beyond the scope of this thesis, the curious reader is advised to consult for instance Little and Rubin (2002).

### **3.4 Qualitative inquiry - data sources and research methods**

The data gathering process for the qualitative part of the research was conducted in Croatia by the author through face-to-face interviews with both under-declared workers and representatives of relevant institutions. The first phase, which took place immediately after finalising the statistical analyses of data from the Special Eurobarometer Survey, encompassed 30 under-declared workers and was primarily focused on their experiences before and during the course of quasi-formal employment. Interviews with representatives of the authorities, trade unions and employers were conducted in the last phase of the study, after obtaining a comprehensive insight into the most important aspects of the phenomenon. There were talks with three individuals from each of the three groups of stakeholders, which gave a total of nine interviews for that phase of the study.

#### ***3.4.1 Interviews with under-declared workers***

As under-declared workers represent a hard-to-reach population, snowball sampling was applied to find potential research participants. Snowballing is an efficient strategy for recruiting informants who are difficult to locate or contact (Faugier & Sargeant, 1997) and therefore was an appropriate choice for the purposes of this thesis. However, given that it yields non-random data, it is essential to point out another important drawback of this sampling method, which had to be addressed during to the fieldwork. As Rapoport (1957) points out, sometimes several different subsets of target individuals may exist and thus snowballing can result in severe bias if only one 'ball' is used. Considering the earlier discussion about potentially different groups of envelope wage earners, there was a reasonable assumption that more than one chain (i.e. several different initial informants) was needed. Following this, all precautions were taken to obtain as diverse a sample as possible, which resulted in four independent chains of research participants.

Fieldwork took place during spring 2015 in Zagreb, the capital of Croatia. Personal contacts and friends were used to find initial informants and only individuals above 18 years of age were considered as potential participants. If an initial interest was expressed after a phone call or e-mail communication, each potential participant was sent the Information Sheet with a comprehensive explanation of the research and their

role in it<sup>36</sup>. This included the aims and objectives of the research, reasons why their participation was important, how they were chosen, clarification of the voluntary nature of their involvement, the envisaged duration of the interview, the topics to be covered, strategies to ensure confidentiality and issues regarding storage and usage of obtained information. Sufficient time to consider whether or not they wished to participate was given.

All interviews were conducted in the Croatian language after obtaining signed consent. Since the intention was to compare standpoints, norms and beliefs of different socio-economic groups, while at the same time allowing new thoughts to be brought up, a semi-structured form of interviewing appeared the most appropriate choice. The accent was on gathering in-depth data by using a set of open-ended questions, supplemented with some scaled attitudinal questions.

An equal emphasis was placed on all research questions, with particular attention to the relationship between employers and employees. This primarily refers to the role of employees in the decision to under-declare income, as well as to the course of the negotiation process between the two parties. Besides this, the focus was on the perception of interviewed individuals about this practice, but also on some important aspects in the decision-making process (such as perceived fairness in distribution of welfare, trust in institutions, trust in long-term viability of the pension system, etc.). As the exact structure of the questionnaire was defined after findings from the quantitative analyses on the EU-level were obtained, a more detailed explanation and justification of the chosen questions will be given in Chapter 5.

The initial idea to embrace solely those individuals that were working on an under-declared basis at the moment of the interview proved to be deficient at the very beginning of the fieldwork. Although they were able to provide the most important rationales for accepting quasi-formal jobs and describe the negotiation process between them and the employer, such individuals were often unable to give a complete and in-depth account of their situation. While some of them had just started their employment and thus could not assess the 'climate' inside the company, others actually never reconsidered their actual position and future prospects. This issue was particularly pronounced in the case of young individuals for whom their current quasi-formal job was the very first experience in their career.

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<sup>36</sup> See Appendix 6.

Given this, after a few interviews the decision was made to include individuals who were not working on an under-declared basis at the time of the interview, but had had recent experience. Indeed, that proved to be appropriate as these individuals were not only able to illuminate the negative aspects of such arrangements (many of which were the main reasons for them leaving their employment), but also had firmly shaped attitudes towards this type of work. For most such participants, the end of employment was the spark that ignited self-reflective assessment and substantially influenced decisions later in their career. Still, since the emphasis of this thesis was on the present-day state of affairs on the under-declared labour market, the researcher decided to focus only on those former quasi-formal workers whose employment had terminated recently. This 'recently' implied ideally a few weeks or months prior the interview and strictly no more than one year.

Still, it should be stated that a few exceptions from this rule were made during the later phase of the interviewing process. This was done not only because the stories of these 'exceptions' were able to illuminate some new aspects of the phenomenon, but also to obtain an insight into the evolution of this type of employment during the last decade. The inclusion of such individuals in the later phase was further justified by the fact that the stories gathered from currently and recently employed under-declared workers had started to repeat, thus indicating that the saturation point was close.

Two of those 'exceptional' individuals had worked on an under-declared basis during the early 2000s, and one during 2010. In addition to these, the sample also includes one retired person who earned his pension as an under-declared director of one small company. He had been receiving part of his salary in cash for 14 years prior to his retirement in 2012. Finally, the sample also includes a person who was still working for the same company in which she had been receiving one part of her salary in cash during the 1990s and 2000s. As well as providing knowledge about the different strategies of generating cash inside the system, which is understandable given her position as a manager, this informant also helped in clarifying some important factors that underlie the decision-making process of employers regarding under-declaration of their workers. In addition, although she personally was not receiving envelope wages any more, she was still a part of the well-established system of (illegitimate) solidarity among employees that created cash for those individuals in the company who were still under-declared.

Alongside these five cases, the final sample includes 16 people who were working under-declared at the time of the interview, three individuals that quit their job up to two months prior to the interview and six who did so between 2 and 12 months preceding the research. This gives a total of 30 interviewed quasi-formal workers, 16 of whom were women and 14 men.

#### ***3.4.1.1 A researcher's reflection on experiences from the recruitment process***

Following uncertainty related to abovementioned difficulties in finding individuals that would be willing to share their experience from this illegitimate type of employment, this stage of the study was envisaged to last for at least three months. However, as there had been some unforeseen delays in previous segments of the thesis, the decision was made to start contacting friends and acquaintances immediately upon obtaining ethics approval so as to speed up the recruitment process. Indeed, that proved to be a good strategy as several potential participants were found even before the departure for Croatia. Notwithstanding expectations, only few of the contacts had known nobody working under such arrangements. What is more, some contacted acquaintances had even been working under-declared themselves.

A further surprising fact was the willingness of people to participate, regardless of whether there was a close social link between them and the researcher (i.e. friends or acquaintances of the researcher) or whether they were further on in the 'snowball chain'. Yet, it should be admitted that the further a person was in the chain, the more encouragement was needed for them to accept participation in the study. However, it was on only a few occasions that those with no firm social tie with the researcher refused to take part after being asked by their friends or colleagues (prior to any contact with the researcher). Once contact with the researcher was established, generally there were no further problems.

Although on several occasions additional clarification about the study was requested before the Consent Form was signed<sup>37</sup>, in most cases the information given in the Information Sheet proved to be enough. For the minority of the vigilant potential participants, the fact that the study was being conducted for a research degree in the UK rather than in Croatia was the crucial factor in agreeing to participate. The fear of prosecution by the Croatian authorities suddenly became far less relevant as an issue once they realised that the thesis would be published elsewhere. Moreover, since

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<sup>37</sup> Details about the Consent Form and other ethical requirements are given in section 3.5.

academic degrees from developed countries have a much higher value in the eyes of Croatian citizens than domestic ones, many of those who would probably decline participation in normal circumstances were willing to help in this particular situation.

As a matter of fact, some of the younger respondents saw the interview as an opportunity to find out more about possibilities for education and/or employment in the UK, as well as about the lifestyle in general. On the other hand, several older individuals expressed serious interest about the research when they heard that the thesis is being financed by the European Commission. Namely, they were quite amazed that the Commission would spend money on a study about what they saw as such a trivial and standard thing. Following this, it is not surprising that many of the participants asked to be sent the final version of the thesis just to find out more about experiences of other quasi-formal workers in Croatia.

The above discussed specifics can also help in explaining the high consent rate regarding the usage of a voice recorder during the interview. Contrary to expectations, some two thirds of informants agreed to be voice-recorded, which significantly facilitated and accelerated the interviewing process. Therefore, soon after commencing the fieldwork it became obvious that the position of Ph.D. student in the UK was quite beneficial for the researcher in several aspects. However, the very same thing also brought some potential issues. To be exact, as most respondents were willing to tell more than anticipated and necessary, the researcher had to be aware of all ethical and moral requirements so as not to overstep his authority.

Since recruiting and interviewing quasi-formal workers proved to be a much easier task than expected, the entire process ended in a far shorter time than envisaged. In spite of several bank holidays, as well as the desire of the researcher to transcribe as many interviews as possible immediately after they were finished, the interviewing phase was completed in exactly two months, to the point that the researcher was convinced that saturation in terms of new information had been reached. In total, 30 under-declared workers with stories from 28 different employers were interviewed. That is to say, there were only two pairs of respondents working for the same employer, whilst all the others had their 'unique stories'.

#### ***3.4.1.2 Arranging and managing interviews - challenges and issues encountered***

Given the sensitivity of the topic, the researcher preferred public places for the interviews as they guaranteed a much larger level of comfort for both parties.



Accordingly, coffee bars with terraces were commonly suggested to participants, and in most cases the interviewees found the offer acceptable. On several occasions when the potential respondents expressed a desire to meet elsewhere, a special procedure was followed to secure the safety of the researcher. That is, on every such occasion a colleague from the Institute of Public Finance, which is the home institution of the researcher, was informed about the exact address that was being visited. The researcher carried a mobile phone and called after the interview to confirm that everything went fine. Nonetheless, there were no unpleasant situations, and this applied to both interviews conducted in private properties and those held in public places.

Several individuals were interviewed in their homes, while two others were interviewed at their respective workplaces<sup>38</sup>. The latter freely talked about their experience in the jobs which they were conducting in the workplace where the interviews were held, without any fear of being interrupted by their colleagues or bosses. In spite of the researcher's unwillingness to conduct interviews at employers' premises, in these two cases the exception was made after ensuring that this would not have any professional consequences for participants or influence the credibility of their stories. This was secured by meeting at a time when the respondents were alone at the workplace and by the agreement to keep the role of the researcher completely secret if someone else were to appear. Nevertheless, it soon became obvious why the two were not afraid to talk about the topic in their offices, as they both were participants in a well-established pact between employers and employees against what they saw as the over-intrusive state.

In general, no problems with terminology were encountered since all respondents were quite familiar with terms such as 'envelope wages' and 'the grey economy'. Although several interviewees were somewhat reserved at the start of their interview due to the nature of the topic, they became more expansive after a few initial questions. This suggests that under-declared employment is not such a sensitive topic in Croatia as one would expect.

There was only one case when an intervention was needed so as to protect the wellbeing of a respondent. That particular conversation seemed to be the first occasion on which the interviewee had seriously reflected on their position, which culminated in the interviewee becoming upset in the middle of the interview.

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<sup>38</sup> These are two non-related individuals working for two different employers.

Nonetheless, after a few minutes break from the topic, the interviewee recovered their composure and the interview continued.

Still, several other participants became quite angry after commencing discussion about the state institutions. While some started cursing the government and politicians in general, some others went on to talk about their desire to leave the country. In such situations, the individuals were left for a while to finish their thoughts and then promptly shifted back to the main topic.

In addition to these, there were also three cases when interviewees expressed some irritation with the researcher. As the researcher strived not to show his level of knowledge about the phenomenon in order to stay as neutral as possible, the participants started challenging his competence. In all three cases they asked the quite common question: “You don’t live in this country, do you?”, which is used in Croatia when a person wants to tell somebody that he or she is stupid or naive. In these cases, the researcher simply reiterated his role in the interview, which was enough to ensure that the interview continued in an amicable way.

Finally, there was only one situation where a person cancelled a previously arranged meeting and later stopped responding to calls. In one other case the candidate did not show up at the interview, but later apologised and set up a new meeting. These two particular events resulted in moments of desperation and disappointment for the researcher, which are inevitable when first conducting this type of research. However, as they were the only unpleasant situations during the fieldwork, this first attempt to conduct qualitative research must be appraised as a positive experience for the researcher.

### ***3.4.2 Interviews with representatives of relevant institutions***

Although workers and their behaviour are in the main focus of this thesis, it is also important to see how other participants in the process (i.e. trade unions, employers and the authorities) perceive the issue of under-declared employment so as to have as comprehensive an overview of the state of affairs as possible. Given that interviews with quasi-formal workers were conducted in Croatia, this South-East European country thus appeared as the most plausible choice for this last phase of the study.

The idea was not only to further extend the acquired knowledge about this practice in Croatia, but also to compare how different stakeholders saw the issue of under-

declared employment from their own perspectives. Particular emphasis was placed on differences in perceptions and attitudes of interviewees that can be ascribed to the role and objectives of the institutions they were representing.

In any case, one must be aware that most of the findings from the qualitative interviews with representatives of institutions in Croatia should be perceived as a pure specificity of this transition country and thus cannot be claimed to hold true in other EU member states. Still, this part of the study indeed revealed a few aspects of this phenomenon that are universal for all countries and societies, and which have not been researched so far. Particularly valuable in this regard were interviews with the representatives of the regulatory apparatus, who shared their experience from the field and pointed out some important obstacles regarding detection and prosecution of this practice.

In line with the objectives of this phase of the study, the interviews were unstructured, i.e. only broader thematic areas to be covered were developed<sup>39</sup>. The idea was to have all three interest groups in the process (i.e. trade unions, employers and the authorities) equally represented, and therefore three institutions from each group were sought. Accordingly, this phase of the study followed a purposive sampling procedure, which was accomplished in two steps. The first step assumed selection of the most relevant institutions in this respect, while in the second step the most suitable interviewees from these institutions were sought.

#### ***3.4.2.1 Selecting most relevant institutions***

The selection of the government institutions was quite straightforward. Since the Ministry of Labour and Pension System is the central body responsible for creating policy measures to tackle unregistered economic activities in Croatia, its inclusion appeared to be a logical decision. Besides obtaining information about the prevalence, structure and dynamics of under-declared employment in Croatia, the interview with the representative of the Ministry was thus also an opportunity to get an insight into the policy strategies applied to tackle this practice.

The other two government institutions whose representatives were interviewed are the Labour Inspectorate and the Tax Administration. The decision to include them was made on the basis that they are responsible for the detection and prosecution of noncompliant practices. Since they are the cornerstones of the regulatory apparatus in

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<sup>39</sup> See Appendix 5.

Croatia, the representatives of these two institutions were expected to share their experience with violators and problems encountered in this respect.

In order to obtain as accurate a depiction of the state of affairs as possible, the initial strategy for finding the most suitable representatives of trade unions and employers' organisations was to start with sectors in which envelope wage practices are most commonly found in Croatia. Since the findings from earlier parts of the study indicated that the construction industry is one such sector<sup>40</sup>, the decision was made to include the CEA - Construction Employers' Association<sup>41</sup> and the Trade Union of Construction Industry of Croatia in the sample. These two are the largest and most influential organisations in this sector, which made them the most appropriate choices.

To get a broader overview of the state of affairs from the perspective of trade unions, the decision was made to select the Independent Trade Unions of Croatia and the Union of Autonomous Trade Unions of Croatia. These two institutions, which essentially operate as representatives of trade unions at the national level, are the largest organisations of this type in Croatia with some 110,000 and 98,000 members respectively (Eurofound, 2015). In line with this, they are among four associations that represent trade unions in the Economic and Social Council, which is the central body for the national tripartite dialogue in Croatia. The Independent Trade Unions of Croatia encompasses trade unions from both the public and private sectors, while the Union of Autonomous Trade Unions of Croatia includes mainly trade unions from the private sector.

Turning to employers, the Croatian Employers' Association emerged as the most logical choice for obtaining a general understanding of employers' views in relation to envelope wages, given that it is the only representative of employers in the Economic and Social Council. The main role of the Croatian Employers' Association, which operates as a voluntary and non-profit organisation comprising 30 branch institutions, is to promote and advocate the interests of its members in Croatia and overseas. Finally, the sample also includes the representative of the Croatian Chamber of Economy, which is the oldest institution of this kind in Croatia and the only one having

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<sup>40</sup> As will be seen in Chapter 5, under-declaration of wages in Croatia is most frequent in the construction industry and agriculture.

<sup>41</sup> CEA stands for the Croatian Employers' Association, which is the supreme employers' association in Croatia. However, it should be stressed that the conversation with the representative of the CEA - Construction Employers' Association was focused only on the situation in the construction sector.

compulsory membership<sup>42</sup>. Since it does not participate in the tripartite dialogue, the Croatian Chamber of Economy was included primarily in order to discover more about the motivations of employers for engaging in envelope wage practices.

To sum up, the last stage of the study on the phenomenon of under-declared employment encompassed nine representatives of relevant institutions in Croatia, one from each of the following: Ministry of Labour and Pension System, Labour Inspectorate, Tax Administration, Independent Trade Unions of Croatia, Union of Autonomous Trade Unions of Croatia, Trade Union of Construction Industry of Croatia, Croatian Employers' Association, CEA - Construction Employers' Association and Croatian Chamber of Economy.

#### ***3.4.2.2 Recruiting participants and arranging interviews – summary of the experience from the fieldwork***

Once the list of institutions was complete, the next step was to find an individual with the most profound understanding of this problem in each of them. This was done by contacting the abovementioned organisations directly, either by phone or e-mail. After explaining the purpose of the research and the exact reasons why their help was needed, each organisation was asked to recommend one of their employees that would be able to provide useful information on this topic. Once the potential candidates were identified, the researcher contacted each of them by e-mail, which involved sending the Information Sheet and all additional information if required.

In general, finding the most suitable candidates and obtaining their consent was a much easier task than expected. All contacted individuals agreed to take part in the study and the interviews were in most cases held within a few days of the initial contact. All nine interviewed individuals were among the highest ranked people in their organisations and therefore had a certain insight into the matter, as well as into the steps their organisation has taken so far to reduce this type of employment in Croatia.

The fieldwork took place during April and May 2016, with all interviews being held at the workplace of the participants. As was the case with under-declared workers, interviewees in this phase of the research also expressed curiosity regarding the findings of the study and therefore most of them asked to see the thesis once it is

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<sup>42</sup> All physical persons, as well as all legal persons having headquarters in Croatia, that run any type of business are obliged by law to be members of the Chamber (Official Gazette, 1991).

published. All interviewees gave their consent for the conversation to be recorded, which significantly facilitated and accelerated this phase of the research. There were no unpleasant situations, nor were any problems encountered during the fieldwork. This final stage of the fieldwork thus additionally increased the self-confidence of the researcher when it comes to conducting qualitative research.

### ***3.4.3 From raw data to meaningful representation of qualitative findings by applying thematic analysis***

Once the fieldwork is done and all material is arranged, a qualitative researcher is faced with the challenge of data analysis. In its essence, qualitative data analysis assumes a strategic approach for “bringing order, structure and interpretation to the mass of collected data” (Marshall & Rossman, 1999, p. 150). This particular stage of qualitative inquiry thus requires a rigorous set of analytic steps so as to achieve meaningful elaboration of the researched matter based on raw qualitative data (Pope, Ziebland, & Mays, 2000).

Many techniques for analysing qualitative data have been developed so far, reflecting the variety of available epistemological positions, the diversity of research goals that can be accomplished by qualitative studies and the complexity of information provided by this particular strategy of inquest (Miles, Huberman, & Saldaña, 2014; Vaismoradi, Turunen, & Bondas, 2013). For instance, if a primary interest of a researcher is on frequency of a particular word or concept used by interviewed individuals during conversation, then they would apply ‘content analysis’ (Hsieh & Shannon, 2005). Similarly, if the focus is on the way people express themselves in relation to a certain topic from the linguistic perspective, then ‘discourse analysis’ would be in place (Hodges, Kuper, & Reeves, 2008). On the other hand, if the aim is to understand various complex mechanisms and their associations, rather than individuals and their discourse, then thematic analysis would be the most appropriate choice (Clarke & Braun, 2017; Guest, Macqueen, & Namey, 2012; Vaismoradi, Jones, Turunen, & Snelgrove, 2016)<sup>43</sup>.

Given the nature of quasi-formal employment and the identified research problems in this thesis, the latter appeared to be the most plausible strategy for analysing both waves of qualitative interviewing introduced above. Thematic analysis can be defined

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<sup>43</sup> These are just some of the most frequently used approaches. For discussion about other available data analysis methods see for instance Miles et al. (2014).

as “a method for identifying, analysing and reporting patterns (themes) within data” (Braun & Clarke, 2006, p. 79). Its main aim is to find and group together key topics that occurred during discussion with research participants so as to enable systematic and articulate interpretation of the researched matter. As argued by Guest et al. (2012, p. 11), thematic analysis is “the most useful in capturing the complexities of meaning within a textual data set”, and was therefore highly suitable for our study.

Besides not imposing any limitation with respect to the nature of the research questions involved, method of data collection and sample size, the main advantage of this strategy over other available data analysis methods can be found in a wide range of philosophical positions it goes in line with (Braun & Clarke, 2006; Vaismoradi et al., 2013). Thematic analysis is essentially compatible with both constructivist and realist paradigms and therefore “can be applied across a range of theoretical and epistemological approaches” (Braun & Clarke, 2006, p. 78). Yet, this does not mean that it is free of epistemological assumptions, but only that it provides a flexible framework for a researcher to analyse data in line with the chosen philosophical standpoint. In any case, it is important to stress that thematic analysis is fully legitimate as a data analysis strategy within the critical realist perspective (which is pursued through this thesis), as long as it is conducted in line with the underlying assumptions of this particular philosophy (Clarke & Braun, 2017).

There are two possible strategies by which to conduct thematic analysis of qualitative data. The first of them is a theory-driven approach, in which a list of themes is developed on an a priori basis (Fereday & Muir-Cochrane, 2006; Guest et al., 2012)<sup>44</sup>. This is done in situations when qualitative research serves to test and/or further develop available theories about the researched phenomenon. However, thematic analysis is also appropriate within the data-driven approach, i.e. in situations when there is a limited previous knowledge about the matter of interest or a particular study represents the very first attempt to understand an issue (Fereday & Muir-Cochrane, 2006). In such circumstances, themes are derived after all interviews are conducted and transcribed. This makes thematic analysis particularly useful when

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<sup>44</sup> A theme can be defined as an attribute which “contains codes that have a common point of reference and has a high degree of generality that unifies ideas regarding the subject of inquiry” (Vaismoradi et al., 2016, p. 101).

investigating under-researched areas (Braun & Clarke, 2006), as quasi-formal employment certainly is.

It is important to stress that these two strategies were combined in our study, reflecting the complexity and interdependency of the identified research questions on the one hand and the role of qualitative research within the study on the other hand. A substantial number of topics had been predefined, especially concerning the analysis of interviews with under-declared workers. This resulted primarily from the fact that the main goal of qualitative research was to further explore the findings from the quantitative inquiry. In addition, since the idea was also to test and extend findings from the previous research on this issue, many themes considered were in fact theory-driven.

However, as explained above, the limited previous knowledge about this phenomenon resulted in a decision to conduct semi-structured interviews with workers and unstructured interviews with institutional representatives so as to enable new thoughts to be brought up. Since the researcher could not predict which new themes would appear important in this respect, they had to be identified after the end of fieldwork according to the data-driven approach.

For both qualitative datasets analysed in this thesis, the six-step scheme was followed (see Braun & Clarke, 2006). That is, the analysis started with a comprehensive reading (and rereading) of the transcribed material in order to identify individual topics that were essential for understanding the subject of the research. To enable a systematic insight into these topics across a vast body of transcribed material, each of them was then assigned its own code, whereas individual parts of the transcribed text referring to a particular topic were coded in the same category. As already said, some categories were predefined owing to the results from the previous research on the matter, as well as reflecting the findings from the quantitative parts of this research. Still, a great many codes were data-driven.

After all the categories were defined, they had to be grouped into broader thematic areas (i.e. themes). The fourth step assumed reviewing themes so as to see if the identified set of themes covered all essential aspects of the subject. Once this process was finished, each theme was given a clear definition and a name. The last step



assumed producing the report on the most important findings in line with identified themes and associations among them<sup>45</sup>.

To sum up, this comprehensive study on the phenomenon of under-declared employment in the EU was conducted in four stages. Quantitative analyses were conducted in phases one and three, each relying on different datasets: the first phase utilised data from the Special Eurobarometer Survey on undeclared work in the EU (2007 and 2013), while the third phase was based on data from the GREY Survey, which encompassed individuals from Croatia, Bulgaria and FYR Macedonia. Qualitative research was conducted during phases two and four. In the second phase of the study, 30 under-declared workers were interviewed in the capital of Croatia, while the last phase embraced nine representatives of relevant institutions in this South-East European country. Yet, before moving to the presentation of research findings, it is first important to point out numerous challenges from the perspective of research ethics and describe all the steps that were taken to avoid potential ethical issues during the course of this study.

### **3.5 Ethical issues**

In general, under-declared employment is perceived as a sensitive topic given that this practice is a form of tax evasion. Although having a legitimate job, workers receiving envelope wages commit an offence and thus can be prosecuted by the authorities. The illicit nature of this practice therefore entails some important ethical issues which had to be addressed during the fieldwork and data storage process. As unfair use of provided information could have caused severe consequences for research participants (e.g. prosecution by the Tax Administration or conflicts with the employer) all necessary steps had to be taken so as to secure full confidentiality.

Starting with the Special Eurobarometer Survey on undeclared work, both the 2007 and 2013 survey datasets provide anonymised data that are publicly available<sup>46</sup>. On the other hand, data gathering for the GREY project was subcontracted to local market research agencies, but followed all ethical procedures required by the European Commission and the University of Sheffield<sup>47</sup>. Given this, the usage of anonymised

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<sup>45</sup> To ease this process, data from both waves of the qualitative inquiry were analysed using the qualitative data analysis tool NVivo.

<sup>46</sup> See <http://www.gesis.org/eurobarometer-data-service/data-access/>

<sup>47</sup> Ethics approval was acquired by Professor Colin C Williams from the University of Sheffield Research Ethics approval system.

datasets in the quantitative inquiries eliminated any ethical issues regarding confidentiality and the safety of the research respondents. There were though some other ethical issues which had to be borne in mind during the quantitative phase of the study. These are first linked to honest, objective and scrupulous processing and presentation of data. Following this, the researcher declares at this point that all conclusions drawn from the statistical analyses on the above datasets are the result of a rigid statistical approach, which followed a composite set of predefined steps to maximise the validity of the findings. In addition, selection of country-level explanatory variables was strictly grounded on the theoretical debates presented in Chapter 2 and only the most credible sources were used for obtaining these indicators (see Chapter 4). Finally, all efforts were made to avoid selective presentation of the findings.

Yet, things were much complicated in the case of the qualitative inquiry as it assumed direct contact between the author, who developed the research instruments and did the interviews, and study participants<sup>48</sup>. Alongside the enumerated necessities for objective presentation of findings, which was crucial for both quantitative and qualitative stages of the research, there were some other ethical issues that were specific to the qualitative inquiry. This firstly applies to minimising the risk of any harm to research participants during and after the interaction. Accordingly, the interviewing process was planned thoroughly, which resulted in interaction with every participant following an identical procedure, as explained below.

Firstly, each participant was familiarised with the purpose of the research and their role in it before commencing the interview. In addition, interviewees were provided with a clear statement that data will be used only for academic purposes, and that names and other personal information which could reveal their identity will be rendered non-identifiable. Finally, each individual was asked to sign the Consent Form and the interview commenced only if consent was obtained<sup>49</sup>. During the interviews, informants were reminded that they were free not to answer the question or even to quit at any moment if they felt uncomfortable. In addition, they were reminded several times about the confidentiality of research and the steps taken to secure full anonymity. Apart from this, each interviewee was treated with full respect: no attempts to influence their answers or decisions about not answering any question

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<sup>48</sup> Ethical approval for qualitative interviews was obtained by the author from the University of Sheffield Research Ethics approval system.

<sup>49</sup> See Appendix 7.

were made at any point. At the end of the interview, each individual was informed they could be sent a summary of the research.

Apart from this, special attention was paid to the comfort of the participants during the course of the interview. Although the potential for psychological distress to participants was not substantial, it was reasonable to expect that some under-declared workers might feel uncomfortable talking about certain aspects of this sensitive topic with a stranger. In a few such situations encountered during the fieldwork, a few-minute break from the topic proved to be an efficient remedy for the problem.

Data from the qualitative research were held securely according to the EU data protection directive and Data Protection Act 1998. Care was taken that personal data and information obtained from each individual interviewee were not conveyed to other participants or anyone else. Audio tapes were transcribed after the end of each interview by the researcher and immediately destroyed. Names and all other personal information which could reveal participants' identity were rendered non-identifiable. If recording had been refused, then notes taken during the conversation were properly transcribed (to secure anonymity) and also destroyed. Following this, no personal details or contact details of any participant were included in the database and the same applied to reported findings in this thesis. In the case of interviews with the representatives of institutions, additional permission was sought to name organisations and indicate the policy of the organisation.

The final databases were stored on a portable storage device (USB memory stick) and adequately protected (i.e. encrypted by a password). A backup version of the data was stored on another storage device, with a password known only to the researcher. The portable devices were securely stored in a locked filing cabinet when not on his person. The researcher was the only person with access to the data. Data were destroyed upon completing all analyses and writing.

After defining the research questions and clarifying methodological issues, we move to the main part of the thesis. The comprehensive insight into the causes and nature of quasi-formal employment starts with Chapter 4, which brings the findings from the quantitative study on this illegitimate wage practice in the EU. Chapter 5 provides yet another set of results based on quantitative inquiry into the matter, but on different data source. As explained, the main purpose of this part of the thesis, which utilises data from the representative sample of individuals in Croatia, Bulgaria and FYR

Macedonia, is to triangulate and further extend findings from the preceding parts of the study<sup>50</sup>. Chapters 6 and 7 provide in-depth discussion about the mechanisms supporting this type of employment in a transition setting, based on qualitative interviews with under-declared workers in Croatia. This is followed by Chapter 8, which summarises the most important findings from interviews with representatives of nine institutions in Croatia. Chapter 9 gives concluding remarks, with particular emphasis on the most appropriate policy strategies to tackle the phenomenon.

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<sup>50</sup> Despite being conducted in the third stage of the thesis, quantitative analyses on data from the GREY Survey will be presented before discussing findings from the qualitative interviews. This is done for practical reasons so as clearly separate outcomes of the two research perspectives, in line with their role in academic research from the standpoints of critical realism.

## **4 EXPLORING RATIONALES OF EU WORKERS FOR JOINING AND STAYING INSIDE (OR LEAVING) THE UNDER-DECLARED REALM - A QUANTITATIVE INSIGHT**

This chapter evaluates the first two research questions, which are related to the supporting mechanisms behind quasi-formal employment. First we search for the factors that can explain why some EU workers engage in envelope wage practices and others do not, and then move on to a discussion about the views of under-declared workers in relation to their own position. This is done by applying logit modelling on data from the Special Eurobarometer Survey on undeclared work in the EU.

The intention here is not to develop universal theories about the phenomenon in the EU, but rather to illuminate some interesting features of this illegitimate type of employment, which will be then used as a starting point for subsequent inquiries. The validity of the findings presented in this chapter is further evaluated on data from Croatia, Bulgaria and FYR Macedonia (see Chapter 5). In addition, the results from the quantitative analyses at the EU-level were subsequently used to develop the questionnaire for in-depth qualitative interviews with under-declared workers in the newest member state, Croatia.

### **4.1 Understanding the reasons for participation in envelope wage practices**

As mentioned in section 3.3.1.3, the Special Eurobarometer Survey lacks some important data that are necessary for a more profound insight into the roots of quasi-formal employment in the EU. This is mainly due to two key reasons. First of all, both waves of the survey (i.e. Special Eurobarometer 284/Wave 67.3 and Special Eurobarometer 402/Wave 79.2) were large-scale studies on a number of matters. Alongside undeclared work, the Special Eurobarometer 284 also covered some non-related topics such as EU relations with neighbouring countries, development aid and health care services. On the other hand, participants in the Special Eurobarometer 402 were also asked a set of questions on science and technology, cultural activities, internal market and non-urban road use. Such a wide range of topics inevitably limited the scope of inquiry regarding undeclared work, as well as the number of questions on the demographic and socio-economic characteristics of the surveyed individuals.

What is more, most questions regarding illegitimate economic practices were focused on completely unregistered activities, and therefore quasi-formal employment was only partially addressed.

Another important reason for a limited range of individual-level variables can be found in the sensitivity of the topic. Given the illicit nature of undeclared and under-declared activities, more delicate questions could have resulted in discomfort being felt by the respondents, which then in turn would have increased the drop-out rate and the proportion of false and faulty answers. Accordingly, one should not be surprised that there were no questions on exact income, the amounts of evaded taxes and social security contributions, nor about personal involvement in other illegitimate activities (such as bribery and pulling strings to have things done).

#### ***4.1.1 Available individual-level data***

Yet, despite all these limitations, there were several useful questions in the survey that can help in the exploration of at least some aspects of the phenomenon. This goes beyond gender, age, occupation and the size of the company, which are the variables whose effect on propensity to participate in quasi-formal activities was already explored in previous studies on the matter (see section 2.2.1). These four predictors will be also used in our analyses, but principally as control variables. That is to say, the idea is not to challenge the findings from the earlier research, but rather to see whether there are some other potential drivers of this practice over and above age, gender, occupation and the size of the company (i.e. after controlling for these four factors).

The first of these supplementary predictors is perceived detection risk, which will be utilised to assess the relevance of voluntarism. It should be recalled that, according to the voluntarist idea, economic agents rely on cost-benefit analysis when making decisions. As deterrence is one of the most important aspects of the cost side, voluntarism suggests that more deterred individuals will be less likely to engage in quasi-formal employment. To check whether this holds true for workers in the EU, we include an explanatory variable based on the following question:

*People who work without declaring income, run the risk that tax or social security institutions find out and issue supplementary tax bills and perhaps fines. How would you describe the risk of being detected in your country?*

Possible answers were: very high; fairly high; fairly low; and very low. Yet, a note of caution is necessary here as the exact wording of the question implies the risk regarding undeclared work in general. Even though one would assume that those who are deterred from undeclared work will feel the same in the case of more specific types of noncompliance, this is not necessarily true. Specifically, the very nature of quasi-formal employment indicates that it is much harder for the authorities to detect it than completely unregistered activities, and therefore the above variable might not completely reflect deterrence in the case of this particular misbehaviour. For that reason, we include an additional indicator of deterrence, based on a question that more directly refers to quasi-formal employment:

*What sanction, if any, do you imagine someone would receive if the authorities find out that they receive an income from work which was not declared to tax or social security authorities?*

Three potential sanctions were offered to each respondent: normal tax or social security contributions due; normal tax or social security contributions due plus a fine; and prison. Note that this question refers strictly to a situation when a person is already detected in noncompliance, therefore putting aside inherent differences regarding detection risk between various types of illegitimate work. Thus, this variable seems to be a much better indicator of the cost side of under-declared employment. Following the viewpoint of the voluntarists, the hypothesis is that individuals expecting more severe sanctions would be less likely to engage in envelope wage practices.

Apart from these two, we also include the tax morale index as another predictor variable. It was derived from four questions on attitudes towards different types of tax evasion; survey respondents were offered four scenarios and asked to what extent they found each of them acceptable on a scale from 1 to 10, with higher values implying greater tolerance. These are:

- 1) Someone receives welfare payments without entitlement
- 2) A firm is hired by a household for work and it does not declare the payment received to the tax or social security authorities
- 3) A firm is hired by another firm for work and it does not declare its activities to the tax or social security authorities
- 4) Someone evades taxes by not declaring or only partially declaring their income

Given that illegitimate financial gain at the expense of the public budget is the central motive behind each of the four practices, a reasonable assumption is that people do not significantly distinguish between them. Accordingly, to check whether there indeed exist latent construct(s) shaping individual's opinions regarding the four illicit practices, exploratory factor analysis was applied<sup>51</sup>.

The analysis revealed the existence of a unique latent factor displaying one's attitude towards the four illegitimate activities. In line with this, extracted values of that factor are used as a proxy of tax morale in further analyses. Since the tax morale index reflects the original four variables (with values from 1 to 10), it is important to note that it is actually on an inverse scale: higher values of the index indicate lower tax morale. In any case, following the ideas of the quasi-voluntarists, the hypothesis is that individuals with lower tax morale will be more likely to work on an under-declared basis.

The last available individual-level covariate that is worth examining is marital status. In general, it is expected that married individuals are less willing to engage in this practice than those who are single. This is principally due to the much lower job security and potential instability of income inherent in quasi-formal employment, which married individuals certainly find more problematic than the rest of the population.

A summary of the individual-level indicators used in our endeavours to understand the rationales for entering the undeclared realm is given in Table 3. Since all enumerated variables are available for both waves of the survey, identical analyses have been conducted on each of the datasets. This was done so as to check the robustness of the applied statistical method, as well as to see whether the economic downturn has had some significant impact on the dynamics of this practice.

Apart from the description and the list of values for the predictor variables, Table 3 also gives information about missing data for each of the two waves. As can be seen, only data on age, gender and occupation are available for all respondents, while for all other variables there are non-existent values. The issue is particularly pronounced when it comes to the two variables associated with deterrence (i.e. detection risk and expected sanctions) as there is a substantial number of missing values for both waves of the survey.

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<sup>51</sup> The use of factor analysis in the reduction of dimensionality has been used in other research studies based on data from the Special Eurobarometer Survey on undeclared work (see Williams & Franic, 2015; Williams, Franic, & Dzhekova, 2014; Williams & Martínez, 2014). More details on the exploratory factor analysis and its application to our case are given in Appendix 2.



**Table 3 Summary of individual-level covariates used in the two-level random intercept logit models**

Variable name	Description	Values	Number of missing values - 2007	Number of missing values - 2013
<b>Gender</b>	A dummy variable for respondent's gender	0 - male; 1 - female	0	0
<b>Age</b>	An interval variable indicating the exact age of a respondent	Values representing exact age	0	0
<b>Marital status</b>	A categorical variable denoting the civil state of a respondent	1 - single; 2 - married; 3 - cohabiting; 4 - divorced/separated; 5 - widowed	96	94
<b>Occupation</b>	A categorical variable describing the job position of a respondent	1 - manual worker; 2 - employed position, at desk; 3 - employed position, service job; 4 - employed position, travelling; 5 - supervisor; 6 - employed professional; 7 - manager	0	0
<b>Size of the company</b>	A categorical variable for the number of individuals working in respondent's company	1 - 1 to 4; 2 - 5 to 9; 3 - 10 to 19; 4 - 20 to 49; 5 - 50 to 99; 6 - 100 to 499; 7 - 500 or more	3,880	843
<b>Detection risk</b>	A categorical variable for perceived risk of being detected when engaged in unregistered activities	1 - very small; 2 - fairly small; 3 - fairly high; 4 - very high	919	908
<b>Expected sanctions</b>	A categorical variable measuring anticipated penalties when caught in carrying out unregistered activities	1 - normal tax or social security contributions due; 2 - normal tax or social security contributions due, plus a fine; 3 - prison	1,273	1,601
<b>Tax morale</b>	An interval variable measuring respondents tax morale	'1' denotes the highest level of tax morale and '10' the lowest level	560	435

*Note: Sample sizes for 2007 and 2013 are 11,135 and 11,025 respectively*

*Source: Author's own work based on the Special Eurobarometer 284/Wave 67.3 and the Special Eurobarometer 402/Wave 79.2*

Since the two questions were neither private nor highly sensitive, such a high rate of faulty answers is an interesting finding per se. A closer insight reveals that a majority of employees who did not provide an exact answer to these questions actually stated they did not know the state of affairs, and this applies both to those who admitted receiving envelope wages and those who did not. What is more, a similar pattern is

noticeable when the complete sample is analysed (i.e. all survey respondents)<sup>52</sup>, which raises some questions about the effectiveness of a repressive policy approach in tackling undeclared practices.

A slightly lower proportion of missing data is noticeable for tax morale and marital status, while significant differences between the two datasets are evident when it comes to the size of the company. As can be seen from Table 3, one in three dependent employees in 2007 did not provide information on the total number of people working in their company. Yet, the decision was made to retain this variable in spite of such a high portion of missing data for 2007, given that this issue is much less pronounced for 2013. In any case, findings on this predictor should be discussed with caution, particularly for 2007.

Problems that can arise due to the existence of missing data were already described. Even though the discussion presented in section 3.3.3 was focused on issues regarding non-existing data on the dependent variable, it can be straightforwardly extended to explanatory variables. In short, it is essential to simulate all missing values for the whole set of variables used in modelling (both dependent and independent ones) so as to avoid obtaining biased results. For that reason, a multiple imputation procedure as defined in section 3.3.3 is to be also applied to the five individual-level predictors with missing values<sup>53</sup>.

To get some initial insight into the possible link between one's propensity to work on an under-declared basis and the individual-level variables, Table 4 and Table 5 present the distribution of the quasi-formal workforce for the two observed years. As expected, men seem to be far more likely to work on an under-declared basis than women, although this difference has decreased during the period of interest. A similar decreasing trend is noticeable in the case of age. Explicitly, younger individuals indeed seem to be more prone to envelope wage practices, but the comparison of the two survey waves suggest that the effect of age has somewhat weakened in the meanwhile.

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<sup>52</sup> One might recall that only individuals who declared themselves to be dependent employees are evaluated in the following statistical models.

<sup>53</sup> REALCOM impute software, which is used in this study, imputes missing values simultaneously for all variables.

**Table 4 Occurrence of under-declared employment in 2007 by personal characteristics of workers, % of formal employees**

		Receives envelope wages	Does not receive envelope wages	Refusal/DK
Gender	Male	7.5	85.9	6.6
	Female	4.1	89.5	6.4
Age	15-24	9.4	81.4	9.2
	25-34	7.2	86.8	6.0
	35-44	6.1	88.2	5.7
	45-54	4.4	89.2	6.4
	55-64	2.9	91.1	6.0
	65 and more	2.3	75.6	22.1
Marital status	Single	6.7	85.3	8.0
	Married	5.3	88.3	6.4
	Cohabiting	7.8	87.8	4.4
	Divorced/Separated	5.7	88.2	6.1
	Widowed	2.8	87.5	9.7
Occupation	Manual worker	8.5	82.4	9.1
	Employed position, at desk	3.7	90.8	5.5
	Employed position, service job	5.3	89.4	5.3
	Employed position, travelling	8.2	85.4	6.4
	Supervisor	5.9	85.5	8.6
	Employed professional	6.1	87.8	6.1
	Manager	3.0	93.1	3.9
Size of the company	1-4	10.8	82.4	6.8
	5-9	10.5	83.4	6.1
	10-19	11.2	83.0	5.8
	20-49	8.7	86.7	4.6
	50-99	7.6	89.1	3.3
	100-499	4.9	91.4	3.7
	500+	1.7	96.1	2.2
Detection risk	Very small	7.9	87.3	4.8
	Fairly small	5.5	89.8	4.7
	Fairly high	5.7	88.1	6.2
	Very high	5.7	87.4	6.9
Expected sanctions	Tax + social security contributions due	8.2	85.4	6.4
	Tax + contributions + fine	5.0	90.9	4.1
	Prison	6.2	89.7	4.1
Tax morale	<2	4.3	89.7	6.0
	2-4	6.4	87.7	5.9
	4-6	10.3	79.8	9.9
	6-8	15.2	74.3	10.5
	8-10	15.4	80.0	4.6

Notes: 1) The sample includes 11,135 individuals

2) Age and tax morale were grouped here solely for the descriptive purpose. Both will be used as interval variables in statistical analyses

Source: Authors' own work based on the Special Eurobarometer 284/Wave 67.3

**Table 5 Occurrence of under-declared employment in 2013 by personal characteristics of workers, % of formal employees**

		Receives envelope wages	Does not receive envelope wages	Refusal/DK
Gender	Male	4.8	90.2	5.0
	Female	3.0	92.9	4.1
Age	15 - 24	7.5	87.0	5.5
	25 - 34	4.9	90.6	4.5
	35 - 44	3.9	91.4	4.7
	45 - 54	2.7	92.8	4.5
	55 - 64	2.1	94.0	3.9
	65 and more	3.0	91.2	5.8
Marital status	Single	4.5	90.3	5.2
	Married	3.4	92.1	4.5
	Cohabiting	5.1	91.8	3.1
	Divorced/Separated	3.5	91.5	5.0
	Widowed	1.5	93.5	5.0
Occupation	Manual worker	6.0	87.5	6.5
	Employed position, at desk	1.9	94.9	3.2
	Employed position, service job	3.5	92.8	3.7
	Employed position, travelling	6.2	87.0	6.8
	Supervisor	5.0	90.4	4.6
	Employed professional	3.5	93.1	3.4
	Manager	1.9	95.1	3.0
Size of the company	1-4	7.6	88.8	3.6
	5-9	6.5	88.2	5.3
	10-19	6.4	89.2	4.4
	20-49	4.6	91.9	3.5
	50-99	2.5	93.2	4.3
	100-499	1.9	95.4	2.7
	500+	1.4	97.4	1.2
Detection risk	Very small	5.0	91.0	4.0
	Fairly small	3.6	93.7	2.7
	Fairly high	3.7	92.4	3.9
	Very high	4.8	91.6	3.6
Expected sanctions	Tax + social security contributions due	4.9	90.9	4.2
	Tax + contributions + fine	3.0	94.1	2.9
	Prison	3.0	93.1	3.9
Tax morale	<2	2.5	93.5	4.0
	2-4	5.0	90.3	4.7
	4-6	8.5	84.4	7.1
	6-8	6.7	87.4	5.9
	8-10	12.9	81.2	5.9

Notes: 1) The sample includes 11,025 individuals

2) Age and tax morale were grouped here solely for descriptive purpose. Both will be used as interval variables in statistical analyses

Source: Authors' own work based on the Special Eurobarometer 402/Wave 79.2

However, associations are much less clear when it comes to marital status. Even though single people and those cohabiting more frequently admitted under-declaration of their wages than the rest of the population, it is questionable whether this difference is statistically significant. Turning to occupation, the table suggests that manual workers and individuals whose jobs include travelling might be more prone to quasi-formal practices than the others. Yet, one must not forget that these outcomes are based on the whole EU, and that there may be significant variations among countries in this regard (see Figure 3 in section 2.2.1).

When it comes to the potential effects of firm size, the situation seems to be quite similar to those relating to gender and age. It is evident for both years that micro and small companies are more likely to under-report the wages of their employees, but the effect of the size is much more pronounced in 2007 than in 2013. Still, given the substantial variation in missing answers between workers from different categories, it is hard to say whether this decrease results from some tangible changes in the structure of quasi-formal practices or whether it is simply a statistical coincidence. Therefore, one cannot say more about the dynamics in this respect before applying multi-level logit modelling with a correction for missing values.

Contrary to what was expected, there seems to be no obvious link between perceived deterrence and participation in quasi-formal practices. For instance, just looking at the figures suggests that individuals who think that the detection risk is very high more frequently admitted receiving envelope wages than those who saw this risk as fairly small, and this applies to both observed years. Likewise, quasi-formal employment was more prevalent in 2007 among individuals expecting imprisonment if prosecuted than among those who believed that the only sanction would be a fine (Table 4). Yet, the results from 2013 indicate no difference in propensity to receive envelope wages between these two groups (Table 5).

On the other hand, tax morale seems to be an important factor for one's willingness to participate in under-declaration. As can be seen from the tables, individuals with the lowest tax morale (i.e. values of the tax morale index between 8 and 10) far more frequently said they were receiving envelope wages than those who expressed zero-tolerance towards tax evasion. This indicates that tax morale might be more important in explaining this practice from the perspective of workers than was suggested by previous research on the matter.

Yet a simple look at the figures is not enough for any firm conclusion to be drawn about the effect of tax morale or any other individual-level predictor. This is not only due to the considerable problem with missing values, but also because the real effect of a predictor can be grasped solely if analysed simultaneously with other predictors. In other words, it is crucial to control for all the remaining explanatory variables to see whether the propensity to enter the quasi-formal realm can be directly ascribed to the change in one particular predictor. For that reason, all these individual-level variables have to be introduced simultaneously in the models of interest. However, before proceeding with the models, we first need to describe and justify the country-level predictors used to explore the causes of quasi-formal employment that are over and above the introduced individual-level characteristics.

#### ***4.1.2 Country-level explanatory variables of interest***

Clearly, the available individual-level covariates are far from being sufficient to test the validity of the five contrasting theories on the reasons for participation in the under-declared realm. For instance, even though the perceived detection risk and expected sanctions can to some extent clarify the potential costs of under-declared employment, nothing can be concluded about the benefit side of the equation introduced by the voluntarists. The problem is particularly pronounced when it comes to the relevance of dualism, structuralism and legalism, as there were no questions in the survey that could be used to evaluate these three schools of thought. Fortunately, this problem can be mitigated by using aggregated country-level indicators from other data sources.

For instance, some insight into the applicability of the dualist notion to the case of quasi-formal employment can be obtained by using macroeconomic figures reflecting the situation on labour markets around Europe. One such parameter is certainly the employment rate, which is defined as “the proportion of the working age population that is in employment” (Eurostat, 2016I). The term ‘working age population’ in this context designates all individuals between 16 and 64 years of age. Applying dualist ideas to the issue of quasi-formal employment, one can hypothesise that lower employment rates in a country entail a higher inclination for workers to accept quasi-formal jobs. If this is true, it would reinforce the findings from earlier studies on the phenomenon, which pointed to the lack of formal employment opportunities as a central motivation of workers to engage in this illegitimate type of work.

To further evaluate the link between employment prospects and under-declared work, special attention has to be paid to the reasons for the younger population to be more prone to this type of employment. The ideas of the dualist school can be quite supportive in this respect bearing in mind severe problems with low employability of new entrants into the labour market in many countries, which have become particularly prominent since the onset of the economic crisis (Choudhry, Marelli, & Signorelli, 2012; Dietrich, 2013; Spreafico & Peruzzi, 2014). To check whether employment prospects of younger individuals can help in explaining their higher participation in quasi-formal practices, the youth employment rate is also included as a country-level indicator in our analyses. In this context, the youth employment rate is the share of the population aged between 15 and 29 years that is in employment. Data on both overall employment rate and youth employment rate are taken from the Eurostat databases (Eurostat, 2016k).

As well as these two, we also include the percentage of the population at risk of poverty or social exclusion, which is yet another macroeconomic parameter that might ascertain the applicability of the dualist school in an explanation of under-declared employment in the EU. A person is considered to be at risk of poverty or social exclusion if their “equivalised disposable income is below 60% of the national median equivalised disposable income after social transfers” (Eurostat, 2016i). Following the dualist view, one would expect that countries having a higher share of their population at risk of poverty or social exclusion are more likely to suffer from more pervasive practices of under-declaring. In the same way as for the previous two indicators, data for this one are also obtained from the Eurostat databases (Eurostat, 2016i).

However, things are much harder to conceptualise when it comes to the structuralist school of thought. Namely, there are no direct statistical indicators to describe the situation regarding employer-employee relationships in a certain country, which is crucial for evaluating the relevance of structuralism for quasi-formal employment. Quantifying such things represents a hard or even impossible task and therefore only a qualitative inquiry can give a clear insight into the matter. Nonetheless, in order to get at least some inkling about the capability of structuralism to explain this practice, we use three proxy indicators. These are just loose depictions of the matter, but it is worthwhile looking at them.

The first of these proxy indicators is the in-work at-risk-of-poverty rate, which is defined as the proportion of employed people who “have an equivalised disposable

income below the risk-of-poverty threshold, which is set at 60% of the national median equivalised disposable income (after social transfers)” (Eurostat, 2016g). In accordance with a structuralist view, it is hypothesised that a higher in-work at-risk-of-poverty rate in a certain country implies a greater prevalence of practices of under-declaring. Still, one must be cautious here because exploitative behaviour by employers is just one of the possible reasons for differences between countries regarding the in-work at-risk-of-poverty rate. For instance, higher rates of this indicator can be a pure consequence of the sectoral structure in a particular country (e.g. if a significant proportion of people are employed in agriculture or the textile industry, which are commonly sectors with below average salaries).

Another possible indicator of exploitative behaviour by employers is the portion of employees with a contract of limited duration. In this context, a contract is considered as being of limited duration “if employer and employee agree that its end is determined by objective conditions such as a specific date, the completion of a task or the return of another employee who has been temporarily replaced” (Eurostat, 2016c).

Probably the best parameter to evaluate the relevance of structuralism is the labour market regulations index, developed by the Fraser Institute and the Economic Freedom Network (Gwartney, Lawson, & Hall, 2015). The index, which is on a scale from 1 to 10, represents the extent to which labour market conditions are determined by economic freedom. It is based on evaluation of the following six components: hiring and firing regulations, conscription, minimum wage, centralized collective bargaining, hours regulations and mandated cost of worker dismissal<sup>54</sup>. Higher values of the labour market regulations index indicate less state interference into labour markets and vice versa. Following the structuralist standpoint, the hypothesis is that workers who are more protected by the state would be less likely to work on an under-declared basis.

However, if the above issue is scrutinised from the perspective of the legalist school, then the opposite is expected. As explained, the legalists point exactly at the over-intrusive state as the main driver of informal practices. Given this, the legalist view implies that more state interference inevitably entails a higher prevalence of quasi-formal employment. For that reason, the labour market regulations index has a

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<sup>54</sup> For more detailed explanation see <http://www.freetheworld.com/2015/economic-freedom-of-the-world-2015.pdf>.



twofold role in our analyses as it enables to test which of the two contrasting theories (if either) holds true.

To further evaluate the ideas of the legalist school of thought, we use the government effectiveness indicator developed by the World Bank (2015). This parameter assesses the achievement of national governments in numerous fields, such as the efficiency of public budget management, policy consistency, the efficiency of business management, prevalence of red tape, the availability and quality of online government services, the quality of public health, care provision, etc. Each country is given a score between 0 and 100, based on comparison with other economies all around the world (higher values represent higher government effectiveness). In accordance with the legalist viewpoint, it is expected that individuals from countries with a less effective government will be more likely to work on an under-declared basis.

Another important parameter to check the relevance of legalism is the rule of law indicator, also developed by the World Bank (2015). This indicator is based on “perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence” (World Bank, 2015). Countries are evaluated on the scale from 0 to 100, with higher values indicating stronger rule of law. If the legalist view is true in this case, then individuals working in countries with weaker rule of law will be more likely to have their wages under-reported.

An additional indicator measuring the strength of the legal system in a country, which will be used here to evaluate both the legalist and voluntarist schools of thought, is a judicial independence index developed by the World Economic Forum (WEF, 2006, 2012). This index assesses the extent to which the judicial system in a country is susceptible to the influence of members of government, firms and citizens. It is given on an interval scale from 1 to 7, with higher values representing higher levels of judicial independence. Both the voluntarists and legalists would argue that lower judicial independence entails higher participation in this illegitimate type of work and vice versa. From the voluntarist viewpoint, this is because the ability of firms and citizens to influence the work of the courts decreases the cost side of the equation, while from the viewpoint of legalism under-declared employment arises through defiance by non-privileged economic agents.

Another important aspect that should be scrutinised at this point is fairness in distribution of income. To do so, we use the indicator measuring inequality of income distribution, which is defined as “the ratio of total income received by the 20% of the population with the highest income (top quintile) to that received by the 20% of the population with the lowest income (lowest quintile)” (Eurostat, 2016h). It is important to note that this parameter is vital not only to test the validity of legalism, but also from the perspective of quasi-voluntarism; both schools of thought argue that substantial inequality of income distribution inevitably motivates low-income workers to conceal (all or part of) their income. Yet, one important limitation of this predictor should be stressed. In countries where low-income earners dominate in the quasi-formal workforce, the income inequality index is actually artificially higher since the wages of many workers from the lowest quintile will be under-reported. For that reason, the relevance of this indicator is to be discussed with caution.

There are several macroeconomic parameters that can help in evaluating the relevance of the voluntarist school of thought. The first of them is the implicit tax rate on employed labour (Eurostat, 2016f). It is defined as the “sum of all direct and indirect taxes and employees' and employers' social contributions levied on employed labour income divided by the total compensation of employees working in the economic territory increased by taxes on wage bill and payroll” (Eurostat, 2016f). Following the ideas of the voluntarists, individuals facing higher implicit tax rates are expected to be more willing to under-declare their income.

Another potential indicator that can help in clarifying reasons for engaging in this illegitimate type of employment from the voluntarist viewpoint is the share of workers having two jobs. Namely, the theory of a rational taxpayer suggests that those having two jobs would be more likely to conceal their income from a supplementary job as they often see no point in paying social security contributions twice. To put it in our context, this would mean that workers holding more than one job would be more likely to have income from their additional employment under-reported. This indicator was derived using official data on employment and unemployment from the Eurostat databases (Eurostat, 2016d).

In addition to the present-day financial aspects that can influence an individual's decisions regarding under-declaration, it is also important to scrutinise the role of future money inflows. This firstly applies to the expected income from the pension system upon retiring. Since contributions to the pension system represent a

significant slice of gross wage, the voluntarist view for instance suggests that a rational taxpayer would be more inclined to under-declare their income if the expected return does not match current liabilities. To evaluate whether the quality of the pension system can help in explaining the phenomenon, two different parameters are used here. The first of them is the pension sustainability index developed by Allianz (2011). It evaluates the robustness of pension systems around the world based on the following criteria: pension payments as % of GDP, level of benefit from first pillar and coverage of workforce, strength of funded pillar and reserve fund as % of GDP, public indebtedness as % of GDP, old age dependency ratio, need for welfare support and legal and effective retirement age. The index is given on a scale from 1 to 10, with higher values expressing greater need for reform<sup>55</sup>.

Following the theory of a rational taxpayer advocated by the voluntarists, individuals operating in countries with a more fragile pension system are expected to be less certain about their future income from the system and therefore less motivated to contribute to it. However, it might be too optimistic to expect that taxpayers are indeed fully informed about the long-term viability of the pension system in their country. In other words, it is possible that the pension sustainability index does not match the perception of taxpayers in reality. Actually, it is more plausible that citizens base their perceptions on some more tangible indicators and therefore a note of caution is necessary when discussing the findings on the effect of the pension sustainability index.

One of these possibly more tangible indicators is the at-risk-of-poverty rate of older people (65 years or over) (Eurostat, 2016a). Since people put more emphasis on the current state of affairs, rather than on ambiguous predictions about the distant future, it is reasonable to assume that the life standard of present-day pensioners will have a central role in one's assessment of the pension system. In other words, if people perceive that the older members of society are not getting enough from the pension system at the moment, they will probably be less inclined to contribute personally. The hypothesis is therefore that workers from countries having a higher at-risk-of-poverty rate for older people will be more likely to under-report their wages.

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<sup>55</sup> The exact values of the index are not publicly available and therefore were obtained by request.

When it comes to quasi-voluntarism and conditional cooperation, there are three further country-level indicators that need to be examined<sup>56</sup>. The first of them is the corruption perception index developed by Transparency International (2015). This index, which is given on a scale from 0 to 10 for 2007 and from 0 to 100 for 2013, reflects the perception of experts, analysts and businesspeople regarding the prevalence of corruption among public sector officials in their countries. The index is given as an inverse scale, with higher values denoting lower perceived corruption in the public sector. Following the ideas of the quasi-voluntarists, the hypothesis is that more prevalent corruption in a country entails a greater inclination of workers to under-declare their wages.

Another important parameter that can illuminate the relevance of quasi-voluntarism is the overall level of trust in the national government. According to the viewpoint of the quasi-voluntarists, citizens who do not have confidence in the work of the ruling elites are less willing to contribute to the public budget. In our case, the hypothesis is that individuals from countries characterised by below-average trust in the national government are more likely to work on an under-declared basis.

As a proxy for the average level of trust in the national government, we use results from the Standard Eurobarometers 67 and 79 on public opinion in the European Union<sup>57</sup>. People were asked the following question:

*I would like to ask you a question about how much trust you have in certain institutions. For each of the following institutions, please tell me if you tend to trust it or tend not to trust it.*

A range of national institutions was offered and each respondent had to choose between two options: tend to trust; and tend not to trust. For the purpose of this study, we are interested solely in level of trust in the national government and hence the percentage of respondents stating they tend to trust in their national government was taken as an indicator.

Finally, to check whether the conditional cooperation theory can help in explaining the roots of under-declared employment, the average tax morale in each country was also taken as a predictor. It was constructed by calculating average values by country of

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<sup>56</sup> One might recall that the income inequality ratio was introduced previously as an indicator which can give some insight into the relevance of quasi-voluntarism.

<sup>57</sup> [http://ec.europa.eu/public\\_opinion/archives/eb\\_arch\\_en.htm](http://ec.europa.eu/public_opinion/archives/eb_arch_en.htm)

the tax morale index introduced earlier. While inclusion of the tax morale index at the individual-level can illuminate the link between one's personal inclination towards tax evasion and participation in quasi-formal employment, the inclusion of average tax morale at the country-level is done to check how the behaviour of other taxpayers influences the behaviour of a particular individual. According to the theory of conditional cooperation, the hypothesis is that individuals from countries with low average levels of tax morale are more inclined to under-declare their income.

Exact values of all the introduced country-level covariates are given in Appendix 3. To sum up, there are 25 predictor variables that will be used to get some initial insight into the nature and causes of under-declared employment in the EU. Eight predictor variables are taken directly from the Special Eurobarometer Survey on undeclared work (i.e. individual-level variables), while the remaining seventeen are country-level indicators compiled from various sources (as described above). Yet, since six out of eight individual-level predictors are in fact categorical variables (see Table 3), the number of coefficients to estimate is substantially larger. This is because each categorical variable has to be transformed into a set of  $n-1$  binary indicators (where  $n$  is the total number of categories), which are then used in a regression (Cramer, 2003; Hosmer et al., 2013). In other words, for every categorical variable one value is taken as a reference and then each of the remaining categories is compared with that reference value. This means there are 26 coefficients to estimate when only individual-level variables are included (24 categories plus intercept term and between-group residual variance  $\sigma_u^2$ ).

In that light, adding all 17 country-level predictors simultaneously would result in 43 coefficients to estimate, which is problematic given the complexity of the chosen modelling approach. Namely, the estimation of the coefficients in multi-level logit models is based on approximations of maximum likelihood procedure<sup>58</sup>, which is a computationally intensive process by itself. The estimation procedure in our case is, however, additionally complicated owing to application of the multiple imputation technique, as identical analyses have to be repeated for each imputed dataset and the final results pooled together to obtain single coefficients. What is more, multiple

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<sup>58</sup> Since level\_2 residuals have to be integrated out of the equation (5), statistical packages use various simplifications or adaptations of this procedure to obtain results (see Snijders & Bosker, 1999).

imputation is per se a quite demanding method, which can take several hours to complete (D. R. Johnson & Young, 2011).

To address this issue, the following strategy was applied: first we examine solely the effects of individual-level covariates, while controlling for the country-specific effects  $u_j$ . In other words, our model 0 is defined as:

$$\ln\left(\frac{\pi_{ij}}{1-\pi_{ij}}\right) = \beta_0 + u_j + \beta_1 X_{ij1} + \dots + \beta_{24} X_{ij24} \quad (13)$$

where  $i = 11,135$  for 2007 and 11,025 for 2013;  $j = 27$  for 2007 and 28 for 2013;

Based on previous research on the matter and the theoretical discussion presented in section 4.1.1, our reference individual is defined as a single male, employed as a manual worker in a company with up to 4 employees. Furthermore, he believes that the risk of being detected in this practice is very small and expects to pay solely tax and social security contributions due if prosecuted.

After examining the above model 0, we add separately each of the seventeen country-level variables to see whether each one can help in explaining why individuals in some countries are more likely to participate in this realm than individuals with identical individual-level characteristics but from other EU member states. In all, 17 different models will be analysed, defined as follows:

$$\ln\left(\frac{\pi_{ij}}{1-\pi_{ij}}\right) = \beta_0 + u_j + \beta_1 X_{ij1} + \dots + \beta_{24} X_{ij24} + \gamma Z_j \quad (14)$$

Only one country-level indicator (variable  $Z_j$  above) is inserted at a time, and this is done in the following order:

- model 1 – employment rate
- model 2 – youth employment rate
- model 3 – at-risk-of-poverty rate
- model 4 – in-work at-risk-of-poverty rate
- model 5 – share of workers with a contract of limited duration
- model 6 – labour market regulations
- model 7 – government effectiveness

- model 8 – rule of law
- model 9 – perceived judicial independence
- model 10 – inequality of income distribution
- model 11 – implicit tax rate on employed labour
- model 12 – share of employees having two jobs
- model 13 – pension sustainability index<sup>59</sup>
- model 14 – at-risk-of-poverty rate of older people (65 years or over)
- model 15 – corruption perception index
- model 16 – trust in government
- model 17 – average tax morale

Such a gradual approach, which is commonly applied in studies utilising multi-level logit models<sup>60</sup>, is useful for two reasons. Not only does it alleviate problems with complexity (i.e. reduces the estimation time to an acceptable level), but it also allows us to evaluate each potential country-level determinant of this practice separately. Including just one country-level indicator at a time (alongside all the individual-level variables) enables us to see whether there exists an additional driver of quasi-formal employment that is over and above individual's personal characteristics, and which could be ascribed to the country-level peculiarity examined.

However, one must also be aware of one apparent problem with this approach. Due to the likely inter-relation between some of the 17 enumerated country-level predictors, there is a reasonable risk of obtaining a higher effect for certain variables than really exists. For instance, since it is known that prevalent public sector corruption undermines trust in institutions, including both these variables together would probably reduce the obtained effect of the trust indicator (to the degree it is affected by the corruption index). A similar reasoning can be for instance applied to the effect of the at-risk-of-poverty rate, as it is dependent on employment prospects in a particular country, etc.

Yet, this issue is not so problematic from the perspective of our study, having in mind the exact purpose of this quantitative part. As already reiterated several times above, the basic purpose of the following statistical analyses is to identify factors that might be relevant for explaining this phenomenon and which will then be further scrutinised

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<sup>59</sup> Model 13 is defined only for 2013 due to non-existence of pension sustainability index for 2007.

<sup>60</sup> See for instance Williams and Horodnic (2015).

during the qualitative phase of the study. As a matter of fact, we are first interested in the statistical significance of particular predictor variables, not in the exact magnitude of their effect. In that light, the discussion in the following section will be limited solely to the existence (or non-existence) and the direction of the effect of the predictor variables on the propensity to participate in quasi-formal employment. What is more, no attempt to compare the relative importance of different predictors will be made in this phase.

The last thing to discuss before moving to the presentation of the findings is the choice of the software. Since the original data are available in STATA format, it was initially decided to conduct the analyses in this software. Yet, even though STATA has a platform for multi-level analyses, as well as for multiple imputations, the extremely low estimation speed proved to be an insuperable obstacle. For that reason, the decision was made to combine STATA with MLwiN, which is specialised software for multi-level modelling (Rasbash, Steele, Browne, & Goldstein, 2015). This software, developed by the Centre for Multilevel Modelling (UK) and freely available to UK scholars and students, provides a user-friendly environment with a much larger number of options than other statistical packages. What is more, the estimation process is considerably accelerated using MLwiN, which makes it the most attractive tool for scholars utilising multi-level models.

Following this, the data preparation phase was completely done in STATA, and the resulting dataset was then translated into MLwiN format. To further increase the efficiency of the calculations, multiple imputations were produced using REALCOM impute software (Carpenter, Goldstein, & Kenward, 2011). This software, which was also developed by the Centre for Multilevel Modelling (UK), simulates missing values based on multi-level random-effects modelling and stores them in a format that can be straightforwardly used by MLwiN. The results presented below are based on ten imputations per each missing value. The coefficient estimation procedure was based on the 2<sup>nd</sup> order penalised quasi-likelihood (PQL2) procedure.

### ***4.1.3 Findings***

The very first step in every multi-level modelling is to examine the so-called 'empty model'. It is a model with no covariates (i.e. only the intercept term and between-group residual variance  $\sigma_u^2$  are estimated), which is used to test whether there is indeed an inherent difference in the outcome variable between level\_1 units from different clusters/groups that can be ascribed to the cluster/group effects. In our case,



the goal of the empty model is to check if a propensity to participate in quasi-formal employment is dependent on the macro-level peculiarities of the EU member states.

The empty model for 2007 yielded  $\sigma_u^2 = 0.877$ , with a standard error of 0.264. The accompanying test statistic for the Wald test is 11.055, which compared with a chi-squared distribution on 1 degree of freedom gives a p-value of 0.001. The conclusion is therefore that the rationales behind individuals' decisions to engage in quasi-formal employment indeed go beyond their socio-economic and demographic characteristics, as there is evidence that the overall 'climate' inside the country also plays a significant role. To illuminate the exact impact of country-level specificities on behaviour of individual workers, we calculate the variance partition coefficient defined by equation (6) in section 3.3.1.1:

$$VPC_{2007} = \frac{\sigma_u^2}{\sigma_u^2 + 3.29} = \frac{0.877}{0.877 + 3.29} = \frac{0.877}{4.167} = 0.21$$

This shows that 21% of the variation in the propensity to receive envelope wages among individual workers in 2007 is attributable to differences in country-level characteristics. Nevertheless, analysis of data from 2013 reveals a somewhat different picture. The estimated residual variance accounts for 0.483, which gives a variance partition coefficient of:

$$VPC_{2013} = \frac{0.483}{0.483 + 3.29} = \frac{0.483}{3.773} = 0.128$$

That is to say, only 12.8% of variation in the propensity to participate in this illegitimate practice during 2013 is attributable to the differences between countries. It is hard to say anything about the exact reason for this drop before examining the changes in the effect of the country-level predictors. In any case, the Wald test shows that the country effect is still highly significant in 2013, as the accompanying test statistic accounts for 9.616 (p-value=0.002). Therefore, the conclusion is that multi-level modelling is justified for both observed years. In line with this, we proceed with presenting findings from all 18 models defined above.

The two-level random intercept logit models with individual-level predictors only, whose results are presented in Table 6, to a great extent endorse the findings on the phenomenon from previous studies. As can be seen from the table, women are indeed significantly less likely to participate in this illegitimate arrangement, and this holds

true for both analysed years. Yet, the coefficient is much lower for 2013 which confirms that the effect of gender had somewhat diminished during the period. When it comes to age, it has a significant and negative effect on participation as expected, and there are no substantial differences in the size of this effect between the two observed years. These results are in line with findings by Kedir et al. (2011), as well as with those by Meriküll and Staehr (2010).

On the other hand, no significant link is found between marital status and propensity to start working on an under-declared basis. This is not surprising given the close association between age and marital status<sup>61</sup> and therefore age appears to be a much better predictor.

Turning to the size of the company, the logit modelling confirms that medium sized and large companies are significantly less likely to employ workers on an under-declared basis, while there is no significant difference for companies with fewer than 20 employees. Yet, the findings on data from 2007 are somewhat inconsistent as they indicate that those employing 5-9 people are less likely to under-declare their workers than those with up to four workers, whereas this does not apply to companies employing between 10 and 19 employees. In any case, the obtained results match those from other studies on this matter (see for instance Kriz et al., 2007; and Williams & Horodnic, 2015).

Things are much less clear when it comes to the link between occupation and propensity to work on an under-declared basis. While findings from the 2007 data indicate that only desk workers and managers are less likely than manual workers to receive more money than reported to the authorities, data from 2013 suggest that employed professionals and service sector workers are also significantly less likely to be under-declared than manual workers. Yet, one should bear in mind that this is an EU-level analysis and therefore the same conclusion does not necessarily hold true for every individual member state (see discussion on the link between occupation and under-declared employment in section 2.2.2).

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<sup>61</sup> Indeed, a certain level of correlation between age and marital status was revealed during the data preparation stage. However, this correlation was inside required limits and therefore it was decided to retain both predictors in the analyses.

**Table 6 Two-level random intercept logit model on participation in quasi-formal employment, individual-level predictors, 2007 and 2013**

	Model 0 - 2007	Model 0 - 2013
<b>Female</b>	-0.582*** (0.102)	-0.322** (0.110)
<b>Age (group centred)</b>	-0.019** (0.006)	-0.021*** (0.005)
<b>Marital status (RC: Single)</b>		
Married	0.052 (0.106)	0.072 (0.155)
Cohabiting	0.355* (0.140)	0.293 (0.173)
Divorced/Separated	0.157 (0.195)	0.022 (0.244)
Widowed	-0.380 (0.336)	-0.928 (0.625)
<b>Occupation (RC: Manual worker)</b>		
Employed position, at desk	-0.544*** (0.135)	-0.871*** (0.182)
Employed position, service job	-0.252 (0.163)	-0.378** (0.160)
Employed position, travelling	-0.114 (0.202)	-0.082 (0.176)
Supervisor	-0.375 (0.292)	0.029 (0.313)
Employed professional	-0.451 (0.256)	-0.564** (0.228)
Manager	-0.631** (0.152)	-0.667*** (0.196)
<b>Size of the company (RC: 1-4)</b>		
5-9	-0.707*** (0.182)	-0.132 (0.188)
10-19	-0.087 (0.212)	-0.200 (0.175)
20-49	-0.384* (0.196)	-0.501** (0.181)
50-99	-0.541** (0.206)	-0.905*** (0.220)
100-499	-0.840*** (0.163)	-1.064*** (0.227)
500+	-1.033*** (0.292)	-1.189*** (0.248)
<b>Detection risk (RC: Very small)</b>		
Fairly small	-0.259 (0.143)	-0.205 (0.147)
Fairly high	-0.346* (0.156)	-0.212 (0.161)
Very high	-0.350 (0.244)	-0.030 (0.215)
<b>Expected sanctions (RC: Tax + social security contributions due)</b>		
Tax + contributions + fine	-0.276*** (0.067)	-0.023 (0.125)
Prison	-0.109 (0.249)	0.218 (0.266)
<b>Tax morale (group centred)</b>	0.157*** (0.031)	0.225*** (0.026)
<b>Cons</b>	-1.709*** (0.269)	-2.381*** (0.262)
<b>Random Part</b>		
$\sigma_u^2$	0.832** (0.273)	0.369** (0.125)
<b>Level_2 units</b>	27	28
<b>Level_1 units</b>	11,135	11,025

Notes: 1) Significance: \* $p < 0.05$ , \*\* $p < 0.01$ , \*\*\* $p < 0.001$ , (standard errors in parentheses)

2) Estimates based on multiple imputation technique with 10 imputations

3) Since tax morale is given on an inverse scale, positive coefficients indicate that lower tax morale entails higher likelihood to participate in quasi-formal employment

Source: Author's own work based on the Special Eurobarometer 284/Wave 67.3 and the Special Eurobarometer 402/Wave 79.2

In any case, since the central focus of this part of the thesis is on testing the validity of the five contrasting theories, at this point we are actually more interested in checking whether tax morale and deterrence play a significant role in the decision-making process of workers. The findings from Table 6 reveal that neither of the two variables conceptualising the cost side of quasi-formal employment is significant for 2013. Still, one category for each of the two predictors is significant for 2007, although the obtained results are not completely meaningful (see Table 6).

On the other hand, tax morale appears to be strongly significant and this is true for both analysed years. Our analysis therefore endorses the findings by Williams and Horodnic (2015). Yet, it is important to note that there is a substantial increase in the coefficient during the observed period, which suggests an increasing role for tax morale in the decision-making process of workers. This indicates that quasi-voluntarism can indeed help in explaining the causes of under-declared employment in the EU and that it is becoming a more important determinant over time. Yet, before providing any firm conclusion, it is first necessary to scrutinise the macroeconomic determinants of this illegitimate practice.

This brings us to the 17 models with country-level predictors, which seem to support a holistic approach to the conceptualisation of the phenomenon. Namely, the analyses of macro-level indicators, which are presented in Table 7 and Table 8, reveal that each of the five schools of thought is relevant for explaining the roots of this practice at least to some extent. Starting with an analysis based on 2007 data (Table 7), we can see that all three indicators used to test the applicability of the dualist school are significant. What is more, each of the three obtained coefficients has the expected sign, thus completely matching the anticipated effect from the dualist perspective. Explicitly, the findings indicate that individuals with better employment prospects are significantly less likely to work on an under-declared basis than those who struggle to find a job. This confirms that the lack of employment opportunities does indeed play an important role in workers' decision concerning under-declaration of their wage, regardless of their demographic and socio-economic characteristics (which are controlled for)<sup>62</sup>.

The same conclusion is reached when the employment prospects of young people are scrutinised. The analysis indicates that young people facing a lower prospect of finding

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<sup>62</sup> This is in accordance with previous studies on the phenomenon, which pointed at unemployment as the key driver of quasi-formal employment (Hazans, 2005; Kriz et al., 2007; Woolfson, 2007).

a job are more likely to accept under-declared employment. Given this, one should not be surprised that poverty risk was also found to be significant. As the results from Table 7 suggest, individuals from countries with a higher at-risk-of-poverty rate are more likely to engage in under-declaration than their counterparts from the member states in which this rate is lower. Thus, one can see that our analysis confirmed the findings from earlier research studies in this respect (Hazans, 2005; Round et al., 2008; Sedlenieks, 2003; Woolfson, 2007).

Yet, one must be aware that these inferences are drawn on data from 2007, which was the pre-crisis period. Therefore, before concluding on the relevance of the dualist school, it is first important to inspect whether the same holds true for 2013. Before that, however, we are going to look at the effect of explanatory variables related to the remaining four schools of thought.

Proceeding with models 4 to 6, whose role was to analyse the extent to which structuralism can contribute to the conceptualisation of under-declared employment, the findings are somewhat different to those expected. Namely, out of the three variables used to illuminate a possible link between exploitative practices and the prevalence of quasi-formal employment, only the in-work at-risk-of-poverty rate was found significant. The prevalence of contracts of a limited duration seems not to have any effect on the dynamics of the quasi-formal labour market. In other words, stronger reliance on limited duration contracts does not per se imply that employers use this option to manipulate their workers (for instance by threatening that the contract will not be extended if envelope wage payments are refused).

Finally, and most surprisingly, there appears not to be any significant effect of labour market rigidity on the prevalence of this type of employment. Contrary to what was expected, quasi-formal practices in the EU seem not to be susceptible to the level of state interference in the labour market. These findings challenge not only the ideas of the structuralists, but also those of the legalists. While the structuralists would argue that state interference in the labour market inevitably leads to a lower prevalence of under-declaration (assuming that the main goal of the inference is protection of workers' rights), the legalists would argue that an over-intrusive state fosters under-declaration out of defiance. Yet, we found that neither reasoning is true in the EU.

**Table 7 Two-level random intercept logit model on participation in quasi-formal employment, individual-level and country-level predictors – 2007 data**

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
<b>Individual-level variables:</b>						
Female	-0.587*** (0.100)	-0.584*** (0.098)	-0.591*** (0.097)	-0.600*** (0.093)	-0.589*** (0.100)	-0.589*** (0.100)
Age (group centred)	-0.020** (0.006)	-0.019** (0.005)	-0.020** (0.006)	-0.020** (0.006)	-0.020** (0.006)	-0.020** (0.006)
<b>Marital status (RC: Single)</b>						
Married	0.053 (0.107)	0.050 (0.129)	0.046 (0.106)	0.043 (0.109)	0.048 (0.108)	0.049 (0.108)
Cohabiting	0.363* (0.141)	0.358* (0.165)	0.365* (0.139)	0.358* (0.141)	0.355* (0.142)	0.356* (0.141)
Divorced/Separated	0.163 (0.197)	0.156 (0.184)	0.157 (0.200)	0.155 (0.203)	0.152 (0.199)	0.155 (0.197)
Widowed	-0.378 (0.342)	-0.379 (0.399)	-0.394 (0.350)	-0.404 (0.364)	-0.393 (0.346)	-0.390 (0.346)
<b>Occupation (RC: Manual worker)</b>						
Employed position, at desk	-0.548*** (0.135)	-0.547*** (0.140)	-0.546*** (0.138)	-0.557*** (0.142)	-0.551*** (0.137)	-0.550*** (0.137)
Employed position, service job	-0.250 (0.164)	-0.249 (0.140)	-0.249 (0.164)	-0.256 (0.168)	-0.257 (0.166)	-0.255 (0.166)
Employed position, travelling	-0.113 (0.202)	-0.118 (0.165)	-0.105 (0.202)	-0.111 (0.202)	-0.115 (0.203)	-0.114 (0.204)
Supervisor	-0.380 (0.296)	-0.374 (0.347)	-0.388 (0.302)	-0.411 (0.318)	-0.383 (0.299)	-0.384 (0.299)
Employed professional	-0.448 (0.255)	-0.445 (0.181)	-0.460 (0.252)	-0.478 (0.253)	-0.461 (0.258)	-0.459 (0.257)
Manager	-0.631** (0.154)	-0.624*** (0.161)	-0.639* (0.153)	-0.650* (0.157)	-0.640* (0.154)	-0.639* (0.155)
<b>Size of the company (RC: 1-4)</b>						
5-9	-0.712*** (0.182)	-0.707*** (0.165)	-0.720*** (0.180)	-0.732*** (0.178)	-0.721*** (0.182)	-0.717*** (0.182)
10-19	-0.083 (0.213)	-0.083 (0.190)	-0.081 (0.211)	-0.076 (0.212)	-0.090 (0.214)	-0.085 (0.213)
20-49	-0.385* (0.196)	-0.383* (0.181)	-0.389* (0.192)	-0.395* (0.195)	-0.396* (0.195)	-0.389* (0.197)
50-99	-0.540** (0.206)	-0.535** (0.204)	-0.536** (0.202)	-0.538** (0.204)	-0.551** (0.206)	-0.544** (0.207)
100-499	-0.843*** (0.164)	-0.836*** (0.195)	-0.841*** (0.161)	-0.858*** (0.166)	-0.858*** (0.165)	-0.849*** (0.165)
500+	-1.039*** (0.291)	-1.031*** (0.231)	-1.041*** (0.287)	-1.061*** (0.286)	-1.052*** (0.291)	-1.045*** (0.293)
<b>Detection risk (RC: Very small)</b>						
Fairly small	-0.259 (0.144)	-0.258 (0.113)	-0.255 (0.145)	-0.267 (0.143)	-0.262 (0.144)	-0.262 (0.144)
Fairly high	-0.349* (0.155)	-0.348* (0.126)	-0.344* (0.153)	-0.364* (0.152)	-0.352* (0.156)	-0.351* (0.156)
Very high	-0.353 (0.245)	-0.353 (0.205)	-0.352 (0.245)	-0.364 (0.249)	-0.354 (0.247)	-0.353 (0.246)
<b>Expected sanctions (RC: Tax + social security contributions due)</b>						
Tax + contributions + fine	-0.279*** (0.067)	-0.277** (0.095)	-0.275*** (0.066)	-0.285*** (0.068)	-0.280*** (0.068)	-0.280*** (0.068)
Prison	-0.105 (0.250)	-0.113 (0.223)	-0.104 (0.250)	-0.101 (0.256)	-0.109 (0.251)	-0.107 (0.252)
<b>Tax morale (group centred)</b>						
Cons	0.158*** (0.030)	0.157*** (0.023)	0.160*** (0.030)	0.164*** (0.028)	0.159*** (0.030)	0.159*** (0.030)
Cons	2.799 (1.921)	0.945 (0.833)	-3.243*** (0.451)	-2.546*** (0.451)	-1.305*** (0.403)	-1.453 (1.265)
<b>Country level variables:</b>						
Employment rate	-0.068* (0.029)					
Youth employment rate		-0.052** (0.016)				
At-risk-of-poverty rate			0.063*** (0.018)			
In-work at-risk-of-poverty rate				0.117* (0.050)		
% of workers with a contract of limited duration					-0.034 (0.027)	
Labour market regulation						-0.045 (0.228)
<b>Random Part</b>						
$\sigma_u^2$	0.632** (0.215)	0.551** (0.175)	0.351** (0.084)	0.590*** (0.137)	0.730*** (0.214)	0.825*** (0.258)
Level_2 units	27	27	27	27	27	27
Level_1 units	11,135	11,135	11,135	11,135	11,135	11,135

Notes: 1) Significance: \* $p < 0.05$ , \*\* $p < 0.01$ , \*\*\* $p < 0.001$ , (standard errors in parentheses)

2) Estimates based on multiple imputation technique with 10 imputations

3) Since tax morale is given on an inverse scale, positive coefficients indicate that lower tax morale entails higher likelihood to participate in quasi-formal employment

Source: Author's own work based on the Special Eurobarometer 284/Wave 67.3

**Table 7 (continued) Two-level random intercept logit model on participation in quasi-formal employment, individual-level and country-level predictors – 2007 data**

	Model 7	Model 8	Model 9	Model 10	Model 11
<b>Individual-level variables:</b>					
Female	-0.584*** (0.100)	-0.586*** (0.100)	-0.590*** (0.101)	-0.591*** (0.098)	-0.584*** (0.102)
Age (group centred)	-0.020** (0.006)	-0.019** (0.006)	-0.019** (0.006)	-0.020** (0.006)	-0.019** (0.006)
<b>Marital status (RC: Single)</b>					
Married	0.061 (0.104)	0.052 (0.105)	0.053 (0.104)	0.052 (0.107)	0.051 (0.107)
Cohabiting	0.384* (0.139)	0.378* (0.139)	0.372* (0.139)	0.364* (0.140)	0.355* (0.140)
Divorced/Separated	0.179 (0.196)	0.171 (0.196)	0.169 (0.196)	0.158 (0.198)	0.156 (0.196)
Widowed	-0.361 (0.338)	-0.377 (0.337)	-0.374 (0.337)	-0.389 (0.350)	-0.383 (0.339)
<b>Occupation (RC: Manual worker)</b>					
Employed position, at desk	-0.556*** (0.129)	-0.559*** (0.129)	-0.555*** (0.130)	-0.545*** (0.137)	-0.546*** (0.136)
Employed position, service job	-0.240 (0.161)	-0.243 (0.161)	-0.245 (0.162)	-0.250 (0.164)	-0.253 (0.164)
Employed position, travelling	-0.113 (0.201)	-0.114 (0.201)	-0.114 (0.201)	-0.108 (0.201)	-0.114 (0.203)
Supervisor	-0.376 (0.294)	-0.373 (0.293)	-0.375 (0.292)	-0.387 (0.300)	-0.377 (0.294)
Employed professional	-0.440 (0.249)	-0.442 (0.25)	-0.440 (0.252)	-0.465 (0.254)	-0.453 (0.256)
Manager	-0.624* (0.151)	-0.626* (0.151)	-0.620* (0.152)	-0.637* (0.153)	-0.633* (0.153)
<b>Size of the company (RC: 1-4)</b>					
5-9	-0.704*** (0.180)	-0.705*** (0.180)	-0.706*** (0.180)	-0.716*** (0.180)	-0.710*** (0.183)
10-19	-0.073 (0.213)	-0.076 (0.212)	-0.079 (0.210)	-0.079 (0.212)	-0.086 (0.213)
20-49	-0.369* (0.194)	-0.377* (0.194)	-0.380* (0.192)	-0.385* (0.195)	-0.386* (0.197)
50-99	-0.516** (0.202)	-0.527** (0.202)	-0.533** (0.202)	-0.533** (0.205)	-0.542** (0.207)
100-499	-0.812*** (0.161)	-0.821*** (0.161)	-0.827*** (0.160)	-0.839*** (0.164)	-0.843*** (0.164)
500+	-1.011*** (0.289)	-1.019*** (0.290)	-1.023*** (0.289)	-1.035*** (0.290)	-1.036*** (0.293)
<b>Detection risk (RC: Very small)</b>					
Fairly small	-0.249 (0.143)	-0.251 (0.143)	-0.249 (0.143)	-0.261 (0.144)	-0.260 (0.144)
Fairly high	-0.338* (0.152)	-0.336* (0.153)	-0.329* (0.153)	-0.358* (0.154)	-0.347* (0.156)
Very high	-0.349 (0.242)	-0.345 (0.242)	-0.336 (0.242)	-0.363 (0.244)	-0.351 (0.246)
<b>Expected sanctions (RC: Tax + social security contributions due)</b>					
Tax + contributions + fine	-0.268*** (0.064)	-0.271*** (0.065)	-0.271*** (0.064)	-0.272*** (0.066)	-0.277*** (0.067)
Prison	-0.105 (0.247)	-0.104 (0.247)	-0.100 (0.246)	-0.101 (0.251)	-0.108 (0.250)
<b>Tax morale (group centred)</b>					
Cons	0.157*** (0.030)	0.157*** (0.030)	0.157*** (0.031)	0.160*** (0.030)	0.157*** (0.031)
Cons	2.689*** (0.611)	2.449*** (0.681)	1.261* (0.525)	-3.813*** (0.649)	-1.757 (0.991)
<b>Country level variables:</b>					
Government effectiveness	-0.054*** (0.007)				
Rule of law		-0.051*** (0.008)			
Perceived judicial independence			-0.616*** (0.094)		
Income inequality				0.442*** (0.120)	
Implicit tax rate					0.001 (0.027)
<b>Random Part</b>					
$\sigma_u^2$	0.229*** (0.059)	0.263*** (0.071)	0.278** (0.097)	0.484*** (0.113)	0.835*** (0.275)
Level_2 units	27	27	27	27	27
Level_1 units	11,135	11,135	11,135	11,135	11,135

Notes: 1) Significance: \* $p < 0.05$ , \*\* $p < 0.01$ , \*\*\* $p < 0.001$ , (standard errors in parentheses)

2) Estimates based on multiple imputation technique with 10 imputations

3) Since tax morale is given on an inverse scale, positive coefficients indicate that lower tax morale entails higher likelihood to participate in quasi-formal employment

Source: Author's own work based on the Special Eurobarometer 284/Wave 67.3

**Table 7 (continued) Two-level random intercept logit model on participation in quasi-formal employment, individual-level and country-level predictors – 2007 data**

	Model 12	Model 14	Model 15	Model 16	Model 17
<b>Individual-level variables:</b>					
Female	-0.583*** (0.103)	-0.587*** (0.101)	-0.587*** (0.100)	-0.586*** (0.101)	-0.581*** (0.102)
Age (group centred)	-0.019** (0.006)	-0.019** (0.006)	-0.019** (0.006)	-0.020** (0.006)	-0.019** (0.006)
<b>Marital status (RC: Single)</b>					
Married	0.052 (0.107)	0.052 (0.108)	0.054 (0.105)	0.053 (0.105)	0.053 (0.105)
Cohabiting	0.357* (0.140)	0.358* (0.141)	0.378* (0.139)	0.359* (0.140)	0.354* (0.140)
Divorced/Separated	0.157 (0.196)	0.157 (0.196)	0.168 (0.197)	0.160 (0.197)	0.152 (0.195)
Widowed	-0.380 (0.338)	-0.384 (0.342)	-0.373 (0.339)	-0.382 (0.341)	-0.379 (0.334)
<b>Occupation (RC: Manual worker)</b>					
Employed position, at desk	-0.546*** (0.135)	-0.544*** (0.136)	-0.550*** (0.131)	-0.547*** (0.134)	-0.546*** (0.132)
Employed position, service job	-0.252 (0.163)	-0.254 (0.164)	-0.241 (0.162)	-0.247 (0.163)	-0.250 (0.163)
Employed position, travelling	-0.114 (0.203)	-0.114 (0.203)	-0.113 (0.201)	-0.108 (0.201)	-0.104 (0.201)
Supervisor	-0.376 (0.293)	-0.379 (0.295)	-0.371 (0.293)	-0.382 (0.294)	-0.366 (0.290)
Employed professional	-0.451 (0.257)	-0.458 (0.259)	-0.441 (0.254)	-0.452 (0.255)	-0.440 (0.257)
Manager	-0.630* (0.154)	-0.634* (0.153)	-0.621* (0.152)	-0.631* (0.154)	-0.625** (0.152)
<b>Size of the company (RC: 1-4)</b>					
5-9	-0.709*** (0.183)	-0.709*** (0.183)	-0.705*** (0.181)	-0.711*** (0.181)	-0.709*** (0.184)
10-19	-0.087 (0.213)	-0.084 (0.213)	-0.079 (0.211)	-0.082 (0.211)	-0.086 (0.212)
20-49	-0.385* (0.196)	-0.384* (0.197)	-0.382* (0.194)	-0.385* (0.195)	-0.388* (0.196)
50-99	-0.542** (0.207)	-0.540** (0.208)	-0.531** (0.203)	-0.537** (0.205)	-0.546** (0.206)
100-499	-0.841*** (0.164)	-0.842*** (0.165)	-0.830*** (0.161)	-0.837*** (0.162)	-0.838*** (0.163)
500+	-1.034*** (0.293)	-1.034*** (0.293)	-1.020*** (0.290)	-1.032*** (0.291)	-1.029*** (0.292)
<b>Detection risk (RC: Very small)</b>					
Fairly small	-0.260 (0.144)	-0.260 (0.144)	-0.252 (0.143)	-0.258 (0.143)	-0.261 (0.143)
Fairly high	-0.347* (0.157)	-0.349* (0.156)	-0.343* (0.154)	-0.347* (0.154)	-0.351* (0.156)
Very high	-0.351 (0.245)	-0.353 (0.246)	-0.352 (0.243)	-0.355 (0.244)	-0.355 (0.244)
<b>Expected sanctions (RC: Tax + social security contributions due)</b>					
Tax + contributions + fine	-0.276*** (0.067)	-0.275*** (0.067)	-0.269*** (0.065)	-0.274*** (0.066)	-0.272*** (0.067)
Prison	-0.109 (0.250)	-0.106 (0.250)	-0.094 (0.247)	-0.112 (0.249)	-0.098 (0.246)
<b>Tax morale (group centred)</b>					
Cons	-1.538*** (0.321)	-2.275*** (0.465)	0.823 (0.537)	-0.368 (0.444)	-4.666*** (0.621)
<b>Country level variables:</b>					
% of employees having two jobs	-0.042 (0.065)				
At-risk-of-poverty rate (65+)		0.027 (0.018)			
Corruption perception index			-0.389*** (0.076)		
Trust in the national government				-0.030*** (0.009)	
Average tax morale					1.287*** (0.242)
<b>Random Part</b>					
$\sigma_u^2$	0.824*** (0.277)	0.745*** (0.219)	0.335** (0.111)	0.537*** (0.162)	0.478 (0.247)
Level_2 units	27	27	27	27	27
Level_1 units	11,135	11,135	11,135	11,135	11,135

Notes: 1) Significance: \* $p < 0.05$ , \*\* $p < 0.01$ , \*\*\* $p < 0.001$ , (standard errors in parentheses)

2) Estimates based on multiple imputation technique with 10 imputations

3) Since tax morale is given on an inverse scale, positive coefficients indicate that lower tax morale entails higher likelihood to participate in quasi-formal employment

Source: Author's own work based on the Special Eurobarometer 284/Wave 67.3



Still, it is important to reiterate once again that the findings regarding the applicability of structuralism should be taken with great caution. The models presented examine only the factors relevant to starting under-declared employment<sup>63</sup> and therefore cannot give any insight into any other aspect of such jobs. Since it is reasonable to assume that the exploitative nature of quasi-formal employment usually comes to light after employment is started, the relevance of the structuralist school can be fully tested solely by the qualitative research.

When it comes to other indicators related to a legalist understanding of the phenomenon, the findings suggest that their ideas are indeed relevant in this respect. However, the two-level logit modelling revealed that this type of employment has more to do with the quality of the state institutions than with the intrusiveness of the state. This does not refer solely to the services taxpayers receive from the state in return for taxes paid, but also to the ability of the state to protect its citizens. The findings, that is, indicate that the propensity of an individual to engage in under-declared employment is significantly determined by government effectiveness, the strength of the rule of law and perceived judicial independence. The more effective government is, the less likely an individual worker is to be under-declared<sup>64</sup>. Similarly, stronger rule of law and higher levels of perceived judicial independence entail lower susceptibility of workers to engage in this type of work.

Turning to the distribution of income, the findings suggest that the propensity of a worker to engage in this type of employment does increase with higher income inequality. On the other hand, no significant effect of the tax burden on individuals' decisions was found, which further challenges the idea of a quasi-formal worker as a rational agent. The latter becomes particularly evident when various other aspects of voluntarism and quasi-voluntarism are inspected; we found that the behaviour of an individual is more linked to their perceptions regarding the behaviour of others than to a simple cost-benefit analysis of under-declared employment relative to completely legal work.

As Table 7 shows, individuals from more corrupt societies, and in particular those with low trust in their government and higher societal approval of tax evasion, are more likely

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<sup>63</sup> Bear in mind that each respondent was asked about their experience with under-declaration during the 12 months preceding the survey. Therefore, it is possible that some of the respondents who answered affirmatively to the question had already terminated their employment by the time they were surveyed.

<sup>64</sup> This is in line with the findings of Williams and Horodnic (2015).

to under-declare their wages. On the other hand, there is no evidence that the behaviour of taxpayers in the EU is determined neither by their expectations regarding future inflows from the pension system<sup>65</sup> nor by increased prospects of holding more than one job. Given that earlier analyses of individual-level covariates showed no significant effect of deterrence on the matter, it seems at a first glance that voluntarism might not be particularly useful in explaining the phenomenon of under-declared employment. In other words, given that the decision-making process of a worker appears to draw more heavily on his or her comparison to others than on the slice they have to give to the state, one can argue that under-declared workers are emotional rather than rational agents.

Yet before any conclusion is drawn on this matter, the data for 2013 should be analysed. This particularly applies to the role of pension systems given that the analysis for 2013 includes the pension sustainability index as an additional country-level indicator. However, even if the 2013 data confirm these findings, one should not completely neglect the voluntarist school of thought. Namely, since the rule of law and judicial independence were found to be significant, deterrence for instance still might be relevant from another point of view. Some taxpayers could perceive a weak legal system as an opportunity to find a shelter for tax evasion. In other words, pulling strings and bribing responsible public officials could be a likely strategy for some individuals to reduce the cost side of under-declared employment. Given that perceived corruption was also found to be a significant factor, this assumption is not so unrealistic and it is therefore worth examining during the qualitative phase of the study.

Conclusions based on 2007 data are to a great extent confirmed by those from 2013 (see Table 8). Starting with the notion of under-declaration as a decision made out of necessity (in line with the ideas of the dualists), the situation in 2013 resembles that from the pre-recession period. That is, the results of models 1 to 3 (Table 8) support the idea that the general lack of formal employment opportunities and risk of poverty indeed encourage many people to participate in the under-declared realm.

Nonetheless, a note of caution is necessary here as the role of employment prospects for youth is not significant in 2013. Yet the sign of the accompanying coefficient is negative as expected and the obtained p-value is fairly close to the threshold. However, the estimated effect of youth employment is much weaker than that for 2007, which

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<sup>65</sup> Again, it would be incorrect to conclude that the same holds true for every individual country. See for instance discussion on Latvia in section 2.2.2.

certainly suggests that something has changed during the observed period. One should also not forget that the data for 2013 include an additional country (Croatia), which might have affected the results, but other explanations for this change are also plausible. For instance, it might be that decreases in formal employment opportunities for young people resulting from the economic downturn were accompanied by an even larger drop in quasi-formal employment opportunities for the same population.

In any case, the general conclusion is that the dualist school of thought can indeed aid in conceptualising the phenomenon and therefore its ideas should be analysed more comprehensively during the qualitative phase of the study. Even though much has already been revealed about quasi-formal employment out of desperation from previous studies (see Hazans, 2005; Williams, 2009; Woolfson, 2007), this issue is worth looking at once again and from different perspectives.

Turning to the evaluation of the structuralist approach, the analyses conducted on data for 2013 reveal that none of the three indicators is statistically significant. This also applies to the share of workers at risk of poverty, which was significant for 2007. Yet, it must be reiterated that it would be inappropriate to conclude, according to these findings, that structuralism is irrelevant for explaining the phenomenon. This is not only due to the limited power of the chosen indicators to capture the mechanisms promoted by the structuralists, but also due to the very nature of the research question. Here the emphasis is solely on the reasons for entering the quasi-formal realm from the perspective of workers, while the structuralist ideas are more focused on the behaviour of employers once the employment has commenced. For that reason, the issue of misbehaviour by employers has to be analysed in a qualitative manner.

When it comes to legalism, the findings based on the data from 2013 to a great extent endorse those from 2007. The analyses confirm the negative relationship between the propensity of an individual worker to engage in quasi-formal employment and the quality of the state institutions (i.e. government effectiveness, rule of law and judicial independence). On the other hand, once again no significant link is found between the prevalence of this practice and labour market rigidity. In conclusion, it seems that some (but not all) the ideas of the legalist school of thought are indeed applicable to under-declared employment.

**Table 8 Two-level random intercept logit model on participation in quasi-formal employment, individual-level and country-level predictors – 2013 data**

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
<b>Individual-level variables:</b>						
Female	-0.323** (0.110)	-0.322** (0.109)	-0.321** (0.110)	-0.322** (0.110)	-0.320** (0.110)	-0.322** (0.110)
Age (group centred)	-0.021*** (0.005)	-0.021*** (0.005)	-0.021*** (0.005)	-0.021*** (0.005)	-0.021*** (0.005)	-0.021*** (0.005)
<b>Marital status (RC: Single)</b>						
Married	0.064 (0.155)	0.061 (0.155)	0.061 (0.155)	0.072 (0.155)	0.071 (0.155)	0.070 (0.155)
Cohabiting	0.300 (0.173)	0.293 (0.173)	0.301 (0.173)	0.300 (0.173)	0.292 (0.173)	0.294 (0.173)
Divorced/Separated	0.027 (0.244)	0.019 (0.244)	0.020 (0.244)	0.027 (0.245)	0.018 (0.245)	0.020 (0.245)
Widowed	-0.921 (0.625)	-0.929 (0.625)	-0.934 (0.625)	-0.924 (0.626)	-0.932 (0.626)	-0.931 (0.626)
<b>Occupation (RC: Manual worker)</b>						
Employed position, at desk	-0.871*** (0.182)	-0.874*** (0.182)	-0.860*** (0.182)	-0.867*** (0.183)	-0.870*** (0.183)	-0.872*** (0.183)
Employed position, service job	-0.372** (0.160)	-0.369** (0.160)	-0.373** (0.160)	-0.375** (0.160)	-0.378** (0.160)	-0.376** (0.160)
Employed position, travelling	-0.086 (0.175)	-0.088 (0.175)	-0.079 (0.175)	-0.082 (0.176)	-0.079 (0.176)	-0.081 (0.176)
Supervisor	0.036 (0.313)	0.038 (0.313)	0.027 (0.313)	0.026 (0.314)	0.023 (0.314)	0.029 (0.314)
Employed professional	-0.555** (0.228)	-0.554** (0.227)	-0.571** (0.228)	-0.569** (0.228)	-0.570** (0.228)	-0.566** (0.228)
Manager	-0.651*** (0.196)	-0.649*** (0.196)	-0.652*** (0.196)	-0.662*** (0.196)	-0.669*** (0.196)	-0.666*** (0.196)
<b>Size of the company (RC: 1-4)</b>						
5-9	-0.123 (0.188)	-0.123 (0.188)	-0.129 (0.188)	-0.129 (0.188)	-0.136 (0.188)	-0.133 (0.188)
10-19	-0.181 (0.175)	-0.180 (0.175)	-0.192 (0.174)	-0.195 (0.175)	-0.207 (0.175)	-0.203 (0.175)
20-49	-0.477** (0.181)	-0.479** (0.181)	-0.484** (0.180)	-0.493** (0.181)	-0.508** (0.181)	-0.505** (0.181)
50-99	-0.882*** (0.221)	-0.883** (0.221)	-0.890*** (0.220)	-0.897*** (0.221)	-0.913** (0.221)	-0.909** (0.221)
100-499	-1.032*** (0.227)	-1.034*** (0.227)	-1.036*** (0.227)	-1.054*** (0.227)	-1.071*** (0.227)	-1.067*** (0.227)
500+	-1.149*** (0.249)	-1.151*** (0.248)	-1.157*** (0.248)	-1.181*** (0.249)	-1.195*** (0.248)	-1.194*** (0.249)
<b>Detection risk (RC: Very small)</b>						
Fairly small	-0.194 (0.147)	-0.193 (0.147)	-0.194 (0.147)	-0.201 (0.147)	-0.210 (0.147)	-0.207 (0.147)
Fairly high	-0.206 (0.160)	-0.206 (0.160)	-0.209 (0.160)	-0.211 (0.161)	-0.220 (0.161)	-0.215 (0.161)
Very high	-0.037 (0.214)	-0.036 (0.214)	-0.040 (0.214)	-0.030 (0.215)	-0.037 (0.215)	-0.033 (0.215)
<b>Expected sanctions (RC: Tax + social security contributions due)</b>						
Tax + contributions + fine	-0.022 (0.124)	-0.025 (0.124)	-0.026 (0.124)	-0.023 (0.125)	-0.029 (0.125)	-0.022 (0.125)
Prison	0.220 (0.266)	0.216 (0.266)	0.217 (0.266)	0.218 (0.267)	0.206 (0.266)	0.218 (0.267)
<b>Tax morale (group centred)</b>	0.226*** (0.026)	0.226*** (0.026)	0.226*** (0.026)	0.226*** (0.026)	0.224*** (0.026)	0.224*** (0.026)
<b>Cons</b>	0.731 (1.151)	-0.983 (0.534)	-3.493*** (0.444)	-2.849*** (0.430)	-1.987*** (0.339)	-2.986** (1.012)
<b>Country level variables:</b>						
Employment rate	-0.049** (0.018)					
Youth employment		-0.032** (0.011)				
At-risk-of-poverty rate			0.043** (0.014)			
In-work at-risk-of-poverty rate				0.056 (0.040)		
% of workers with a contract of limited duration					-0.032 (0.019)	
Labour market regulation						0.090 (0.147)
<b>Random Part</b>						
$\sigma_u^2$	0.269** (0.098)	0.268** (0.097)	0.239** (0.089)	0.340** (0.118)	0.312** (0.110)	0.361** (0.123)
Level_2 units	28	28	28	28	28	28
Level_1 units	11,025	11,025	11,025	11,025	11,025	11,025

Notes: 1) Significance: \* $p < 0.05$ , \*\* $p < 0.01$ , \*\*\* $p < 0.001$ , (standard errors in parentheses)

2) Estimates based on multiple imputation technique with 10 imputations

3) Since tax morale is given on an inverse scale, positive coefficients indicate that lower tax morale entails higher likelihood to participate in quasi-formal employment

Source: Author's own work based on the Special Eurobarometer 402/Wave 79.2

**Table 8 (continued) Two-level random intercept logit model on participation in quasi-formal employment, individual-level and country-level predictors – 2013 data**

	Model 7	Model 8	Model 9	Model 10	Model 11
<b>Individual-level variables:</b>					
Female	-0.323** (0.109)	-0.324** (0.109)	-0.324** (0.109)	-0.320** (0.110)	-0.322** (0.110)
Age (group centred)	-0.021*** (0.005)	-0.021*** (0.005)	-0.021*** (0.005)	-0.021*** (0.005)	-0.021*** (0.005)
<b>Marital status (RC: Single)</b>					
Married	0.060 (0.155)	0.059 (0.155)	0.064 (0.154)	0.067 (0.155)	0.070 (0.155)
Cohabiting	0.307 (0.172)	0.309 (0.172)	0.315 (0.172)	0.302 (0.173)	0.297 (0.173)
Divorced/Separated	0.019 (0.244)	0.024 (0.244)	0.024 (0.243)	0.022 (0.245)	0.023 (0.245)
Widowed	-0.934 (0.623)	-0.930 (0.624)	-0.916 (0.623)	-0.930 (0.626)	-0.929 (0.626)
<b>Occupation (RC: Manual worker)</b>					
Employed position, at desk	-0.877*** (0.181)	-0.879*** (0.181)	-0.881*** (0.181)	-0.860*** (0.183)	-0.867*** (0.183)
Employed position, service job	-0.356** (0.159)	-0.365** (0.159)	-0.362** (0.159)	-0.376** (0.160)	-0.377** (0.160)
Employed position, travelling	-0.085 (0.175)	-0.087 (0.175)	-0.082 (0.175)	-0.080 (0.176)	-0.079 (0.176)
Supervisor	0.027 (0.313)	0.032 (0.313)	0.036 (0.312)	0.033 (0.314)	0.031 (0.314)
Employed professional	-0.572** (0.227)	-0.560** (0.227)	-0.549** (0.226)	-0.572** (0.228)	-0.568** (0.228)
Manager	-0.633*** (0.196)	-0.636*** (0.196)	-0.634*** (0.195)	-0.658*** (0.196)	-0.667*** (0.196)
<b>Size of the company (RC: 1-4)</b>					
5-9	-0.130 (0.187)	-0.132 (0.187)	-0.130 (0.187)	-0.126 (0.188)	-0.131 (0.188)
10-19	-0.195 (0.174)	-0.191 (0.174)	-0.188 (0.173)	-0.189 (0.175)	-0.199 (0.175)
20-49	-0.488** (0.179)	-0.487** (0.179)	-0.491** (0.179)	-0.482** (0.181)	-0.499** (0.181)
50-99	-0.888** (0.219)	-0.887** (0.219)	-0.884** (0.219)	-0.888** (0.221)	-0.904** (0.221)
100-499	-1.026*** (0.226)	-1.025*** (0.226)	-1.024*** (0.226)	-1.039*** (0.227)	-1.062*** (0.227)
500+	-1.136*** (0.246)	-1.137*** (0.247)	-1.129*** (0.246)	-1.162*** (0.248)	-1.188*** (0.248)
<b>Detection risk (RC: Very small)</b>					
Fairly small	-0.192 (0.146)	-0.191 (0.146)	-0.186 (0.146)	-0.197 (0.147)	-0.204 (0.147)
Fairly high	-0.210 (0.159)	-0.206 (0.159)	-0.200 (0.159)	-0.212 (0.160)	-0.212 (0.161)
Very high	-0.039 (0.213)	-0.034 (0.213)	-0.021 (0.213)	-0.036 (0.215)	-0.032 (0.215)
<b>Expected sanctions (RC: Tax + social security contributions due)</b>					
Tax + contributions + fine	-0.027 (0.124)	-0.029 (0.124)	-0.032 (0.123)	-0.022 (0.124)	-0.023 (0.125)
Prison	0.213 (0.265)	0.210 (0.265)	0.205 (0.265)	0.225 (0.266)	0.217 (0.267)
<b>Tax morale (group centred)</b>					
Cons	0.773 (0.636)	0.284 (0.559)	-0.549 (0.384)	-3.794*** (0.602)	-1.783* (0.851)
<b>Country level variables:</b>					
Government effectiveness	-0.039*** (0.007)				
Rule of law		-0.033*** (0.006)			
Perceived judicial independence			-0.404*** (0.071)		
Income inequality				0.287** (0.108)	
Implicit tax rate					-0.018 (0.024)
<b>Random Part</b>					
$\sigma_u^2$	0.140* (0.061)	0.141* (0.061)	0.114* (0.054)	0.275** (0.099)	0.354** (0.121)
Level_2 units	28	28	28	28	28
Level_1 units	11,025	11,025	11,025	11,025	11,025

Notes: 1) Significance: \* $p < 0.05$ , \*\* $p < 0.01$ , \*\*\* $p < 0.001$ , (standard errors in parentheses)

2) Estimates based on multiple imputation technique with 10 imputations

3) Since tax morale is given on an inverse scale, positive coefficients indicate that lower tax morale entails higher likelihood to participate in quasi-formal employment

Source: Author's own work based on the Special Eurobarometer 402/Wave 79.2

**Table 8 (continued) Two-level random intercept logit model on participation in quasi-formal employment, individual-level and country-level predictors – 2013 data**

	Model 12	Model 13	Model 14	Model 15	Model 16	Model 17
<b>Individual-level variables:</b>						
Female	-0.322** (0.110)	-0.322** (0.110)	-0.322** (0.110)	-0.322** (0.109)	-0.321** (0.110)	-0.322** (0.110)
Age (group centred)	-0.021*** (0.005)	-0.021*** (0.005)	-0.021*** (0.005)	-0.021*** (0.005)	-0.021*** (0.005)	-0.021*** (0.005)
<b>Marital status (RC: Single)</b>						
Married	0.065 (0.155)	0.072 (0.155)	0.071 (0.155)	0.066 (0.155)	0.066 (0.155)	0.066 (0.155)
Cohabiting	0.295 (0.173)	0.298 (0.173)	0.294 (0.173)	0.313 (0.172)	0.296 (0.173)	0.281 (0.173)
Divorced/Separated	0.024 (0.245)	0.025 (0.245)	0.022 (0.245)	0.026 (0.244)	0.020 (0.244)	0.004 (0.244)
Widowed	-0.925 (0.626)	-0.923 (0.626)	-0.929 (0.627)	-0.917 (0.623)	-0.931 (0.625)	-0.952 (0.626)
<b>Occupation (RC: Manual worker)</b>						
Employed position, at desk	-0.877*** (0.182)	-0.871*** (0.183)	-0.869*** (0.183)	-0.893*** (0.181)	-0.873*** (0.182)	-0.878*** (0.182)
Employed position, service job	-0.372** (0.160)	-0.376** (0.160)	-0.379** (0.160)	-0.364** (0.159)	-0.368** (0.160)	-0.372** (0.160)
Employed position, travelling	-0.082 (0.176)	-0.084 (0.176)	-0.082 (0.176)	-0.091 (0.175)	-0.082 (0.176)	-0.083 (0.176)
Supervisor	0.028 (0.313)	0.029 (0.314)	0.032 (0.314)	0.035 (0.312)	0.041 (0.313)	0.027 (0.313)
Employed professional	-0.555** (0.228)	-0.561** (0.228)	-0.569** (0.228)	-0.555** (0.227)	-0.561** (0.227)	-0.552** (0.228)
Manager	-0.658*** (0.196)	-0.662*** (0.196)	-0.668*** (0.197)	-0.645*** (0.195)	-0.655*** (0.196)	-0.665*** (0.196)
<b>Size of the company (RC: 1-4)</b>						
5-9	-0.131 (0.188)	-0.128 (0.188)	-0.132 (0.188)	-0.129 (0.187)	-0.121 (0.188)	-0.143 (0.188)
10-19	-0.194 (0.175)	-0.193 (0.175)	-0.200 (0.175)	-0.189 (0.174)	-0.185 (0.175)	-0.220 (0.175)
20-49	-0.493** (0.181)	-0.492** (0.181)	-0.500** (0.181)	-0.483** (0.180)	-0.482** (0.181)	-0.519** (0.180)
50-99	-0.897** (0.221)	-0.896** (0.221)	-0.906** (0.221)	-0.878** (0.219)	-0.883** (0.220)	-0.919** (0.220)
100-499	-1.048*** (0.227)	-1.051*** (0.227)	-1.063*** (0.227)	-1.018*** (0.226)	-1.035*** (0.227)	-1.074*** (0.226)
500+	-1.164*** (0.249)	-1.172*** (0.249)	-1.187*** (0.249)	-1.120*** (0.247)	-1.156*** (0.248)	-1.188*** (0.247)
<b>Detection risk (RC: Very small)</b>						
Fairly small	-0.197 (0.147)	-0.200 (0.147)	-0.203 (0.148)	-0.185 (0.146)	-0.191 (0.147)	-0.215 (0.147)
Fairly high	-0.208 (0.161)	-0.210 (0.161)	-0.211 (0.161)	-0.199 (0.159)	-0.203 (0.160)	-0.231 (0.161)
Very high	-0.034 (0.215)	-0.031 (0.215)	-0.028 (0.215)	-0.028 (0.213)	-0.029 (0.215)	-0.048 (0.215)
<b>Expected sanctions (RC: Tax + social security contributions due)</b>						
Tax + contributions + fine	-0.032 (0.125)	-0.025 (0.125)	-0.022 (0.125)	-0.035 (0.124)	-0.019 (0.124)	-0.018 (0.125)
Prison	0.201 (0.266)	0.215 (0.266)	0.220 (0.267)	0.197 (0.265)	0.217 (0.266)	0.235 (0.267)
<b>Tax morale (group centred)</b>						
Cons	-1.904*** (0.335)	-3.265*** (0.822)	-2.631*** (0.412)	-0.401 (0.450)	-1.818*** (0.323)	-4.070*** (0.536)
<b>Country level variables:</b>						
% of employees having two jobs	-0.121* (0.057)					
Pension sustainability index		0.194 (0.169)				
At-risk-of-poverty rate (65+)			0.017 (0.021)			
Corruption perception index				-0.032*** (0.006)		
Trust in the national government					-0.021*** (0.008)	
Average tax morale						0.779*** (0.214)
<b>Random Part</b>						
$\sigma_u^2$	0.306** (0.109)	0.352** (0.121)	0.353** (0.121)	0.142** (0.062)	0.286** (0.103)	0.222** (0.085)
Level_2 units	28	28	28	28	28	28
Level_1 units	11,025	11,025	11,025	11,025	11,025	11,025

Notes: 1) Significance: \* $p < 0.05$ , \*\* $p < 0.01$ , \*\*\* $p < 0.001$ , (standard errors in parentheses)

2) Estimates based on multiple imputation technique with 10 imputations

3) Since tax morale is given on an inverse scale, positive coefficients indicate that lower tax morale entails higher likelihood to participate in quasi-formal employment

Source: Author's own work based on the Special Eurobarometer 402/Wave 79.2

The outcome is also quite similar when it comes to voluntarism, which was found to have rather low potential in explaining the drivers of quasi-formal employment in 2007. Alongside the non-significance of individual-level variables conceptualising the cost-side of under-declared employment, the data for 2013 further reveal there is no significant link between the propensity to start working on an under-declared basis and most of the country-level predictors linked with voluntarism. Along with the at-risk-of-poverty rate for the retired, which is again not significant, the findings also indicate there is no significant effect of long-term pension sustainability on individuals' behaviour (model 13 in Table 8). These findings on the quality of pension systems are quite surprising and therefore are worth examining in detail during the qualitative phase of the study.

Apart from this, analyses of the 2013 data also reveal the absence of a link between participation in quasi-formal employment and the tax burden, therefore confirming our earlier findings on the matter. This is not the case with the share of workers holding two jobs, which is now found to be significant. Yet, the sign of the coefficient is opposite from that expected, indicating that higher prospects for holding two jobs decrease the propensity to work on an under-declared basis.

The situation is much clearer when it comes to the relevance of quasi-voluntarism and conditional cooperation in explaining mechanisms behind practices of under-declaring. Namely, two-level random intercept logit models on the 2013 data reconfirm the findings based on 2007 data regarding the impact of corruption, trust in the government and average values of tax morale on an individual's decisions to engage in quasi-formal employment. Explicitly, there is statistical evidence that workers from more corrupted countries, as well as from those with lower trust in the national government and higher societal tolerance of noncompliant behaviour are more likely to under-report their income from waged employment.

We now turn to the analysis of factors shaping the contentment of under-declared workers with their own position. As explained in the methodology section, this matter was examined solely in the Special Eurobarometer 284/Wave 67.3 and therefore only the first wave of the survey (i.e. data from 2007) can be analysed.

## 4.2 Factors shaping attitudes of under-declared workers towards envelope wages

Contrary to the prevalent assumption among scholars, the first wave of the Special Eurobarometer Survey revealed that only three out of ten quasi-formal workers would prefer full declaration. In fact, 41% of those who admitted receiving envelope wages stated that they were happy with the practice, while 29% were completely dissatisfied. A further 16% were neither happy nor unhappy with their position, and some 17% gave other answers (i.e. Refusal/Do not know).

Following this, the main goal in this section is to explore why some quasi-formal employees are content with receiving one part of their wages in cash while others are not. Since no research study so far has scrutinised the motives of quasi-formal workers to keep working under such an arrangement in spite of all the negative consequences it entails, the analysis presented in this section is the very first attempt to explore relevant elements of this practice. We start with a short overview of differences between countries in this regard, followed by a description of explanatory variables used in the logit modelling and presentation of the findings.

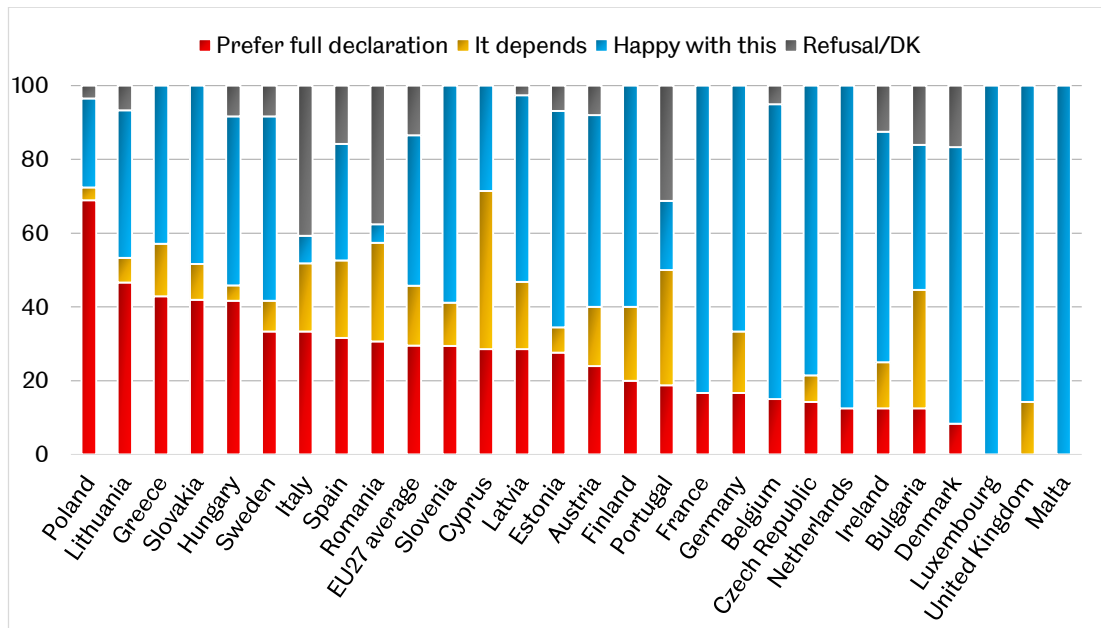
### *4.2.1 A descriptive insight and definition of the model*

Unlike the case of participation, there is no apparent difference between transition countries and older member states regarding satisfaction with this type of employment. As can be seen from Figure 4, which illustrates the spatial distribution of attitudes towards envelope wage practices in 2007, Poland, Lithuania and Greece have the highest share of workers who are dissatisfied with their position. They are followed by Slovakia, Hungary, Sweden, Italy, Spain and Romania, which are also countries with an above-average share of dissatisfied workers. On the other hand, quasi-formal workers in Malta, the United Kingdom and Luxembourg seem to be the most satisfied with envelope wages.

Even though indecisive participants are a minority in most countries, there are several member states with a substantial share. For instance, 43% of quasi-formal workers in Cyprus were neither happy nor unhappy with their position, followed by 32% in Bulgaria and 31% in Portugal. On the other hand, in some countries a significant proportion of respondents refused to answer or chose the 'Do not know' option. For instance, four out of ten quasi-formal workers in Italy and Romania did not provide a clear answer to the question.



**Figure 4 Spatial distribution of attitudes towards envelope wage practices, % of quasi-formal employees in 2007**



*Note: The sample includes 616 individuals*

*Source: Author's own work based on the Special Eurobarometer 284/Wave 67.3*

Nevertheless, due to the small size of the overall sample, as well as the small samples within countries, it is not possible to explore the reasons for such differences among countries. As explained in the methodology section, the analysis here will be focused solely on individual-level predictors. Apart from the eight covariates that were utilised earlier in the analyses on the motives for participation in this realm, there are two additional explanatory variables that can be used at this stage; all survey participants that admitted participating in envelope wage practices were asked two supplementary questions so as to further explore the nature of their employment.

The first of them referred to the exact purpose of envelope wage payments, with the following options: part of the payment for regular work; payment for overtime, extra-work; and payment for both regular and overtime work. The second question was concerned with the approximate percentage of gross yearly income which under-declared workers got in cash. Unfortunately, this variable suffers from a substantial proportion of missing data (as 186 out of 616 respondents did not provide the exact answer) and therefore will be used only in a descriptive overview. The same applies to the size of the company which has 170 missing values<sup>66</sup>.

<sup>66</sup> Both these variables (with simulated values) were initially included in the models, but this caused instable results and therefore it was decided to omit them from the final models.

**Table 9 Attitudes towards envelope wage practices, % of quasi-formal employees in 2007**

		Prefer full declaration	It depends	Happy with this	Refusal/DK
Gender	Male	28.5	13.3	44.8	13.3
	Female	31.1	20.8	34.4	13.7
Age	15-24	23.6	14.6	57.3	4.5
	25-34	29.1	16.8	43.6	10.6
	35-44	32.2	13.0	37.9	17.0
	45-54	31.8	20.6	33.3	14.3
	55-64	26.8	26.8	29.3	26.8
	65 and more	25.0	25.0	25.0	25.0
Marital status	Single	22.5	19.4	51.9	6.2
	Married	31.2	18.1	31.5	19.3
	Cohabiting	31.5	9.0	55.1	4.5
	Divorced/Separated	31.2	11.5	49.2	8.2
	Widowed	37.5	12.5	25.0	25.0
Occupation	Manual worker	29.8	14.9	42.6	12.7
	Employed position, at desk	18.0	21.8	39.7	20.5
	Employed position, service job	35.9	16.3	38.0	9.8
	Employed position, travelling	26.2	13.1	54.1	6.6
	Supervisor	20.0	20.0	60.0	0.0
	Employed professional	37.8	13.3	28.9	20.0
	Manager	32.7	20.0	29.1	18.2
Size of the company	1-4	32.0	20.0	44.0	4.0
	5-9	39.6	7.6	50.9	1.9
	10-19	28.8	13.8	51.3	6.3
	20-49	22.2	24.4	43.3	10.0
	50-99	28.3	9.4	49.1	13.2
	100-499	32.8	10.9	43.8	12.5
	500+	32.3	16.1	38.7	12.9
Type of payment	Part of regular work	29.3	18.1	37.1	15.6
	Overtime/extra-work	22.3	14.3	60.0	3.4
	Regular and overtime	37.6	17.3	31.5	13.7
Share of gross income received in cash	1-20%	26.0	18.0	54.0	2.0
	21-40%	28.8	13.6	54.6	3.0
	41-60%	47.8	5.8	44.9	1.5
	61-80%	30.0	25.0	45.0	0.0
	81-100%	44.0	20.0	12.0	24.0
Detection risk	Very small	30.8	13.5	50.0	5.8
	Fairly small	26.3	17.9	45.8	10.0
	Fairly high	32.6	16.0	34.7	16.7
	Very high	39.5	15.8	21.1	23.7
Expected sanctions	Tax + social security contributions due	32.8	14.6	39.6	13.0
	Tax + contributions + fine	27.9	15.5	44.3	12.3
	Prison	35.5	19.4	32.3	12.9
Tax morale	<2	36.2	15.9	30.3	17.7
	2-4	30.0	17.7	40.6	11.8
	4-6	20.9	13.6	57.3	8.2
	6-8	14.0	18.0	56.0	12.0
	8-10	20.0	20.0	60.0	0.0

*Note: The sample includes 616 individuals*

*Source: Author's own work based on the Special Eurobarometer 284/Wave 67.3*

Cross-tabulation of the participants' responses regarding satisfaction and their demographic and socio-economic characteristics, which is presented in Table 9, further emphasises the role of tax morale in the process. As can be seen from the table, lower tax morale seems to entail a higher level of satisfaction with one's position. Yet, things are not that clear when it comes to age and gender, which were earlier identified as having a significant effect on decision-making processes regarding entry into the quasi-formal realm. It seems there is no substantial difference between age cohorts regarding their attitudes. In general, older survey participants were more indecisive and gave faulty answers more often. On the other hand, it is noticeable that women were more hesitant and far less likely to express satisfaction than men.

It seems that attitude is not related to one's marital status, the size of the company one works for or expected sanctions, while it is hard to say anything about the possible effect of occupation at this point. For instance, employed professionals and managers much less frequently expressed satisfaction with this practice, but at the same time they hesitated more often and did not provide the exact answer. A similar pattern is noticeable in the case of risk of detection, as a higher expected risk also seems to be related to a higher propensity to hesitate or withhold the answer.

On the other hand, things are clearer when it comes to the exact purpose of envelope wages. As can be seen from Table 9, quasi-formal workers whose cash payments compensated solely for overtime and/or extra work seem to be most satisfied with this practice, while the opposite applied to individuals whose envelope wages served as remuneration of both regular and overtime work. Finally, no apparent pattern exists regarding the portion of income one receives in cash. For instance, almost one half of the individuals receiving between 41% and 60% of their gross annual salary in cash expressed dissatisfaction with their position, while just three out of ten workers whose envelope wages accounted for 61-80% of the total payment did so. Yet, one should bear in mind that more than 30% of the surveyed quasi-formal workers did not provide an answer to this question, which makes it hard to give any conclusion in this regard.

To explore whether some of these individual-level predictors have a statistically significant effect on the attitudes of quasi-formal workers towards this practice, we proceed with two-level random intercept cumulative logit model defined by equation (12). As mentioned, variables indicating the size of the company and the share of gross income received in cash are omitted from further analyses due to the substantial

number of missing values. Therefore, our model is based on eight explanatory variables, the description of which as well as information on missing values are given in Table 10.

**Table 10 Summary of individual-level covariates used in a two-level random intercept cumulative logit model on satisfaction with quasi-formal employment**

Variable name	Description	Values	Number of missing values
<b>Gender</b>	A dummy variable for respondent's gender	0 - male; 1 - female	0
<b>Age</b>	An interval variable indicating the exact age of a respondent	Values representing exact age	0
<b>Marital status</b>	A categorical variable denoting the civil state of a respondent	1 - single; 2 - married; 3 - cohabiting; 4 - divorced/separated; 5 - widowed	8
<b>Occupation</b>	A categorical variable describing the job position of a respondent	1 - manual worker; 2 - employed position, at desk; 3 - employed position, service job; 4 - employed position, travelling; 5 - supervisor; 6 - employed professional; 7 - manager	0
<b>Type of payment</b>	A categorical variable denoting the exact function of envelope wage payments	1 - part of the payment for regular work; 2- payment for overtime, extra-work; 3 - payment for both regular and overtime work	39
<b>Detection risk</b>	A categorical variable for perceived risk of being detected when engaged in unregistered activities	1 - very small; 2 - fairly small; 3 - fairly high; 4 - very high	38
<b>Expected sanctions</b>	A categorical variable measuring anticipated penalties when caught in carrying out unregistered activities	1 - normal tax or social security contributions due; 2 - normal tax or social security contributions due, plus a fine; 3 - prison	77
<b>Tax morale</b>	An interval variable measuring respondents tax morale	'1' denotes the highest level of tax morale and '10' the lowest level	47

*Note: The sample includes 616 individuals*

*Source: Author's own work based on the Special Eurobarometer 284/Wave 67.3*

For the seven predictors used in the earlier analyses, reference values are as before, while for the indicator denoting type of payment the most logical option was to take the first category (i.e. part of the payment for regular work) as a reference. Again, the data preparation phase was done in STATA, while the analysis was conducted in MLwiN. Furthermore, the problem with missing values was addressed by simulating ten different datasets using REALCOM impute software. The coefficient estimation procedure was based on the Markov Chain Monte Carlo (MCMC) method.

### ***4.2.2 Findings***

The results of the two-level random intercept cumulative logit model presented in Table 11 reveal that the satisfaction of workers is determined solely by their tax morale and the exact function of envelope wages. The findings show that lower tax morale entails a greater level of satisfaction with receiving envelope wages, holding other things constant<sup>67</sup>. Since tax morale was already earlier detected as being significant for entering the under-declared realm, on both an individual and a national level, one can conclude, based on these findings, that intrinsic willingness to pay taxes plays a quite important role in development and sustaining of envelope wage practices. Therefore, particular attention is to be paid to this matter during the qualitative phase of the study.

When it comes to the type of payment, the analysis reveals that individuals receiving cash solely for overtime and/or extra work are the most satisfied with their position. Although it is hard to hypothesise why this is so without more tangible and in-depth evidence, the most plausible explanation might be that such workers find it much easier to draw a line between their efforts and remuneration. In other words, individuals who are receiving cash for additional work may be more motivated to invest additional effort since this entails higher cash payments. Again, this is just an assumption whose validity has to be evaluated in the qualitative interviews with under-declared workers.

Yet, the situation is blurred when those in the remaining payment categories are compared. Namely, the findings are that individuals for whom envelope wages cover both regular and overtime work are much less happy with their position than the rest of the under-declared workforce, holding other things constant. Following the above theory for workers receiving cash solely for overtime work, one might similarly argue that individuals paid in cash for both regular and overtime work are probably more likely to think their employers are exploiting them. In other words, such individuals are required to work more than stated in the contract, but at the same time they cannot draw a clear line between the effort invested and remuneration (since envelope wages cover both), which might be demotivating. Another plausible explanation would be that such individuals actually receive a much higher portion of

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<sup>67</sup> One might recall that interpretation of coefficients in cumulative logit modelling is counter-intuitive. Namely, a negative value of the obtained coefficient means that a one-unit increase in the corresponding explanatory variable entails a decrease in the propensity of being dissatisfied with receiving envelope wages.

their wage in cash than the rest of the quasi-formal population. This in turn would make them dissatisfied due to constrained access to loans and mortgages. In any case, the exact effect of the payment strategies on one's satisfaction with their position will also be explored in more detail during the qualitative phase of the thesis.

When it comes to other characteristics of the surveyed individuals, none of them appears significant. The two-level random intercept cumulative logit modelling reveals there is no significant effect of gender and age on the level of satisfaction and the same applies to marital status. Even though these findings might seem problematic at a first glance, a deeper consideration can offer plausible explanations. Given that numerous studies have confirmed the existence of a firm link between various social and demographic characteristics of individuals and their tax morale (see section 2.1.5), a possible explanation is that the effect of age, gender and marital status on one's satisfaction is actually mediated by tax morale. Unlike the case of participation in which age and gender were found to be significant, therefore indicating an additional effect over and above one's intrinsic willingness to pay taxes<sup>68</sup>, tax morale seems to fully reflect the socio-demographic dimension of satisfaction.

Although one would expect those in higher positions in the company to have different attitudes towards their position than low-paid workers, the findings of the cumulative logit model indicate this is not the case. The model, that is, implies that occupation has no statistically significant effect on the level of satisfaction. A plausible explanation can be once again found in tax morale, as a closer insight into the raw data reveals for instance that professionals and managers far more frequently express absolute toleration towards noncompliant behaviour than other occupation groups.

Turning to the two indicators of deterrence, we found no significant effect of perceived detection risk and expected sanctions on one's level of satisfaction. Even though it would be reasonable to expect more deterred individuals to feel less comfortable with cheating the state, the analysis refutes such reasoning. These findings further challenge the applicability of the rational agent theory to the case of quasi-formal employment.

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<sup>68</sup> In other words, age and gender probably reflect other aspects of the decision-making process regarding participation, which cannot be ascribed to tax morale. For instance, younger individuals have a lower prospect of finding a regular job, are less aware of negative consequences of under-declaration, etc.

**Table 11 Two-level random intercept cumulative logit model on satisfaction with quasi-formal employment, in 2007.**

	$\beta_k$	Standard error
<b>Female</b>	0.255	0.190
<b>Age (group centred)</b>	0.014	0.009
<b>Marital status (RC: Single)</b>		
Married	0.340	0.242
Cohabiting	0.117	0.295
Divorced/Separated	-0.089	0.353
Widowed	0.758	0.821
<b>Occupation (RC: Manual worker)</b>		
Employed position, at desk	-0.163	0.281
Employed position, service job	0.332	0.270
Employed position, travelling	-0.507	0.307
Supervisor	-0.525	0.723
Employed professional	0.046	0.353
Manager	0.321	0.305
<b>Type of payment (RC: Part of the payment for regular work)</b>		
Overtime, extra-work	-0.442*	0.226
Both regular and overtime work	0.417*	0.200
<b>Detection risk (RC: Very small)</b>		
Fairly small	0.036	0.212
Fairly high	0.146	0.240
Very high	0.513	0.389
<b>Expected sanctions (RC: Tax + social security contributions due)</b>		
Tax + contributions + fine	-0.196	0.184
Prison	0.249	0.385
<b>Tax morale (group centred)</b>	-0.250***	0.043
<b>alpha1</b>	-0.958**	0.358
<b>alpha2</b>	-0.004	0.356
$\sigma_u^2$	0.369	0.217
<b>level_2 units</b>		27
<b>level_1 units</b>		616

Notes: 1) Significance: \* $p < 0.05$ , \*\* $p < 0.01$ , \*\*\* $p < 0.001$

2) Estimates based on multiple imputation technique with 10 imputations

Source: Author's own work based on the Special Eurobarometer 284/Wave 67.3

There are several plausible explanations for the limited role of deterrence in the process. The first of them once again points to the strong effect of tax morale, which presumably overpowers the effect of repressive endeavours by the authorities. That is to say, it might be that under-declared workers build their attitude from the combination of factors advocated by the legalists and quasi-voluntarists, rather than on fear of the legal consequences of their behaviour. That is, if low tax morale reflects personal beliefs about ineffective, unfair and/or corrupt states, then an individual can see noncompliance as desired and welcome behaviour regardless of the potential consequences.

Another possible explanation for a limited role of deterrence could be found in the rule of law. Namely, our earlier analyses indicate that the quality of the legal system in their country has a significant effect on the decision-making process of individuals regarding entry into this realm. If the same holds true for the case of satisfaction<sup>69</sup>, it could explain why deterrence is not high on the priority list of workers. For instance, economic agents operating in countries with low judicial independence do not necessarily expect to be sentenced even if the perceived risk of being detected by the tax authorities is very high. Besides, in countries with a weak legal system even those who are sentenced can eventually find strategies to outsmart the system.

Yet there is another possible theory in this regard. It is possible that workers do not perceive themselves as responsible for under-declaration. If they think their employer is the only one to be prosecuted by the authorities for this illegitimate arrangement, then deterrence becomes irrelevant from the perspective of workers. However, it is impossible to say which of the enumerated theories is indeed true without in-depth interviews with under-declared workers. For that reason, this matter will be scrutinised comprehensively during the elaboration on results from the qualitative phase of the study. Before that, we first give the most important findings from quantitative analyses on data from the GREY Survey.

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<sup>69</sup> Unfortunately, this cannot be tested quantitatively for the reasons explained in the methodology section.



## **5 EVALUATING THE MOTIVES FOR PARTICIPATION IN UNDER-DECLARED EMPLOYMENT AND THE ROLE OF THE MINIMUM WAGE IN CROATIA, BULGARIA AND FYR MACEDONIA**

To extend our understanding of quasi-formal employment, this chapter evaluates the causes and nature of this practice in South-East Europe. This is done using both a descriptive overview and statistical analysis of the data from the GREY Survey, which is a representative inquiry into undeclared and under-declared employment in Croatia, Bulgaria and FYR Macedonia. Not only did this supplementary data source enable triangulation of the results presented in the previous chapter, but it was also used to address additional aspects of under-declared employment. This was possible because the GREY Survey included some supplementary questions on this practice that were not asked in the Special Eurobarometer Survey. Particularly valuable from the perspective of this thesis was the question on the link between the minimum wage legislation and the declared part of the wage within quasi-formal employment.

It should be stated that this chapter directly addresses three out of the four research questions of interest. Since there is no information on the distribution of financial gain resulting from under-declaration of wages between workers and their employers, this research question will be evaluated only in the qualitative part of the study.

The first part of the chapter is focused on exploring the determinants of participation in under-declared employment in the three observed countries. The main idea is to check whether the conclusion drawn at the EU-level holds true when a smaller set of (transition) countries is analysed. It is important to reiterate that the questionnaire for the GREY Survey to a great extent reflected those for both waves of the Special Eurobarometer Survey on undeclared work, which enables a quite straightforward comparison of the findings (see section 3.3.2).

This is followed by a descriptive insight into several vital peculiarities of quasi-formal jobs in South-East Europe. The second part of this chapter, accordingly, gives an overview of answers to six supplementary questions that only those respondents in the GREY Survey who admitted receiving envelope wages were asked. As explained in the methodology section, statistical analysis was not feasible at this second stage

owing to the fairly small size of the total sample. Only 291 quasi-formal workers were detected in all three countries, and thus the robustness of regression models applied to such a small sample would be quite limited. The chapter ends with a concise summary of the most important findings from both stages of the quantitative insights into the phenomenon.

## **5.1 Prevalence and dynamics of envelope wage practices in South-East Europe**

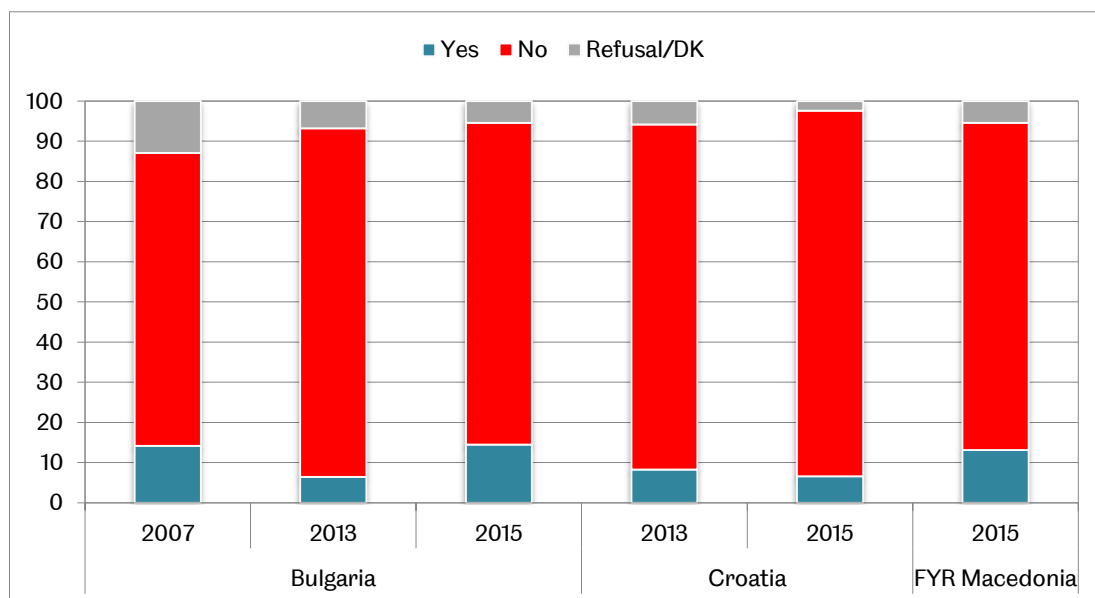
The first issue to scrutinise is the dynamics of envelope wage practices in the observed three countries. Given that not only was the sampling procedure of the GREY Survey identical to that in both waves of the Special Eurobarometer Survey, but also the question on participation in this type of employment was structured identically in all three surveys (see section 3.3.1.1 and Appendix 1), comparison of the findings is completely legitimate. Yet it is important to recall at this point that only Bulgaria was included in all three surveys, while Croatia was encompassed by the last two and FYR Macedonia solely by the GREY Survey.

Figure 5, which summarises the results on participation in quasi-formal employment in Croatia, Bulgaria and FYR Macedonia, illuminates significant longitudinal changes in the prevalence of this practice. Starting with Croatia, there seems to have been a slight decrease in the share of workers engaged in quasi-formal employment during the period 2013-2015. While 8.2% of employed Croatian citizens admitted receiving envelope wages in 2013, this decreased to 6.6% in 2015. Again, one must be cautious when drawing any conclusion about the dynamics of this practice due to a substantial portion of refusals/don't knows for both observed years.

The situation is opposite in Bulgaria, as there was a considerable increase in the share of individuals admitting engagement in this practice over those two years. In 2013 only 6.5% of dependent employees in Bulgaria stated they were receiving a part of their wage in cash, which is a significant decrease in comparison to 2007 when more than 14% of surveyed individuals identified themselves as under-declared workers. However, by 2015 the share returned to the level of 2007, accounting for 14.5%. This is accompanied by considerable variation in the proportion of faulty answers, which accounted for 12.9% in 2007, 6.8% in 2013 and 5.4% in 2015. One cannot say whether such disparities in outcomes between the observed years indeed reflect the changes in the economic environment in Bulgaria or whether this should be ascribed to the

aforementioned limitations of quantitative inquiries into sensitive topics. In any case, these rather unusual discrepancies are certainly not due to differences in methodological approach, given that an identical sampling procedure was applied in all three surveys.

**Figure 5 Dynamics of envelope wage practices in South-East Europe, % of respondents**



*Note: The sample includes 2,545 individuals*

*Source: Author's own work based on the Special Eurobarometer 284/Wave 67.3, the Special Eurobarometer 402/Wave 79.2 and the GREY Survey*

When it comes to FYR Macedonia, the findings from the GREY Survey reveal that in 2015 at least 13% of workers in this EU-candidate country were being paid more money than stated in their work contract. The share is probably even higher, as 5.5% of surveyed individuals did not provide an exact answer to this question.

Leaving aside the Special Eurobarometer Survey, the next step is to introduce the demographic and socio-economic variables that will be used in analysing which categories of workers in Croatia, Bulgaria and FYR Macedonia were more likely to join the under-declared workforce. As the reader will soon realise, the list of explanatory indicators used here is quite similar to that introduced in Chapter 4, which is again a consequence of the similarities between the three questionnaires.

To start with demographic variables, particular emphasis here should be paid to age and gender, which were both found to be significant at the EU-level. Based on the earlier findings, it is expected that more experienced individuals in South-East Europe will be less likely to participate in this practice than new entrants to the labour market. Similarly, men are expected to be more inclined to under-declare than women.

Although no significant effect of marital status was revealed earlier, the decision was made to include this indicator, primarily as a control variable. It is coded as before, with the following categories: single; married; cohabiting; divorced/separated; and widowed.

To further elucidate the relevance of deterrence, as well as of personal and social norms in the process, all three variables conceptualising them are once again included in the analysis. Explicitly, the respondents in the GREY Survey were asked about perceived deterrence risk and expected sanctions, both questions being identical to those in the Special Eurobarometer Survey and with the same offered answers. The same applies to attitudinal questions on the four types of noncompliance, which completely matched those from the Special Eurobarometer Survey. In line with this, the tax morale index was calculated following an identical procedure to that used previously.

Unfortunately, questions on occupation and size of the company were omitted from the GREY Survey owing to restrictions on the size of the questionnaire. Since the goal of the Survey was to encompass quite a wide range of topics<sup>70</sup>, this came at the cost of the part dedicated to demographic and socio-economic characteristics of respondents. Still, there is one valuable question that was asked in this particular survey (but not in the Special Eurobarometer Survey), and which can shed some extra light on the phenomenon. Each employed individual in the Survey was asked about the exact sector in which they were working. Given the wide range of the possible answers, this indicator was recoded to denote broader areas of economic activity, thus resulting in a categorical variable with the following classification: construction; industry and transport; household and repair services; hospitality and service sector; retail; agriculture; and other sectors.

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<sup>70</sup> Apart from undeclared and under-declared work, the GREY Survey also covered some other illegitimate practices, such as bribery and pulling strings to have things done. In addition, one part of the Survey was dedicated to the evaluation of various policy measures to tackle unregistered economic activities.

**Table 12 Prevalence and distribution of quasi-formal employment in Croatia, Bulgaria and FYR Macedonia, % of formal employees in 2015**

		Overall			Croatia			Bulgaria			FYR Macedonia		
		Yes	No	Refusal/DK	Yes	No	Refusal/DK	Yes	No	Refusal/DK	Yes	No	Refusal/DK
Gender	Male	13.4	81.5	5.1	7.7	89.0	3.3	16.6	77.6	5.8	15.1	79.1	5.8
	Female	9.5	86.7	3.8	5.5	93.2	1.3	12.3	82.8	4.9	10.1	84.9	5.0
Age	15-24	19.0	76.0	5.0	22.3	75.7	2.0	15.5	78.1	6.4	20.1	73.6	6.3
	25-34	14.4	83.2	2.4	8.4	91.2	0.4	18.4	77.8	3.8	16.4	80.6	3.0
	35-44	11.7	82.7	5.6	5.1	90.9	4.0	13.7	80.2	6.1	16.0	77.2	6.8
	45-54	7.8	87.1	5.1	3.5	94.5	2.0	11.7	81.0	7.3	7.4	86.9	5.7
	55-64	10.2	84.7	5.1	2.3	93.2	4.5	16.4	79.2	4.4	6.9	86.1	7.0
Marital status	Single	15.1	82.1	2.8	11.6	87.1	1.3	17.9	76.7	5.4	16.6	81.6	1.8
	Married	9.4	86.2	5.4	3.3	94.6	2.1	11.4	83.6	5.0	12.2	82.2	5.6
	Cohabiting	18.9	75.6	5.5	8.6	87.1	4.3	25.1	68.2	6.7	20.7	79.3	0.0
	Divorced/Separated	15.1	79.8	5.1	11.3	84.5	4.2	18.9	74.9	6.2	16.3	79.1	4.6
	Widowed	16.9	73.5	9.6	16.2	83.8	0.0	18.8	73.5	7.7	12.0	61.3	26.7
Area of economic activity	Construction	22.2	70.6	7.2	16.1	79.4	4.5	21.9	67.6	10.5	27.6	66.3	6.1
	Industry and transport	12.7	83.1	4.2	6.0	89.9	4.1	17.9	76.6	5.5	12.2	85.2	2.6
	Household and repair services	16.1	80.3	3.6	8.6	91.4	0.0	24.9	69.6	5.5	6.3	90.3	3.4
	Hospitality and service sector	11.9	84.4	3.7	6.4	91.4	2.2	14.5	81.1	4.4	15.9	79.6	4.5
	Retail	11.3	85.9	2.8	7.5	90.7	1.8	12.8	84.5	2.7	12.0	83.0	5.0
	Agriculture	14.8	75.4	9.8	28.3	58.2	13.5	9.7	77.8	12.5	22.5	77.5	0.0
Detection risk	Other	7.3	90.2	2.5	4.2	94.8	1.0	8.8	88.2	3.0	9.8	86.3	3.9
	Very small	12.7	84.5	2.8	7.6	89.0	3.4	15.9	80.9	3.2	13.7	85.4	0.9
	Fairly small	10.9	85.3	3.8	7.2	90.8	2.0	11.4	84.2	4.4	16.2	78.3	5.5
	Fairly high	11.6	84.0	4.4	5.4	92.9	1.7	16.6	77.9	5.5	12.5	81.8	5.7
	Very high	14.2	81.9	3.9	7.5	92.5	0.0	28.5	63.9	7.6	11.9	83.8	4.3
Expected sanctions	Tax + social security contributions due	11.4	84.9	3.7	5.2	91.4	3.4	15.0	81.1	3.9	14.0	82.3	3.7
	Tax + contributions + fine	11.2	85.2	3.6	7.9	91.0	1.1	13.8	81.1	5.1	11.4	84.3	4.3
	Prison	11.4	86.7	1.9	0.0	100	0.0	11.6	86.3	2.1	20.2	76.4	3.4
Tax morale	<2	8.5	87.8	3.7	5.7	92.3	2.0	10.9	84.9	4.2	9.0	85.7	5.3
	2-4	13.7	81.9	4.4	7.7	91.6	0.7	15.4	78.3	6.3	17.1	78.4	4.5
	4-6	16.1	78.1	5.8	7.1	83.6	9.3	18.4	77.6	4.0	20.5	73.0	6.5
	6-8	26.2	63.8	10.0	18.4	81.6	0.0	32.9	48.3	18.8	24.5	67.9	7.6
	8-10	42.8	39.1	18.1	0.0	100	0.0	61.7	0.0	38.3	44.1	44.2	11.7

Note: The sample includes 2,545 individuals

Source: Author's own work based on the GREY Survey

An insight into the structure of envelope wage earners in Croatia, Bulgaria and FYR Macedonia according to the introduced indicators, as given in Table 12, reveals a substantial similarity between these countries. In all three transition economies men seemed to be far more likely to receive undeclared income alongside an official wage than women. In total, 13.4% of surveyed men in the survey admitted receiving envelope wages, while only 9.5% of women did so. It must be, however, emphasised that in Croatia the difference between genders was less pronounced than in Bulgaria and FYR Macedonia. Still, even though the descriptive findings on the role of gender seem to support the earlier inference based on the Special Eurobarometer Survey, it is vital to evaluate the role of gender in parallel with all other relevant explanatory variables (i.e. by applying statistical modelling) before coming to any conclusion in this regard.

A similarity among the countries is also noticeable when it comes to age, to the extent that the share of envelope wage earners declines with age in all three observed economies. This is particularly pronounced in Croatia and Macedonia, while in Bulgaria differences among age cohorts are slightly less evident. For instance, in Bulgaria individuals aged between 55 and 64 years seemed to be much more active in this type of employment than is the case in the other two economies.

A descriptive overview of the distribution of the under-declared workforce according to marital status seems to support earlier findings that marital status is not a particularly vital factor for this practice. The results presented in Table 12 indicate that married individuals might be somewhat less prone to receiving additional payments in cash than others, while no apparent difference between remaining groups is noticeable. Akin to the previously discussed indicators, there is once again a substantial similarity between countries in the case of marital status.

The identical conclusion can be drawn for two variables conceptualising deterrence: no noticeable association seems to exist between detection risk and participation in quasi-formal employment, and this holds true for all three observed countries. In fact, in Bulgaria those who perceived this risk as very high were actually most likely to receive cash-in-hand payments alongside their officially declared wage. A similar pattern is visible regarding the expected sanctions as, observing all three countries together, one can see that expected sanctions were most likely to have no effect on decisions about participation in this illegitimate arrangement. Besides, in FYR Macedonia for instance those who saw imprisonment as a possible outcome seemed

to be more prone to under-declaration of wages than those who believed only financial consequences might be incurred.

The results presented in Table 12 further suggest that the association between tax morale and participation in quasi-formal employment, which was earlier found to be quite strong at the EU-level, is probably also in existence in the three observed countries. Namely, while only 8.5% of survey respondents expressing the highest tax morale stated they were receiving cash-in-hand payments alongside regular wages, this share gradually increases up to 42% for individuals who expressed absolute tolerance towards tax evasion. Even though the same pattern is noticeable for all three countries, the role of tax morale seems to be the most pronounced in Bulgaria. The share of envelope wage earners in this country ranges from 10.9% (for respondents strongly opposing noncompliant behaviour) to 61.7% (for those with a highly permissive attitude towards tax evasion).

The distribution of envelope wage earners according to their area of economic activity is the only aspect in which a certain difference between the three transition countries is observable. While in Croatia under-declaration of wages was most frequently encountered among agricultural workers, in Bulgaria this practice seemed to be most inherent in household and repair services. On the other hand, in FYR Macedonia it was the construction sector where envelope wages occurred most frequently. However, a broader look at the descriptive results indicates that the difference between countries is not as pronounced as it appears at first glance. For instance, the construction sector is among the top two sectors in this respect in all three countries, while the same holds true for agriculture in Croatia and FYR Macedonia (but not in Bulgaria). Following this, the construction sector appears as the natural reference category for the quantitative modelling, which is described in the following section.

## **5.2 Determinants of under-declared employment in South-East Europe - logit modelling**

To evaluate which of the introduced factors can help in explaining participation in practices of under-declaring from the perspective of workers in the chosen South-East European countries, logit modelling was undertaken. As already clarified in the methodology chapter, a multi-level approach is not feasible here as there are only three level\_2 units (i.e. three countries). For that reason, the analysis here is based on a single-level logit modelling, whereas the potential differences between the countries are controlled for by using a country indicator.

The model is defined as follows:

$$\ln\left(\frac{\pi_i}{1-\pi_i}\right) = \beta_0 + \beta_1 X_{i1} + \beta_2 X_{i2} + \dots + \beta_{20} X_{i20} \quad (15)$$

where  $i = 2,545$ .

The full list of explanatory variables and the information about missing values for each of them is given in Table 13. As can be seen, age and gender are the only variables without missing values (alongside the country indicator, which was created by the researcher).

**Table 13 Summary of covariates used in the logit model on data from the GREY Survey**

Variable name	Description	Values	Number of missing values
<b>Gender</b>	A dummy variable for respondent's gender	0 - male; 1 - female	0
<b>Age</b>	An interval variable indicating the exact age of a respondent	Values representing exact age	0
<b>Marital status</b>	A categorical variable denoting the civil state of a respondent	1 - single; 2 - married; 3 - cohabiting; 4 - divorced/separated; 5 - widowed	29
<b>Area of economic activity</b>	A categorical variable describing the economic sector (in a wider sense) in which a respondent works	1 - construction; 2 - industry and transport; 3 - household and repair services; 4 - hospitality and service sector; 5 - retail; 6 - agriculture; 7 - other	72
<b>Detection risk</b>	A categorical variable for perceived risk of being detected when engaged in unregistered activities	1 - very small; 2 - fairly small; 3 - fairly high; 4 - very high	189
<b>Expected sanctions</b>	A categorical variable measuring anticipated penalties when caught in carrying out unregistered activities	1 - normal tax or social security contributions due; 2 - normal tax or social security contributions due, plus a fine; 3 - prison	446
<b>Tax morale</b>	An interval variable measuring respondents tax morale	'1' denotes the highest level of tax morale and '10' the lowest level	90
<b>Country</b>	A categorical variable denoting a country of residence	1 - Croatia; 2 - Bulgaria; 3 - FYR Macedonia	0

*Note: The sample includes 2,545 individuals*

*Source: Author's own work based on the GREY Survey*

For all other variables there is a need to simulate non-existent values and this is done using the same strategy as described in Chapter 3. However, since the computation speed in single-level modelling is not as significant a problem as in the multi-level case, the decision was made to rely on a higher number of imputations. In line with that, 30 parallel datasets were simulated and the results were then combined using Rubin's



procedure (see section 3.3.3). It is also important to state that both data preparation and the analysis in this case were done using the statistical software STATA. This was because STATA is much more computationally efficient than MLwiN when data are given solely on one level.

### ***5.2.1 Findings***

The results of the conducted logit model are presented in Table 14. The first interesting thing to notice is that gender is not significant here, thus contradicting our earlier results on the matter, as well as the findings by Kedir et al. (2011) and Meriküll and Staehr (2010). Although such an outcome might seem surprising at first glance, there is a plausible explanation for this peculiarity. Namely, since a sequential model building strategy was applied (i.e. variables were added one at a time), the researcher was able to monitor how the effect of each individual predictor changed after adding subsequent covariates. Essentially, gender was significant until the area of economic activity was included in the model. Once the latter was controlled for, the effect of gender diminished.

A detailed look at the raw data reveals that a majority of construction workers in the survey were men, while women dominated in some other sectors, such as retail and the service sector. As can be seen from the presented results, firms from sectors in which women were the major workforce were less likely to under-declare their employees. More precisely, the findings are that workers in retail, industry and transport, as well as in hospitality and service sector were less likely to be under-declared than their counterparts in construction. On the other hand, no statistically significant differences in the propensity to receive envelope wages was found between individuals working in agriculture and construction workers, and the same applied to workers conducting household and repair services<sup>71</sup>.

It therefore seems that gender is probably just an intermediary variable for participation in under-declared employment. The sector of the economy in which one works seems to determine the propensity to participate, whilst gender exhibits a strong influence on choice of the area of economic activity.

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<sup>71</sup> These findings on the link between the sector in which one works and their propensity to be under-declared are in line with previous studies (see Kriz et al., 2007).

Table 14 Results of the logit model on participation in quasi-formal employment, data from the GREY Survey

	$\beta_k$	Standard error
<b>Female</b>	-0.209	0.146
<b>Age</b>	-0.027***	0.007
<b>Marital status (RC: Single)</b>		
Married	-0.459*	0.196
Cohabiting	0.184	0.260
Divorced/Separated	0.594	0.338
Widowed	0.840	0.477
<b>Area of economic activity (RC: Construction)</b>		
Industry and transport	-0.727**	0.256
Household and repair services	-0.635	0.337
Hospitality and service sector	-0.926**	0.282
Retail	-1.122***	0.290
Agriculture	-0.598	0.487
Other	-1.268***	0.270
<b>Detection risk (RC: Very small)</b>		
Fairly small	-0.112	0.190
Fairly high	-0.034	0.203
Very high	0.202	0.243
<b>Expected sanctions (RC: Tax + social security contributions due)</b>		
Tax + contributions + fine	-0.070	0.154
Prison	-0.146	0.353
<b>Tax morale</b>	0.263***	0.035
<b>Country (RC: Croatia)</b>		
Bulgaria	1.000***	0.193
FYR Macedonia	0.899***	0.215
<b>Cons</b>	-1.164**	0.427
<b>Number of observations</b>		2,545
<b>Number of imputations</b>		30
<b>Prob &gt; F</b>		0.000
<b>Pseudo R2</b>		0.119
<b>Area under ROC</b>		0.739

Notes: 1) Significance: \* $p < 0.05$ , \*\* $p < 0.01$ , \*\*\* $p < 0.001$

2) Estimates based on multiple imputation technique with 30 imputations

3) Since tax morale is given on an inverse scale, positive coefficient indicates that lower tax morale entails higher likelihood to participate in quasi-formal employment

Source: Author's own work based on the GREY Survey

This however suggests another interesting question, which is why firms in some sectors were more prone to under-declaration of their workforce. Whether this was due to differences in the ability to create cash for envelope wages or owing to some other factors will be discussed later in the part of the thesis that brings in the findings from the qualitative fieldwork.

Apart from this particularity, the findings based on the GREY Survey generally reconfirm all the other results from the Special Eurobarometer Survey, as well as those from earlier research studies<sup>72</sup>. Explicitly, the logit modelling on data from Croatia, Bulgaria and FYR Macedonia indicates again that younger individuals are more likely to engage in this practice, while marital status seems not to be an important factor. As before, tax morale is a significant predictor for a propensity to start receiving envelope wages, while there is no effect of the two variables conceptualising deterrence. Finally, the variable controlling for the country of residence confirmed earlier notions that workers from Croatia are less likely to work on an under-declared basis than their counterparts in the other two analysed countries.

To further explore the effect of the available explanatory variables on an individual's propensity to receive envelope wages, Figure 6 outlines the predicted probabilities (as defined in equation (15)) for a 'representative' worker according to their age and level of tax morale. This 'representative' worker is defined using mean and modal values of the remaining six predictors. That is to say, the representative citizen is a married Croatian male working in the industry sector, who thinks that the risk of being detected by the authorities is fairly small and expects to pay taxes and social security contributions due plus a fine if prosecuted. For simplicity, only the figures for representative workers aged 24, 35, 50 and 62 are shown in Figure 6.

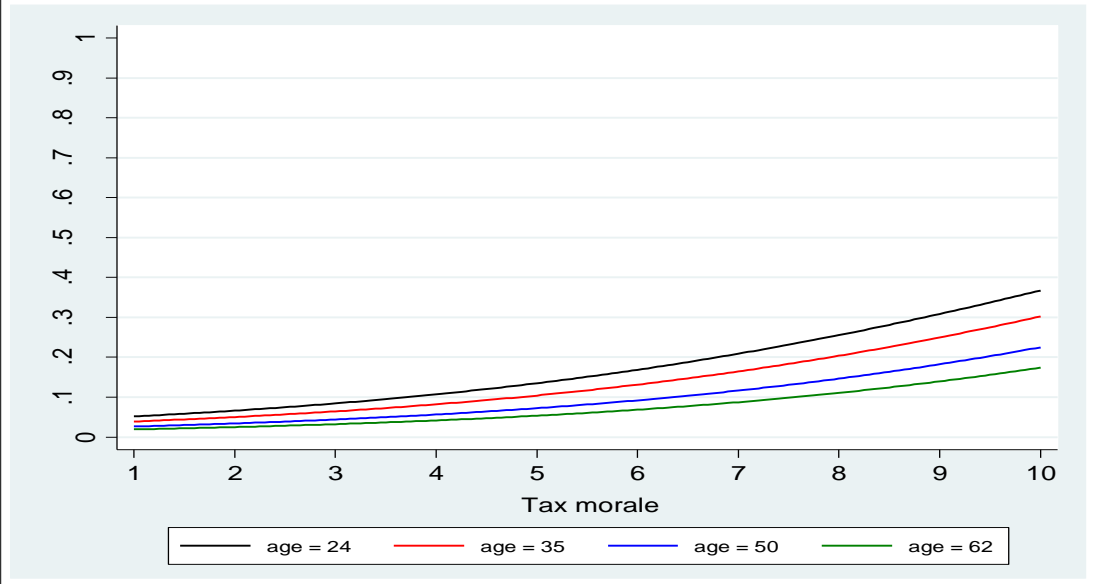
As can be seen, the probability of being under-declared ranges from slightly above zero to almost 40%, depending on the age and the level of tax morale of the representative worker. For instance, while only two out of 100 workers who are 62 years of age and express the highest tax morale (and with all other characteristics as defined above) are expected to work on an under-declared basis, this increases to some 18 out of 100 for those who find tax evasion absolutely acceptable. When it comes to dependent employees being 24 years old, one in 20 of such individuals expressing zero-tolerance towards tax evasion is expected to receive envelope wages,

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<sup>72</sup> See Kedir et al. (2011), Kriz et al. (2007), and Williams and Horodnic (2015).

and this rises to some 38 out of 100 for those with a completely permissive attitude towards flouting the tax legislation.

**Figure 6 Predicted probability of a 'representative' worker receiving envelope wages: by tax morale and age**



*Note: Tax morale is measured on the scale from 1 to 10, with value 1 indicating completely unacceptable and 10 absolutely acceptable. Therefore, higher levels mean lower tax morale.*

*Source: Author's own work based on the GREY Survey*

A further interesting aspect to notice is the difference between age groups at different levels of tax morale. While this dissimilarity in probabilities of participating in the under-declared realm is almost negligible for individuals with the highest tax morale, age appears to play an increasingly important role as tax morale declines.

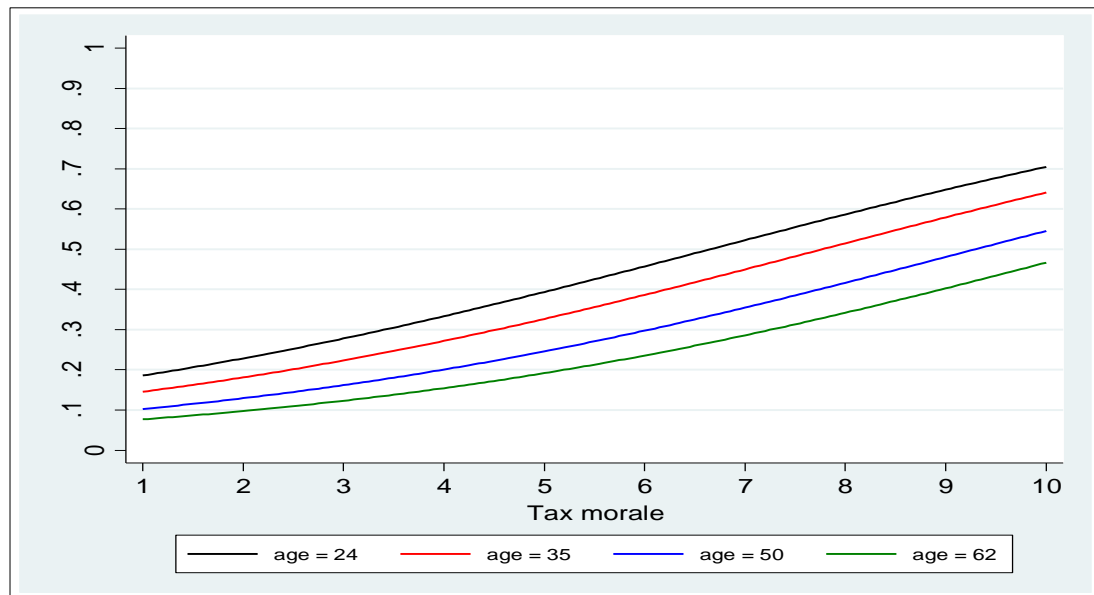
The importance of tax morale and age for development of this illegitimate practice becomes even more evident when examining some more extreme individuals. For instance, Figure 7 illustrates how the predicted probability of receiving envelope wage changes for one such individual. This 'extreme' employee is defined as a non-married male working in the construction sector. The construction sector was chosen on purpose so as to reflect the findings of the logit modelling, which revealed that this sector is particularly susceptible to under-declaration of its workforce<sup>73</sup>.

Yet, to demonstrate the absence of a significant effect on the part of deterrence, this person is delineated as a highly fearful individual. Explicitly, he thinks that the risk of being detected is very high and expects to be imprisoned if prosecuted. Finally, a

<sup>73</sup> Note that the decision on gender and marital status was arbitrary in this case, since neither of the two appeared significant for the development of this practice. Following this, any other value of these two variables would yield similar results.

worker is again defined as a Croatian citizen, simply to ease comparison with the findings on the representative employee. As before, only figures for individuals aged 24, 35, 50 and 62 are shown.

**Figure 7 Predicted probability of an 'extreme' worker receiving envelope wages: by tax morale and age**



*Note: Tax morale is measured on the scale from 1 to 10, with value 1 indicating completely unacceptable and 10 absolutely acceptable. Therefore, higher levels mean lower tax morale.*  
*Source: Author's own work based on the GREY Survey*

The first thing to notice from Figure 7 is the much larger span of predicted probabilities than for a representative individual. Namely, the probability of receiving more money than stated in the work contract for the extreme individual ranges from some 9% to 70%, depending on his age and tax morale. In addition to this, there is also a substantial difference between age cohorts and this applies to all levels of tax morale. However, as in the case of the representative individual, this difference here is also more pronounced for workers with lower tax morale. While for the extreme workers expressing zero-tolerance towards tax evasion the probability of receiving additional payments in cash ranges from 9% (for those aged 62) to 19% (for individuals having 24 years of age), this increases to 48% and 70% respectively among people with the lowest tax morale.

### 5.3 Some other characteristics of under-declared employment in South-East Europe

To further evaluate the nature of their employment, all survey respondents who admitted receiving envelope wages were asked six additional questions. Questions on the exact function of envelope wage payments and satisfaction with the arrangement were identical to those asked in the 2007 Special Eurobarometer Survey on undeclared work (see Chapter 4), while the question on the approximate percentage of yearly income received in cash was somewhat modified (see Appendix 1). Namely, net monthly income rather than gross yearly income was taken as a basis, because it was a more convenient choice for several reasons. Firstly, since some workers might have been receiving envelope wages only for one part of the year, the monthly wage was a much better reference point. In addition, given that envelope wages actually represent non-taxable income, it was more suitable to ask people what their take-home pay was, rather than to refer to gross amounts.

Besides these three questions, envelope wage earners in the GREY Survey were also asked to state who actually suggested this arrangement, with the following options offered: 'It was on my initiative'; 'It was a joint idea (involving both myself and the employer)'; and 'It was initiated by my employer'. Additionally, to analyse how the minimum wage legislation affects the arrangement, respondents were also asked to compare their declared wage with the minimum prescribed wage. Three answers were offered: the wage is below minimum; the wage equals the minimum wage; and the wage is above minimum.

The descriptive overview of these five matters, which is given in Table 15, shows that most often it was the employer who suggested this arrangement. More than six out of ten envelope wages earners in the Survey stated their employer initiated under-declaration of wages. However, in every fourth case it was a joint idea, which indicates that a non-negligible proportion of workers in South-East Europe are actually willing accomplices in this illegitimate practice. The role of employees in the process is further endorsed by the fact that almost 9% of under-declared workers in the survey admitted personally initiating under-declaration of their wages. This therefore

suggests that the widely accepted depiction of quasi-formal employment as a strictly employer-driven practice is not completely true<sup>74</sup>.

Yet, there is a substantial difference between the three transition countries in this respect. For instance, employers in Croatia were more frequently the only initiators of under-declaration than in the other two countries. On the other hand, under-declaration of wages strictly at the initiative of a worker was quite frequent in FYR Macedonia, while such a situation rarely occurred in Bulgaria.

**Table 15 Distribution of quasi-formal workers according to five different criteria, % of total under-declared population**

		Overall	Croatia	Bulgaria	FYR Macedonia
<b>Who suggested under-declaration</b>	Worker	8.7	10.1	2.3	18.4
	Joint idea	24.2	20.4	29.0	18.5
	Employer	61.3	69.5	65.3	50.1
	Refusal/DK	5.8	0.0	3.4	13.0
<b>Type of payment</b>	Part of regular work	46.7	46.9	48.1	44.2
	Overtime, extra-work	25.9	28.9	20.4	33.2
	Regular and overtime	23.3	24.2	25.8	18.9
	Refusal/DK	4.1	0.0	5.7	3.7
<b>Size of the declared wage</b>	Below minimum	12.8	18.0	10.2	14.1
	Equals minimum	29.8	47.2	22.3	32.0
	Above minimum	48.0	27.8	59.6	40.7
	Refusal/DK	9.4	7.0	7.9	13.2
<b>Share of net income received in cash</b>	1-20%	30.4	31.4	30.3	30.0
	21-40%	26.3	29.2	34.0	12.2
	41-60%	8.7	10.5	6.7	11.1
	61-80%	1.5	0.0	1.3	2.6
	81-100%	4.4	1.7	2.1	9.6
	Refusal/DK	28.7	27.2	25.6	34.5
<b>Satisfaction</b>	Prefer full declaration	36.7	54.4	27.4	41.5
	It depends	27.0	23.4	33.7	18.4
	Happy with this	29.5	18.9	31.2	32.7
	Refusal/DK	6.8	3.3	7.7	7.4

*Note: The sample includes 291 individuals*

*Source: Author's own work based on the GREY Survey*

Table 15 further reveals that envelope wages in South-East Europe predominantly served to remunerate regular work, given that this was stated by almost one half of the envelope wage receivers. Only one in four under-declared workers in the three observed countries was getting cash strictly for overtime or extra work, while a slightly lower proportion was remunerated in cash for both regular and overtime

<sup>74</sup> See Woolfson (2007).

work. There are, however, moderate differences between the observed countries in this regard. For instance, cash-in-hand payments strictly for overtime work seemed to be more frequent in FYR Macedonia than in the other two countries, while the opposite held true in the case of remuneration for both regular and overtime work. On the other hand, only one in five under-declared workers in Bulgaria was receiving cash exclusively for overtime or extra work, which is a substantially lower proportion than in the other two countries.

Turning to the link between the legislation on the minimum wage and the size of the declared wage, which is in the central focus of this thesis, the descriptive insight reveals that an under-declared worker was declared exactly on the minimum in less than 30% of the encountered cases. On the other hand, almost every second quasi-formal worker stated their wage was above minimum, while approximately 13% were receiving less than the minimum prescribed by the law in their bank account. These findings suggest that our suspicion might indeed be true, i.e. that employers generally tend to pay more than just the minimum, contrary to the prevalent belief among scholars (see Elek et al., 2011; OECD, 2003; Williams, 2013b). This issue will be further analysed in the following chapters.

Yet, the link between the minimum wage legislation and the declared part of the wage seems to be the feature in which there is the most noticeable difference between the three analysed countries. While in Croatia almost every second worker stated their declared wage was equal to the minimum wage, only 32% in FYR Macedonia and 22% in Bulgaria did so. On the other hand, six out of ten quasi-formal workers in Bulgaria were receiving declared wages that were above the minimum, which is significantly higher than in the other two countries. Similarly, the instances of workers being declared on less than the minimum were more frequent in Croatia than in Bulgaria and FYR Macedonia.

When it comes to the share of net income received in cash, the findings indicate that most under-declared workers in the observed countries get up to 40% of their income in an envelope. For approximately three out of ten quasi-formal workers their cash payments did not exceed 20% of their total remuneration, while one in four were receiving between 21% and 40% of net income in cash. Lastly, fewer than 6% of under-declared workers stated their envelope wages comprised more than 60% of the total net wage.



There is again a slight discrepancy between the countries, as it is noticeable that workers in FYR Macedonia were receiving a greater slice of their income in cash than their counterparts in Bulgaria and Croatia. In any case, a note of caution is necessary here as there was a significant proportion of respondents who did not provide a clear answer on this question; almost 30% of quasi-formal workers either stated they did not know the exact share of the wage they received in cash or simply refused to answer this question.

Finally, the results on satisfaction are somewhat different from those in the Special Eurobarometer Survey. The findings summarised in Table 15 indicate that only three out of ten quasi-formal workers surveyed were satisfied with their position, which is a much lower proportion than in the 2007 Special Eurobarometer Survey where approximately 41% of respondents stated they were happy with receiving envelope wages. On the other hand, more than one third of respondents in the GREY Survey would prefer full declaration, which is substantially higher than in the 2007 Special Eurobarometer Survey, and the same conclusion can be drawn for the proportion of hesitant individuals. Unfortunately, it is not possible to say whether this difference can be ascribed to some peculiarities of the three countries in question, or whether it is a pure consequence of deteriorating conditions on the labour markets following the economic downturn.

Still, there are considerable differences between the three countries in this respect. For instance, workers in Croatia much more frequently expressed dissatisfaction with such an arrangement than their counterparts in Bulgaria and FYR Macedonia. On the other hand, Macedonians in general seemed to be happier with their position, while Bulgarians hesitated more often than workers in the remaining two countries. In any case, even though the share of individuals who were satisfied with their position is not as high in these three countries as in the EU, it is far from being negligible. This therefore reinforces the assumption that not all quasi-formal workers are oppressed by their employers.

Alongside these five questions, the survey respondents who admitted receiving envelope wages were also asked one supplementary question with multiple answers allowed. This question, whose aim was to explore whether under-declaration entailed some additional requirements on the part of employers, was structured as follows:

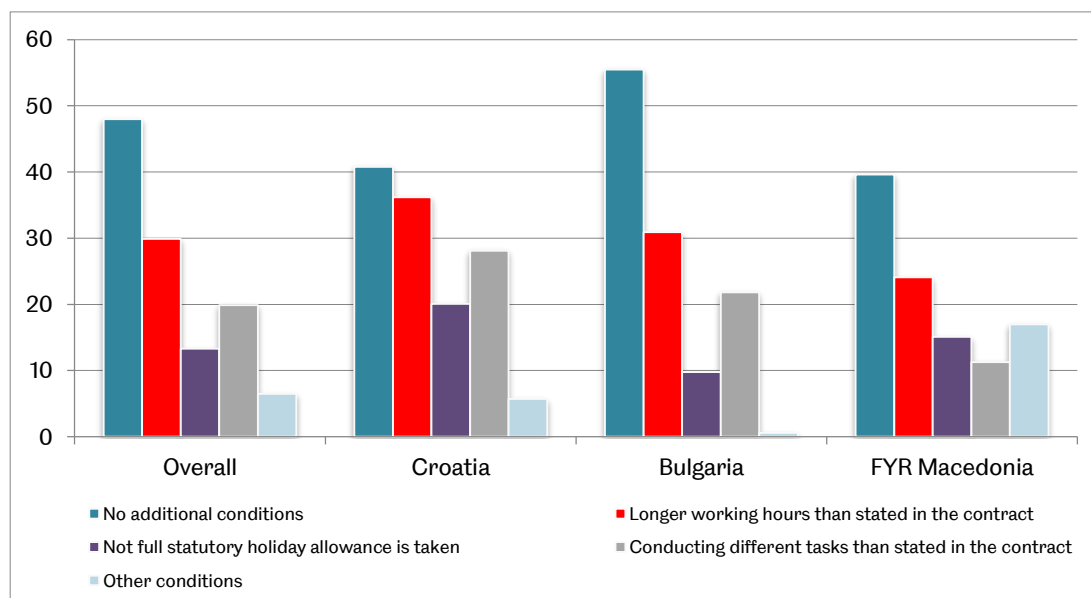
*Did you verbally agree with your employer to any of the following conditions in return for receiving this additional cash-in-hand payment?*

Five possible options were given:

- 1) No additional conditions were agreed
- 2) Agreed to work longer working hours than stated in the formal contract
- 3) Agreed not to take full statutory holiday allowance
- 4) Agreed to do different tasks than stated in the formal contract
- 5) Some other conditions were agreed to

The summary of answers to this question is presented in Figure 8. Note that the sum of percentages exceeds 100 since respondents were allowed to choose more than one option. As can be seen, a substantial proportion of workers in South-East Europe were indeed expected to disregard what was stated in their work contract. This first showed up as a longer work schedule than defined in the contract, as almost 30% of under-declared workers in the survey stated they were expected to stay longer at their workplace. There is again a slight variation between the countries in this respect. For instance, while 36% of quasi-formal workers in Croatia pointed out this peculiarity of their verbal agreement, only 24% did so in FYR Macedonia.

**Figure 8 Overview of additional conditions that accompanied under-declaration, % of quasi-formal workers**



*Note: The sample includes 291 individuals*

*Source: Author's own work based on the GREY Survey*

Conducting tasks that were different from those stated in the contract appears to be the second most frequent extra condition in Croatia and Bulgaria, while in FYR Macedonia it was not so commonly encountered. While 28% of under-declared workers in Croatia and 22% in Bulgaria pointed out this aspect of their jobs, no more than 11% in FYR Macedonia stated they were expected to conduct some non-related tasks.

When it comes to the commitment of a worker not to take full statutory holiday allowance, it appears to be a far more frequent practice in Croatia than in the other two countries. Every fifth worker in Croatia accepted this requirement, compared to 15% and 10% in FYR Macedonia and Bulgaria respectively.

However, almost 50% of the surveyed quasi-formal workers specified that no additional conditions were agreed between them and their employers. Therefore, under-declaration in such cases probably was first and foremost done to evade taxes and social security contributions. This rationale seemed to be most prevalent in Bulgaria, although in the other two analysed countries there was also a substantial proportion of workers who did not verbally agree to any special conditions.

#### **5.4 Summary of the findings from the quantitative inquiry and explanation of further steps**

This quantitative study on quasi-formal employment in Europe has revealed that a holistic approach is necessary to understand the complex mechanisms supporting this practice from the perspective of workers. Yet, even though none of the five theories should be neglected, the findings suggest that the ideas of the dualists, legalists and quasi-voluntarists are particularly helpful in conceptualising this phenomenon.

First of all, based on the Special Eurobarometer Survey we found that the behaviour of labour market participants in this regard is determined not only by their personal characteristics, but also by the macroeconomic and social 'climate'. Some 21% of the variation in the behaviour of individual workers in 2007 is attributable to economic, institutional and cultural differences between EU member states, while in 2013 this is reduced to 12.8%.

When it comes to individual-level determinants of this practice, the analyses conducted on data from the Special Eurobarometer Survey revealed a significant effect of gender, age, occupation, size of the company and tax morale on workers' propensity to

participate in this illegitimate realm. On the other hand, no statistically significant impact of marital status, perceived detection risk and expected sanctions was found.

Logit modelling applied on data from the GREY Survey mostly endorsed these findings, except for the effect of gender. The results suggest that it is the segment of the economy in which one works, not gender, which determines his or her propensity to engage in under-declaration of wages. Essentially, firms from sectors in which women dominate as a workforce were found to be far less likely to under-declare their employees. In line with that, gender is probably just an intermediary variable for participation in under-declared employment, given that it exhibits a strong influence on the choice of the area of economic activity. Whether this reasoning really holds true will be evaluated in the following chapters of the thesis.

Satisfaction with receiving envelope wages appears to be determined solely by tax morale and the exact function of cash-in-hand payments. In short, the analysis indicated that quasi-formal workers with a more permissive attitude to noncompliance, and particularly those who are compensated in cash solely for overtime and/or extra work, are more likely to express a higher level of contentment with their position.

This quantitative inquiry further revealed that in a majority of cases envelope wages served to remunerate regular work (at least in South-East Europe). It also showed that most employers saw under-declaration primarily as a strategy to evade taxes and social security contributions rather than as an efficient tool for oppressing their workers. What is more, every third quasi-formal worker in Croatia, Bulgaria and FYR Macedonia actually initiated the arrangement (on their own or in collaboration with the employer), which suggests that the prevailing depiction of under-declared workers as an endangered group<sup>75</sup> is probably not completely true.

In general, the quantitative part of the thesis confirmed the results from the previous studies on the matter, as the lack of formal employment opportunities and risk of poverty were indeed found to be important triggers of this practice from the perspective of workers (see Hazans, 2005; Kriz et al., 2007; Williams, 2013b). Yet, a comprehensive evaluation of numerous micro and macro indicators presented above suggests that the roots of the phenomenon go far beyond the dualist view. In other words, it seems that previous research on this matter, while accurately describing the

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<sup>75</sup> See for instance Hazans (2005), Williams (2009) and Woolfson (2007).

phenomenon for a certain proportion of labour market participants, has failed to grasp the entire universe of under-declared employment. The main conclusion of this part of the study is therefore that what has been known so far about this illicit practice is probably just one piece of a perplexing puzzle.

Explicitly, the quantitative inquiry indicated that one must not neglect the role of socio-cultural factors in the process. This applies to tax morale, at both individual and societal levels. In addition, we found a steady link between corruption and the propensity to work on an under-declared basis, as well as between trust in the government and people's willingness to conceal a part of their wage. The study also pointed to the overall quality of state institutions as an important element in this regard, thus confirming the relevance of legalism. That is, more effective state apparatus in a particular country entails a lower likelihood of workers engaging in under-declaration of wages. Similarly, a stronger rule of law and a higher level of perceived judicial independence in a country reduce the propensity of workers to participate in this illegitimate arrangement. All these findings can certainly explain why this type of employment is by far the most prevalent in transition countries, given that these economies are characterised by lower levels of tax morale, more prevalent public sector corruption and a lower quality of state institutions than the older member states (see discussion in Chapter 2).

Contrary to what was expected, the analyses question the relevance of voluntarism in explaining the matter. First of all, we found no link between perceived deterrence and the propensity to participate in this realm. Furthermore, there is no evidence that the behaviour of taxpayers is subject to their expectations regarding future inflows from pensions or is influenced by the overall tax burden. A similar conclusion can be drawn in the case of the prospects of holding more than one job, which certainly challenges the applicability of the rational agent theory to the phenomenon of quasi-formal employment. In short, statistical insights into the matter revealed that workers place more emphasis on the psychological contract between them and the state, as well as on the social contract they have with other members of society, rather than on simple cost-benefit analysis. In line with this, one can argue that under-declared workers are more emotional than rational agents.

Yet one should not reject voluntarism at this stage because of the possibility of hidden mechanisms through which some ideas of this school of thought might appear indirectly applicable. This is related to the role of deterrence, which is dependent on

various institutional aspects. For instance, the legal system in countries with weak rule of law may be prone to the influence of firms and individuals, who can resort to pulling strings and/or bribing responsible officials so as to reduce the risk of being audited and prosecuted.

Our findings do not support a structuralist view on the mechanisms behind the phenomenon. In short, quasi-formal practices in the EU seem not to be susceptible to the level of state interference in the labour market and the same applies to prevalence of contracts of limited duration. On the other hand, the in-work at-risk-of-poverty rate was found to be significant in 2007, but not in 2013. Yet, these outcomes do not mean that the structuralist school is irrelevant, as our models were not able to grasp the everyday experience of workers, which is the central focus of this school of thought. Therefore, the applicability of structuralist ideas can be fully tested only by the qualitative research.

There are also numerous other aspects of this practice that can be understood solely by in-depth discussion with quasi-formal workers. This primarily applies to the negotiation process between a worker and their employer regarding under-declaration of income. For instance, at this point we do not know which strategies are used by employers to motivate workers to accept the arrangement (when under-declaration is offered by the employer) nor which options are available for workers in those circumstances. In addition, the quantitative study was not able to say anything about the dynamics of the relationship between workers and their employers during the course of employment, or about potential problems with payment and the strategies used by workers to resolve conflicts that may arise.

Finally, even though the quantitative research pointed to numerous factors that might be important for the development and sustaining of this type of employment, it was not possible to say anything about the interaction of these factors, or about the weights each individual worker applies to them. For instance, it is possible that older individuals place more emphasis on certain aspects, which on the other hand might be perceived as relatively unimportant for new entrants to the labour market (e.g. pension contributions, working hours or moral cost of noncompliance).

Yet, the quantitative analyses undoubtedly have shed new light on the phenomenon by illuminating many interesting features that have not been previously considered. The knowledge gained from this part of the study provided a firm foundation for the

preparation of qualitative interviews<sup>76</sup>. First of all, it became apparent that non-alignment between formal institutions (i.e. laws, codes and regulations relating to the legal framework of a country) and informal institutions (i.e. norms, beliefs and values of citizens) might be of vital importance for the development of this type of employment from the perspective of workers. This principally relates to the quality of state institutions and the strength of the legal apparatus on the one hand, and tax morale on the other. Besides this, the quantitative part of the study also raised the need to understand why deterrence and the quality of the pension system, contrary to expectations, have only a limited (if any) role in the decision-making processes of workers. These topics therefore had to be placed as a central focus of the qualitative interviews with quasi-formal workers<sup>77</sup>.

Alongside all these matters, it was also essential to pay attention during the interviews with workers to the last two research questions (i.e. how the financial gain from such evasion is distributed between the two stakeholders and the link between the legislation on the minimum wage and the formal part of remuneration within under-declared employment). Given this variety of topics to cover, a semi-structured form for the interviews with quasi-formal workers appeared to be the most suitable option. Such an approach enabled all important matters to be embraced, while at the same time allowing new thoughts to be brought up by the interviewees.

What is more, the semi-structured form of interviews was the most reasonable choice given the sensitivity of the topic. To be more exact, the main strategy for the qualitative interviews with workers was to ask people some general questions about their experience from quasi-formal jobs, which would then enable them to spontaneously expand on the topic if they wanted.

Following this, the decision was made to divide the interview schedule for interviews with workers into six parts<sup>78</sup>. The first part, which served as an ice-breaker, was dedicated to non-sensitive matters such as the total experience on the labour market, occupation and the exact sector the participant works in. The second part started

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<sup>76</sup> It should be reiterated that the interviews with workers were conducted after the analyses on the Special Eurobarometer Survey were concluded (but before analysis of the GREY Survey), while interviews with representatives were conducted in the last stage of the study.

<sup>77</sup> The interviews with representatives are discussed later.

<sup>78</sup> The questionnaire is given in Appendix 4.

with broad questions about their under-declared job(s), including the duration of employment and type of contract (part-time, full-time or some other).

This was followed by more detailed questions about the negotiation process between workers and their employers, reasons for engaging in this arrangement and the functioning of the practice on an everyday basis (i.e. potential problems with payment, disputes with the employer, distribution of the profit from this type of tax evasion, etc.). In addition, the role of the minimum wage legislation was also discussed in this part. Finally, particular attention was paid to the link between the exact function of envelope wage payments and workers' satisfaction with this practice.

The latter was further explored in part three, which was completely dedicated to obtaining an in-depth understanding of workers' attitudes towards their own under-declared employment. After part four, which aimed at exploring the link between undeclared and under-declared work, we moved to the role of formal and informal institutions in the development of quasi-formal employment. The closing part of each interview was concerned with demographic and socio-economic aspects of participants, including those that were found to be significant during the quantitative research. The main idea here was to prompt self-reflection in workers that could shed new light on their behaviour and decisions.

As mentioned in section 3.4, the fieldwork was conducted in Croatia, which faces particularly salient problems with this type of employment. Affecting approximately 7% of all dependent employees in this South-East European country, this type of work is inherent in all social and economic groups (see Table 12 on p. 127). Particularly interesting in this regard is the occupational structure of the quasi-formal workforce in Croatia (see Franic & Williams, 2014). The practice seems to be highly prevalent among individuals holding highly-paid positions, given that some 11% of formally employed professionals and 9% of managers in Croatia receive more money than stated in their contracts (Franic & Williams, 2014). This is where the main strength of the snowball sampling came to light, as finding a 'ball' of such individuals enabled a comparison of how their reasoning and attitudes differ from those of low-income earners.

One plausible explanation for quasi-formal employment being so pervasive in Croatia can be found in the turbulent political history of the country (Bejaković, 2009; Franic & Williams, 2014). Undoubtedly, the foundations of a weak culture of tax compliance



can be traced back to the period of socialism<sup>79</sup>. Like other socialist regimes, Yugoslavia also had to struggle with inefficient public administration, low trust in the state institutions and consequently with quite low tax morale (Bejaković, 2009).

The situation in Croatia did change in this respect after the collapse of the socialist system in 1991, but in the opposite direction from desired. Explicitly, the country had to fight for its independence during the initial phase of economic and political transformation, which resulted in many illicit activities related to the privatisation of public companies staying out of the main focus of the public (Franičević, 1997)<sup>80</sup>. The early 1990s were thus a fertile ground for the development of various dishonest economic and social practices (primarily corruption and string-pulling), which enabled many privileged individuals to gain substantial wealth on an illegitimate basis (Čučković, 2002; Šundalić, 1999). Not only did this additionally broaden the existing gap between the state and citizens, but it also caused a deterioration in horizontal trust (Williams & Franic, 2015). Tax evasion out of defiance has thus become a frequent occurrence in Croatia (Bejaković, 2009; Williams & Franic, 2015).

There are some other important reasons why Croatia appeared interesting for fieldwork. Alongside the low level of economic development in comparison to other member states, Croatia is also one of the countries paying the highest price of the economic downturn (Eurostat, 2016e). Explicitly, severe disturbances on the labour market during the last few years have placed this country at the top of the EU lists regarding unemployment rates (particularly considering the youngest labour market participants), as well as in terms of poverty rates (Eurostat, 2016i, 2016m). What is more, the country is also among the member states with the most pressing problems concerning government effectiveness and the rule of law (World Bank, 2015), which we also identified as highly significant factors for the development of quasi-formal employment.

In addition to these factors, another peculiarity of this transition country that made it highly suitable for qualitative fieldwork is the fact that practices of under-declaring are mostly found in its capital. According to the Special Eurobarometer survey on undeclared work, some 40% of the total under-declared population is identified as

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<sup>79</sup> Croatia was a part of the Socialist Federal Republic of Yugoslavia from 1945 to 1991.

<sup>80</sup> A similar pattern with respect to non-transparent privatisation process and its effect on citizens' willingness to pay taxes was documented in other post-socialist countries (Torgler, 2003). However, in Croatia this problem was heightened by the war.

being in Zagreb (see Franic & Williams, 2014), and therefore the capital of Croatia appeared a reasonable location for the qualitative study on the matter<sup>81</sup>.

Before proceeding with the presentation of the findings from the qualitative inquiry in Croatia, it should be stressed that the elaboration given in the following chapters is by no means an attempt to provide a representative overview of practices of under-declaring in Europe. On the contrary, the reader should bear in mind that many features of under-declared employment in Croatia presented here are not necessarily applicable to other member states. In line with this, the sole purpose of the remaining parts of this thesis is to broaden the understanding of this illegitimate type of employment, as well as to point to some peculiarities of its own which have not been considered so far.

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<sup>81</sup> The exact explanation for this disproportion in the distribution of quasi-formal workers will be given later.

## 6 QUALITATIVE INSIGHTS INTO THE CAUSES AND NATURE OF UNDER-DECLARED EMPLOYMENT IN A TRANSITION SETTING

The following two chapters scrutinise in detail the complex mechanisms behind under-declared employment from the perspective of workers by setting out the most important findings from interviews with quasi-formal workers in Croatia conducted during spring 2015<sup>82</sup>. Besides further extending the knowledge grasped during the quantitative phases of the study, this qualitative part also illuminates some other characteristics of the practice, which were not discussed earlier but are crucial for conceptualising the phenomenon.

It is important to say that all four research questions are addressed in the following two chapters, but this is done in an indirect manner. As already explained, uncovering the numerous processes underlying this illicit type of employment requires comprehension of the complete picture behind the behaviour of each individual. It would therefore be hard to unravel all of the hidden elements supporting under-declared employment if each research question is evaluated on its own. Given this, the discussion here will follow a thematic approach, in line with the topics that are identified as essential for understanding the practice (see section 3.4.3). This will be done in a sequential matter, i.e. by examining different segments of a quasi-formal job as they appear chronologically during the 'life-span' of such jobs (i.e. from negotiation and signing a contract to the termination of employment). During the course of this discussion, remarks on the four matters of interest will be made.

We start with description of the sample, followed by the classification of quasi-formal workers by their motives for entering this realm. The last part of this chapter provides a comprehensive discussion about the link between the exact function of cash payments and employee satisfaction with quasi-formal employment. Discussion of the matter is then continued in Chapter 7, which dissects various other aspects of this practice that exert a significant effect on the perception of workers as regards their own position. These are in first line the role of professional standards in the

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<sup>82</sup> As explained earlier, presentation of findings from this stage of the study was divided into two chapters simply for practical reasons. Given the complexity of the research problems and multifaceted nature of the phenomenon, it was not possible to summarise all the findings in one chapter.

workplace, problems with payments and strategies to resolve them, as well as the importance of social relations in the company for this practice. Apart from these, Chapter 7 also examines three central factors that every under-declared worker has to bear in mind: fear of prosecution by the authorities, moral aspects of under-declaration and various short- and long-term financial consequences for workers.

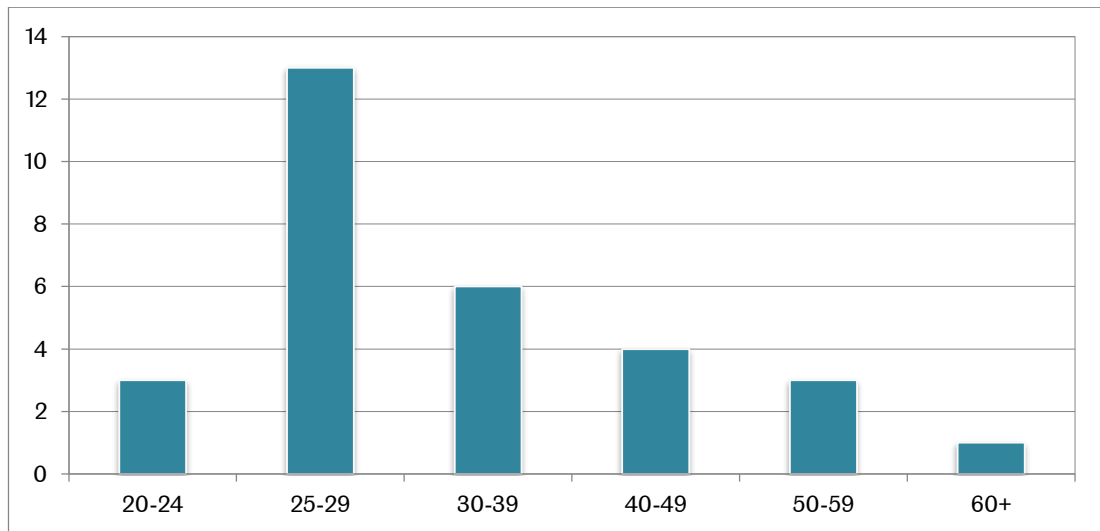
## **6.1 Overview of the sample**

Before commencing discussion of the findings concerning the causes and nature of under-declared employment in Croatia, we shall describe the demographic and socio-economic characteristics of the interviewed individuals. It needs to be stressed that the various distributions of respondents presented in this section should be perceived as accidental rather than planned. As the sample could not be considered representative, not only due to the snowball sampling method used but also because of its size, the primary emphasis in the recruitment phase was on the search for different and contrasting stories from the under-declared realm, rather than on the demographic and socio-economic characteristics of potential respondents.

The first issue to discuss is the age structure of the sample. In short, the fieldwork embraced all age cohorts, with the youngest participant being 23 years old and the oldest being 64. As Figure 9 reveals, those in the early stage of their career are predominantly represented in the sample. In fact, more than one half of the participants were below 30 years of age. They are followed by those between 30 and 40 years of age, who represent some 20% of all interviewed workers. Finally, the sample also contains a non-negligible number of individuals in the later stages of their career. In any case, in spite of a noticeable overrepresentation of individuals aged between 25 and 29, the age structure of our sample to a great extent reflects the overall situation in Croatia in this respect (see Table 12 in section 5.1).

Such a variety in age structure proved to be highly beneficial for understanding some crucial aspects of envelope wage practices. Namely, it became clear at the very beginning of the fieldwork that it is much easier to understand the viewpoint of quasi-formal workers if it is scrutinised through the lens of their experience in the labour market. In line with this, a key emphasis during the interviewing process was placed on ascertaining the differences in attitudes and opinion among participants which can be ascribed to their experience.

**Figure 9** Age structure of the sample, y-axis representing the number of respondents in a certain age category



*Notes: 1) The sample includes 30 individuals*

*2) For the participants that did not work on under-declared basis at the time of the interview the age in the moment they terminated their last quasi-formal employment was used*

*Source: Author's own calculation based on the findings from the fieldwork*

This task was facilitated by the fact that many of the informants had undertaken several under-declared jobs during their careers. The stories of such people enabled insight into the evolution of personal attitudes as well as into the modification of their strategies to handle various conflict situations that commonly arose during their employment. However, interviews with such individuals were often challenging as sometimes it was not possible to distinguish which particular job their statements were referring to. As a matter of fact, on several occasions even the interviewees themselves had to struggle to place a certain experience into an exact job. As an efficient remedy to this issue, the researcher kept bringing the story back to their current or most recent under-declared job. Still, in cases where the previous experiences could add to the overall picture, the participants were left to talk about them. Nonetheless, even during such interviews the researcher always tried to place the emphasis on the latest job.

When it comes to the educational background of the participants, it should be stressed that those having a university degree predominate in the sample. To be precise, the sample contains 12 individuals with secondary education only and 18 with a university degree. Although a non-Croatian reader might be concerned about such a dominance of university degree holders in the sample, those familiar with the education system and labour market in Croatia would see this as neither unusual nor

problematic. This would be justified by the 'academic boom' that resulted from the reform of the education system<sup>83</sup> and by the research being conducted in the capital, an even more important factor. Croatia is a highly centralised country with its financial assets and high-tech industry heavily concentrated in Zagreb (Croatian Bureau of Statistics, 2015c; Lőrinczné Bencze, 2013; Sumpor & Đokić, 2013). In addition, the University of Zagreb is by far the most prestigious university in Croatia, and as such attracts prospective students from all over the country. Since many of them never go back to their home towns upon graduating, the education structure in Zagreb is highly skewed (Croatian Bureau of Statistics, 2011a).

Yet another reason why such a high ratio of respondents with a university degree to those without it is not problematic can be found in the weak link between education obtained and income in Croatia. The problem is particularly pronounced in the case of young highly educated individuals who are often forced to accept low-paid jobs. For instance, the survey by the United Nations Development Programme (UNDP) conducted in 2008 reveals that more than 40% of the new entrants to the labour market found first jobs that did not match their educational attainments (Matković, 2009). In most cases, such young individuals were over-qualified for the particular job. There is no surprise, then, in young people with a bachelor or master's degree working on jobs that do not require university education (Bejaković & Mrnjavac, 2014; Matković, 2009). Yet at the same time it is also not rare in Croatia to find people (mainly more experienced ones) with vocational school diplomas holding highly paid jobs that would in normal circumstances presume a university education. Indeed, this mismatch between educational attainment and income opportunities is one of the main characteristics of the sample and thus particular attention will be paid to this issue and its role in the development of practices of under-declaring in Croatia throughout this part of the thesis.

Following this, the occupational structure of the respondents will be much more informative. As well as salespeople, commercial travellers, dental technicians,

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<sup>83</sup> The main reason for the reform, which was launched in the mid-2000s, was the aspiration of the government to align the university education system in Croatia with those in other European countries. Yet the main side-effect of this reform was a substantial increase in the number of offered study programs, and consequently the tremendous growth of student quotas. To illustrate the inflation of university degree holders in Croatia during the last decade, it suffices to say that the number of individuals who graduated in 2011 was almost two times as large as that of those who obtained their university degree in 2006 (Croatian Bureau of Statistics, 2011b, 2012).

secretaries, gardeners, waiters, cooks and goldsmiths, the sample also encompasses professionals (accountants, teachers, linguists, graphic designers, dentists, lawyers, architects, construction engineers and mathematicians) and various managers. Again, the reader should not be concerned about the high number of professionals and managers in the sample, bearing in mind the distribution of this practice in Croatia (see discussion in section 5.4).

Since many of the respondents worked in companies that are renowned or unique in the country, particular attention will be paid to securing the anonymity of the research participants throughout this part of the thesis. Pseudonyms are used instead of real names for all participants and for some of them the occupational and educational details have been altered when their experiences are recounted.

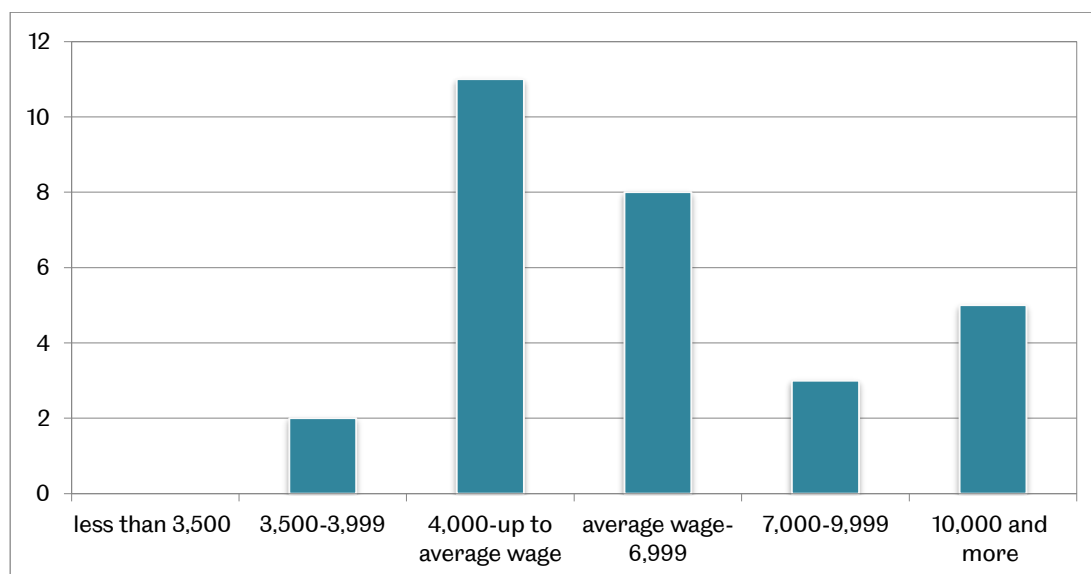
It should be stressed at this point that all respondents came from the private sector. Although a few of them had friends or acquaintances working under-declared or even completely undeclared for governmental bodies or state owned companies, they were commonly not willing to assist in contacting those people. In some cases, it was because the respondents were not so close to the person and in some cases because they were sure the person would refuse to participate. Still, it must be admitted that most interviewees did not know any cases of such work in public institutions, which suggests that quasi-formal employment is at most a minor issue in the public sector. As several research participants pointed out, public sector officials do use some other illegitimate strategies to increase their earnings. This relates to corruption, as well as to all other similar types of misbehaviour assuming cash-in-hand for various favours. Indeed, this is in line with research from other transition countries, which draws a distinction between bribery and envelope wages (Round et al., 2008; Sedlenieks, 2003). That is to say, bribery might be perceived as the public sector's equivalent of envelope wages.

The distribution of the respondents according to overall take-home pay from their current or most recent under-declared job (for those who were not working quasi-formally at the moment of the interview), which is given in Figure 10, provides an interesting insight into this practice in Croatia. As can be seen, individuals earning slightly less than the average<sup>84</sup> dominate the sample, which is not surprising given the research findings from other transition countries.

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<sup>84</sup> The average net wage in May 2015 was HRK 5,679 (Croatian Bureau of Statistics, 2015a). HRK stands for 'Croatian kuna', which is the official currency in Croatia.

**Figure 10 Distribution of the respondents according to the overall monthly take-home pay from the under-declared job, in number of respondents**



*Notes: 1) The sample includes 30 individuals*

*2) The calculation is based on the most recent payment for a particular under-declared job. For respondents with variable wages, the annual average of their monthly take-home pay is taken*

*3) Average net wage in May 2015 was HRK 5,679*

*Source: Author's own calculation based on the findings from the fieldwork*

Yet the sample also contains a significant proportion of those earning above the national average, which suggests that quasi-formal employment in Croatia might be less dependent on overall wage than one would assume. Finally, every sixth respondent was earning more than HRK 10,000 per month, which is considered quite a high income bearing in mind the standard of living in Croatia<sup>85</sup>. To illustrate the range of overall net payments in the sample, we can add that the lowest take-home pay encountered during the fieldwork was HRK 3,750, while the highest was HRK 16,000.

Turning to the net monthly wage they were officially declared as having, things are somewhat different than revealed by the GREY Survey, for only one fifth of the interviewees stated they were receiving exactly the minimum prescribed amount in their bank accounts (Figure 11), while those declared as being a bit above the minimum wage were more frequently encountered during the fieldwork<sup>86</sup>.

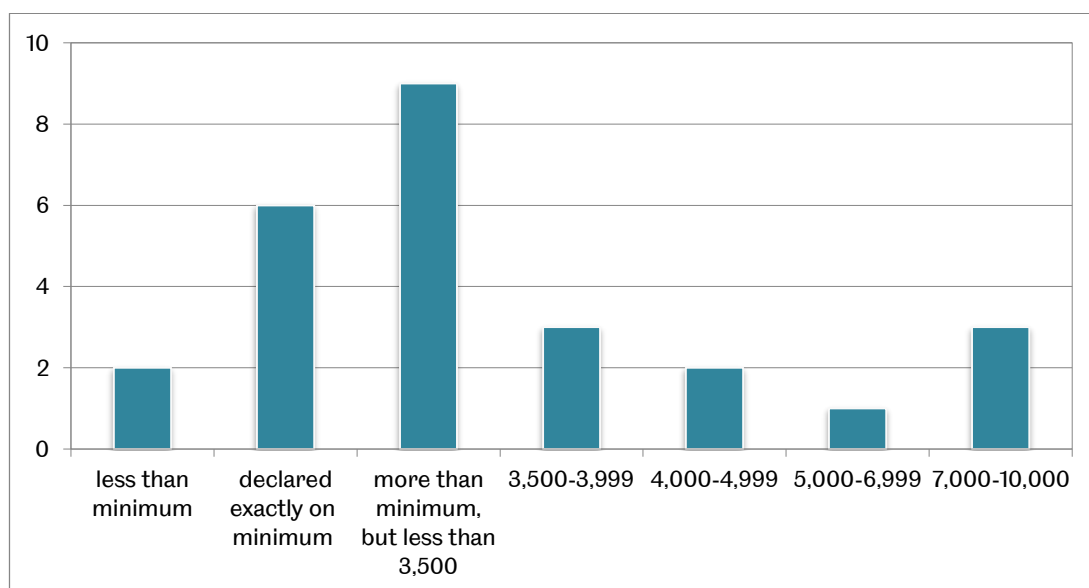
<sup>85</sup> Official data for March 2014 show that only 6.2% of Croatians in paid employment had a net monthly wage above HRK 10,000 (Croatian Bureau of Statistics, 2015b).

<sup>86</sup> All interviewees declared on a minimum amount were either working on an under-declared basis at the moment of the interview or had had recent experience. Therefore, the minimum wage for 2015 was used as a reference. The minimum gross wage for 2015 was set at HRK 3,029.55 (Official Gazette, 2014a), which gives a net monthly wage of HRK 2,423.64.



The exact explanation for this discrepancy between the state of affairs inside our sample and the findings from the GREY Survey can be found in a quite unusual issue that emerged during most of the interviews. Namely, the researcher realised that the majority of the interviewed individuals actually did not know the amount of the minimum wage. Explicitly, when asked to draw a line between their officially declared wage and the minimum wage (see question 16 in Appendix 4), many respondents straightforwardly said that they received exactly the minimum required amount in their bank account. On every such occasion the researcher then stated the minimum wage and asked them whether this really applied to their case, which made most of such respondents quite confused. Many admitted that they were sure it was the minimum (as in their opinion their declared wage was shamefully low), but then changed their answers.

**Figure 11 Distribution of the respondents according to the officially declared monthly net wage, in number of respondents**



*Notes: 1) The sample includes 30 individuals*

*2) Calculation is based on the most recent payments for a particular under-declared job. For respondents with variable wages, the annual average is taken*

*3) Minimum wage for 2015 was HRK 2,423.64*

*Source: Author's own calculation based on the findings from the fieldwork*

Since this rather unusual occurrence needed following up, it was soon realised that the phrase 'earning a minimum' actually has a kind of metaphoric meaning in Croatia. To be more precise, the term 'minimum wage' in the mind of a typical Croatian worker refers to the minimum amount one would accept to work for, not the minimum amount prescribed by the law. This is certainly a very worrying issue, especially from the perspective of questionnaire surveys as it can yield incorrect outcomes. In line

with this, one must take the findings of the GREY Survey on this matter, which were presented in Chapter 5, with great caution.

In any case, when asked why their employer decided to declare them on a particular amount, participants receiving slightly more than a minimum in their bank accounts in most cases suggested that this may be due to the employer's endeavours to decrease the risk of detection. This indicates that the earlier discussed suspicion might be true at least to some extent, namely that some employers tend to pay a little more than the minimum so as to escape the radar of the tax authorities.

Yet, besides individuals declared exactly on the minimum and those that were receiving slightly above the minimum, the sample also contains respondents with official wages substantially higher than the minimum, as well as those who were declared on less than the minimum (see Figure 11). The latter were individuals declared as part-time workers.

It is worth saying at this point that all 30 respondents were essentially full-time employees, even though some of them were declared as part-time workers. On the other hand, some of those who were declared as full-time employees had to work overtime on an everyday basis, and in most cases that additional work was unpaid. Yet there were also some individuals who had no problems with remuneration of overtime work, despite being rarely encountered.

Another important facet to examine is how the overall take-home pay was divided into the declared and undeclared parts. Judging from the experience of the research participants, there was no general rule regarding the portion of the wage that is given in an envelope. As a matter of fact, the arrangement seemed to be conditional upon the potential of the company to generate cash. That potential in turn depended on various factors, the most important among them being the exact sector the company operated in and the nature of the business in general<sup>87</sup>, as well as the readiness of the management to participate in other illegitimate activities.

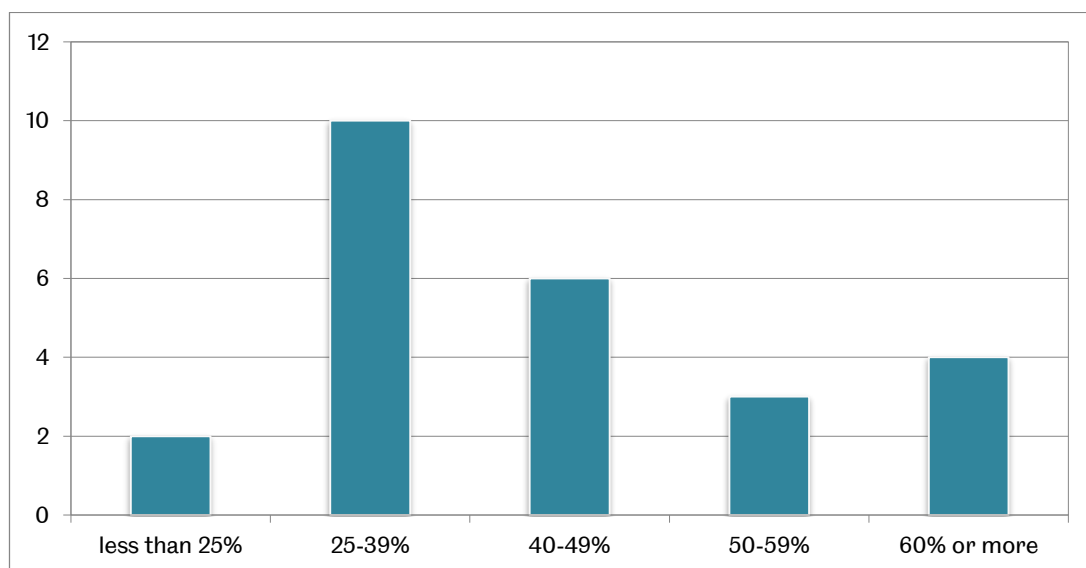
As can be seen from Figure 12, which summarises the findings on the share of envelope wages in overall take-home pay, the greatest number of respondents received 25-39% of their remuneration in cash. Every fifth participant was receiving between 40% and

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<sup>87</sup> For instance, companies from the construction, trade and service sectors find it much easier to obtain cash (e.g. by selling goods and services on the informal market) than companies from other sectors.

50% of their total payment in cash, while for every fourth interviewed worker the envelope wage was larger than the official payment. On the other hand, only a few individuals stated their employer was giving them up to 25% of the total wage in cash. In any case, the distribution of respondents according to the size of the envelope wages to a great extent matches the situation in the whole population, as revealed by the GREY Survey (see section 5.3).

**Figure 12 Share of the take-home pay given in cash, in number of respondents**



*Notes: 1) The sample includes 30 individuals*

*2) The calculation is based on the most recent payment for a particular under-declared job. For respondents with variable wages, the annual average is taken.*

*Source: Author's own calculation based on the findings from the fieldwork*

Given the variety in the demographic and socio-economic characteristics of the research participants, the qualitative phase of the study itself illuminated many aspects of the phenomenon that have not been considered so far. In the rest of this chapter, as well as in the following chapter we therefore disclose the most important features of under-declared employment in Croatia, with particular attention to factors that are specific for transition economies.

The remaining parts of this chapter first present a typology of workers based on their rationales for entering quasi-formal employment and follow with a summary of various payment strategies that employers commonly relied on. The next chapter provides an overview of problems with payment that commonly arose during such employment, together with a discussion about other important aspects of day-to-day experience from the workplace that influenced individuals' attitudes and behaviour.

## 6.2 A typology of workers by their motives for entering the quasi-formal realm

At its core, a typical interview for a job that will ultimately be under-declared is essentially a psychological game of two players (an employer and a worker), wherein the two do not necessarily have the same negotiating power. In most cases encountered during the fieldwork, the employers were the first to show their cards (i.e. offer this arrangement)<sup>88</sup> and the workers had a very limited time to make a decision. Given this, it is vital to understand the factors behind a decision to accept (or refuse) the offer so as to better comprehend the subsequent behaviour of a worker and their employer. Namely, the course of a job interview can significantly help in predicting the future experience of a worker during their employment if the job is accepted. This is not only because the cards played by employers tell us quite a lot about their own personal and professional ethics (and therefore can be a good indicator of their determination to respect the agreement), but also because the initial reaction of the worker inevitably sends a clear message to the employer about their willingness to collaborate.

It should be stressed that in this context the term 'interview for an under-declared job' refers not solely to the very first contact of the two stakeholders (i.e. meeting that typically precedes employment), but also to all other types of negotiation which resulted in a worker starting to receive one part of their wage in cash. To be more precise, several interviewed individuals had actually started working either completely declared or completely undeclared on a particular job, and then later shifted to under-declared employment while all other aspects of the job remained unchanged.

This section gives a rough systematisation of workers based on their rationales for entering the quasi-formal realm. It must be admitted that this was the most challenging task in the research, given the variety and intertwining of factors shaping decisions. What is more, every single individual put their own weight on each 'input variable', which strongly imbued the decision-making process with subjectivity. Yet, after a comprehensive analysis of the transcribed interviews, it was realised that in every single case there was one dominant factor that was actually crucial for the

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<sup>88</sup> Although this was the most common course of action, it was not always the case. Some exceptions will be described later.

worker to enter the quasi-formal sphere<sup>89</sup>. Given that four such dominant factors were detected, this made it possible to classify under-declared workers into four groups, namely those who entered the realm by deception, reluctant voluntarists, monetary rationalists and pure voluntarists.

### ***6.2.1 Under-declared by deception***

In general, quasi-formal workers in Croatia can be divided into those who were recruited with their consent and those who were deceived. In order to understand how the latter is possible, one must first understand one vital feature of the Croatian labour market. Namely, the common practice among workers in this South-East European country is to negotiate the amount of their monthly net wage with the prospective employer. As a matter of fact, it is not unusual to find that a person does not even know the approximate amount of their gross salary, which was quite frequently encountered during the fieldwork. It is take-home pay that matters for Croatians, which clearly shows the lack of sensitivity about how much an individual personally contributes to the state budget and thus represents a good starter in endeavours to understand why tax evasion is so widespread in this new EU member state. Since for a typical Croatian worker the phrase 'income from employment' strictly means 'take-home pay', throughout the rest of this thesis every discussion about personal income actually refers to net value per month.

Knowing this, it is easy to understand how a person can be pulled into under-declared employment by deceit. To demonstrate this type of quasi-formal employment, we start with the story of a 62-year-old economist, Sara. When the company she had worked for went bankrupt, Sara was offered a job in one of the partner companies of her former employer. She did not have any doubts whether to accept the offer or not, given that she had had only positive experiences while collaborating with this company during her previous job and given that the offered position of financial director completely matched her expertise. In addition, the firm was in the textile industry which she was quite familiar with, since her previous company operated in the same sector.

All these reasons were more than enough for Sara to accept the post. Indeed, the interview for the job was quite satisfying and there were no problems during

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<sup>89</sup> Note that here we use the term 'factor', instead of 'rationale'. The explanation will become clear in the following subsection, which shows that in some cases it was the employer who made a decision, not the worker.

negotiation about her take-home pay. She and one of the co-owners agreed on all terms and signing the contract was the only thing to do before commencing the job. Yet, although she expected this last task to be nothing more than a formality, this was not the case. A few days later she was approached by another co-owner and asked to sign a contract that specified a much lower wage than previously agreed. Upon her request for clarification, it was explained to her that the policy of the company was to officially declare workers as being paid an amount that was only a bit above the minimum wage, while the rest was to be paid in cash.

This was the very first direct contact with such an arrangement for Sara, which certainly explains why she was caught unprepared. Although familiar with this practice from the stories of her friends, the respondent admitted never having really believed that she could be offered anything similar, given her education background and experience. Having in mind that the company had some 80 employees and the agreed net wage for her job was above HRK 10,000, one can understand why Sara was left completely speechless upon realising the truth. When asked why then she decided to sign the contract, the respondent answered:

*Of course I was shocked at that moment, but since I really needed a job at that time, I decided to sign the contract. However, in the very same moment I said to myself that I was going to leave the company as soon as the first opportunity to change jobs appeared.*

*(Sara, 62)*

And this was exactly what she did some six months later. She had not changed her initial decision in spite of the employer always fulfilling the agreement regarding her take-home pay during those six months. A similar experience befell Ana, a 53-year-old architect who also had never witnessed this type of employment until she found herself working in a quasi-formal way against her will. She had decided to quit her previous job and accept the position of a sales manager in one large company in the construction sector, which at that time had some 100 employees. Besides the attractive job description, another reason for Ana to move to this post was the much higher wage in comparison to her former job.

Again, everything went fine at the job interview and she had no reason to believe that something would soon go wrong. It was not until the first payment when the respondent realised that only the minimum required amount was paid into her bank

account<sup>90</sup>. Even though she was satisfied with the overall take-home pay, which was above the national average, she was completely disappointed after realising the truth.

Apart from the payment method, the employer had also failed to clarify some other important details, one of the most essential being that she was supposed to work on Saturdays. As Ana elaborated: "What I hate most is when people deceive me". Instead of complaining to her employer about all these things, Ana rather decided to express her dissatisfaction by finding another job as soon as possible. Indeed, she did find a completely legal job (in terms of mode of payment) after nine months. Even though the new job was paid 25% less than this one, she decided to accept it and left the company.

It should be mentioned here that their zero-tolerance towards illegitimate economic activities was an additional reason for leaving the company for both women. Unlike many other interviewees, who found justification for their own behaviour, these two respondents expressed a high level of self-criticism. As Sara explained: "I am not used to working against the law", which clearly shows that any form of illegitimate behaviour was entirely against her personal norms and beliefs.

In any case, these two stories indicate that the ideas of the structuralist school of thought might be applicable to quasi-formal employment, at least to some extent. Although not oppressing their workers in any of the standard ways described earlier in the literature review, the fact that both employers used dishonest methods at the very beginning clearly articulated their distorted perception of the employer-employee relationship. Still, these were the only two examples of accidental entrance into the quasi-formal sphere encountered during the fieldwork. Given the small and non-representative sample, it is impossible to say whether the two are exceptions from the general practice or whether such cases could be commonly found elsewhere.

One possible explanation for this misconduct by employers can be found in them anticipating that the candidate might decline the offer. As Sara explained, since such employers are also frequently involved in many other types of illicit activities, they developed an extraordinary ability to 'read people'. Therefore, if they foresaw the

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<sup>90</sup> Although one can ask how this is possible since the official wage has to be specified in the contract and thus the employee can check this information in any moment, the answer will become clear after some other stories are described later. For now it suffices to say that in several other cases the respondents actually never signed the work contract. Instead, someone from the management would just forge their signature. In this particular case the exact reason was not discussed as the interviewee had limited time available for the conversation.

possibility of failure, those employers rather chose to withhold information in order to trap the candidate they wanted.

However, there is also another plausible explanation why the respondents were deceived. Both these experiences date from the pre-crisis period. Since that was a phase of outstanding economic expansion in Croatia, accompanied by a constant decline in the unemployment rate<sup>91</sup>, finding a decent highly skilled worker was quite a hard task. This can certainly help in explaining why no similar recent experience was found given that the unemployment rate has gone back to its level from the early 2000s.

### ***6.2.2 Reluctant voluntarists***

Some other examples from the fieldwork indicate that the strategy 'take it or leave it' is nowadays a quite widespread tactic among employers in Croatia. This strategy assumes employers disclosing their offer and all the worker can do is accept it or find another job. Given the army of the unemployed, an employer is certain they will eventually find someone who will accept the offer. This brings us to the group of workers whose decision to enter the quasi-formal realm can be described as confined or reluctant voluntarism. Although such people freely chose to receive a part of their remuneration in cash, they were by no means happy with this. Their entrance into this realm was rather a decision out of desperation given the lack of alternative employment opportunities.

For that reason, their rationales should be scrutinised from the perspective of the dualist school of thought rather than from a voluntarist standpoint. The term 'voluntarism' in this particular context is used primarily to illuminate the fact that such workers gave their consent to under-declaration, which was not the case with those who were deceived. Yet, to acknowledge the limitations of this voluntarism, throughout the thesis the workers from this category will be referred to as 'reluctant voluntarists'.

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<sup>91</sup> During the period 2001-2008 the unemployment rate dropped from 16.3% to 8.0% (Eurostat, 2016m). However, a constant reduction in the number of workplaces after the onset of the crisis resulted in the rate reaching its peak of 18.0% in August 2013. At the moment of conducting the fieldwork, the official unemployment rate was 16.2% (Eurostat, 2016m).



A typical example of a reluctant voluntarist is Luka, a 26-year-old manual worker in a company from the production sector<sup>92</sup>. When asked how and why he decided to enter quasi-formal employment nine months ago, the participant answered quite simply:

*My friend had been working in that firm and he asked me to come with him as they had been searching for workers. One day I went there just to see what they do and they told me to come to work next day. There was not any official interview for the job. I needed a job at the moment and I was ready to do anything. I did not have any other choice and as long as I do not find some better job I have to accept working on this one - let's call this the 'survival approach'.*

*(Luka, 26)*

Since he knew that it was easy for the employer to find someone else, the interviewee decided to accept all the terms of the employment and started working the day after. The company was employing approximately 40 workers, with some 25-30 of them receiving a part of their wage in cash<sup>93</sup>.

Still, this rationale for accepting quasi-formal jobs seemed not to be confined to low skilled workers in Croatia. Namely, inflated rates of new university degree holders on the one hand and pervasive unemployment on the other forced many young professionals to reluctantly accept under-declared jobs. One of them was Helena, a 28-year-old dentist who had been unwillingly receiving a significant part of her wage in cash for the last 15 months. As she explained: "After six months without any success in finding employment, I decided to weaken my criteria far beyond the usual limits in order to get a job". Indeed, although being completely dissatisfied with her situation, Helena kept working for the same employer since there were no better options at the moment. She was not the only one as all 16 of her colleagues were also working quasi-formally.

Judging from her experience and the experience of the other two research participants from the same sector, quasi-formal employment has become standard among dental practitioners in Croatia. For instance, a 30-year-old dental technician, Marijana, who has had nine and half years of experience in this field, was 'familiar' solely

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<sup>92</sup> Given that the company produced quite specific and rare products, no further details are given so as to secure the anonymity of the participant.

<sup>93</sup> Judging from experience of other participants, it is not uncommon for employers in Croatia to under-declare just one part of their workforce. More details about this practice are given in subsequent sections.

with this type of employment. She had changed employers three times during her career and all of them had applied the same practice. The employer she was working for at the moment had 20 workers on the payroll and all of them were receiving a significant part of their salaries in an envelope.

Yet, inside the category of reluctant voluntarists we can also find those individuals who had accepted a quasi-formal job in order to shift to their own profession after years of working in completely unrelated jobs. One such person was Linda, a teacher in her late twenties who was working at the time in a private school. Although she had been continuously working since her student days, her previous jobs had little or nothing to do with her profession. Following her determination finally to start working at something she had been educated for and something she really liked, a year and a half prior to the interview the respondent had decided to quit her old job and accept this post regardless of many apparent deficiencies. As Linda explained:

*I was not happy with the time schedule, locality of the school or the agreed wage, but I simply wanted to work in my profession. I really appreciate my current employer as he gave me this chance regardless of my age, but it was desperation that forced me to accept this type of payment.*

*(Linda, 29)*

She was not surprised to be chosen for the job amongst some 70 applicants since she had accepted all the imposed terms without any complaints. She commented briefly on that: "Unlike the others, I did not ask too many questions".

Finally, the most extreme subgroup of the reluctant voluntarists were those who had lost hope of finding a completely regular job. Such people had accepted under-declared employment as a standard practice in their occupation and did not believe that anything else was possible. They are actually the most endangered category inside the army of under-declared workers as they commonly stopped seeking escape opportunities.

To illustrate this, we can examine the story of Dado, a 40-year-old headwaiter with some 20 years of experience in this vocation. Since in his case the number of years he had been working under-declared equalled the overall number of years on the labour market, one can understand his viewpoint. When asked about the possibility of finding a completely regular job in his vocation, Dado replied:

*If someone said they work as a waiter fully declared, I would be completely astonished. As far as I know, quasi-formal employment is a standard way of operating in this branch. Whichever job interview I was preparing for, I always expected them to offer only the minimum to be paid into the bank account and the rest in cash. If any of those people had told me during the interview that I was going to be fully declared, I would have fallen on my back and asked them: "How? Why? What happened?"*

*(Dado, 40)*

Since he was responsible for employing new workers at his workplace, where he had been working for the last eleven years, Dado was able to depict how most employers and workers look at the practice nowadays:

*Employers are looking for a person that will accept all the terms. Since there is a huge army of the unemployed, they know they will eventually find someone. All in all, 99% of the people agree to work on an under-declared basis straightforwardly. It is an unwritten rule that only the minimum goes into the bank account, and all that is to be arranged is the amount which would be paid in cash.*

*(Dado, 40)*

The overall impression gained during the interviews was that there was a significant risk of ending in this extreme category for many of the reluctant voluntarists. Except for a few optimistic ones, all the others in this group had their moments of pessimism regarding their future prospects during the conversation. The number and duration of those moments was commonly proportional to the amount of work experience inside the quasi-formal realm. Still, in some cases experience was not the crucial factor behind such an attitude. This can be exemplified with the story of 23-year-old Kristina, who had been working as a cook in one renowned restaurant for the last five years. Even though this was the first job in her career, the interviewee had quite a pessimistic view on her future:

*You can either work under-declared or not work at all. The boss says that you are going to receive one part of your wage in cash and you simply accept it. There is no discussion on the matter. This type of employment is so normal in our country that you do not even think that it could be any different. It has never occurred to me to go to my boss and start complaining about this. Of course I would like to be completely declared, but I am not sure if this is ever going to happen.*

*(Kristina, 23)*

What is particularly interesting about this individual is the level of indifference that could be grasped from every sentence of hers. As she sees this type of employment as something so common, on several occasions she was even surprised why someone would ask such trivial and obvious things. Having in mind her age and lack of experience, one can realise that quasi-formal employment is not only an economic issue in Croatia, but also a cultural one. Indeed, many of the other young interviewees did not see this type of employment as some minor and temporary disturbance of the labour market, but rather as something that is standard or would become standard in the near future. Such a standpoint is understandable given that their parents, relatives and/or acquaintances had been working under-declared for most of the career and thus they did not expect much better for themselves.

All these stories confirm that the ideas of the dualist school of thought are undoubtedly valid and should be considered when explaining rationales behind the phenomenon of quasi-formal employment. Indeed, most of the abovementioned research participants were far from being happy with their position and were ready to grab the very first opportunity for escape. Yet, while some still believed they would eventually escape, others either lost hope or never actually had any hope of anything different.

### ***6.2.3 Monetary rationalists***

Instead of the 'take it or leave it' strategy, some employers decided to apply a more potent recruitment approach. This particular tactic, which seemed to be more prevalent in Croatia than one would expect, assumes an employer offering two options to a candidate. Both the options commonly suppose an employer determining the financial terms, and all that is left for a worker is to accept one of them or find another job. The first option was to receive quite a low amount (usually slightly above the minimum) on-the-record and the rest of the offered wage in cash. The second option was to work completely declared, but in that case the offered wage was just a bit higher than the declared part of the wage from the first option.

Such offers appeared to be quite efficient for employers from several aspects. Firstly, in this way an employer sent a seductive message to a candidate that the company does care about the wellbeing of its workers and therefore is ready to disobey the law so that the workers can earn as much as possible. Secondly, by giving a worker freedom to choose, employers created an impression that they respected the will of their employees. And finally, the two offered options with significantly different

amounts clearly illustrated to a worker what they were going to lose if the second option were chosen.

For that reason, the worker is pushed into a tricky process of mental accounting in which the financial aspect plays a dominant role. Indeed, the stories of the individuals who were offered these two alternatives show that mental accounting regularly resulted in the worker choosing the first option (i.e. to be under-declared). For all of them, it was take-home pay that was the most important aspect of employment and thus they rather chose to receive more money than less. Following this, such under-declared workers can be described as 'monetary rationalists'. That is to say, even though their decision to enter the quasi-formal realm might be classified as a rational choice in a given situation, it was heavily reliant on the financial dimension while all other elements of the cost-benefit analysis remained secondary.

One of the monetary rationalists was Josip, a 25-year-old manual worker in one company from the construction sector. In his case, the first option was to be paid according to the actual number of working hours he had each month, and the second was to receive quite a low fixed amount. The interviewee explained his position:

*The boss told me at the very beginning that I can be completely declared, but in that case he could not give me more than HRK 4,000. Yet, since summer is the busiest part of the season and I have to work overtime during that period, my wage would have been the same as during winter if I had accepted full declaration. He clearly said that regardless of the number of working hours during summer I would not get more if I am completely declared. Of course I agreed to receive more money. Over summer I have 240-250 working hours per month, which brings me some HRK 6,500-6,700.*

*(Josip, 25)*

When asked about the moral aspects of his decision, the interviewee answered:

*I do not have any moral problems with this. They [the state officials] are stealing from us, so why would not we steal from them? I do not want to give anything to this state. I do not want to and that is the end of the story.*

*(Josip, 25)*

Josip was just one of many with similar reasoning, for even those who were not offered the two options argued that they would always choose to get more money in spite of

the legal and moral issues arising from their decision. As 28-year-old horticulturist Teo explained:

*The most important thing for me is the amount of money I get at the end of the month. It is less important how it will be paid. If for instance I was paid HRK 4,000 officially plus additional HRK 3,000 in cash, and if upon requesting to be completely declared my employer offered full declaration on HRK 5,500, I would not accept it. That would be HRK 1,500 less, which is a lot. If I had to choose between HRK 20,000 and HRK 19,000, then it might be reasonable to accept full declaration. If you earned only HRK 7,000, you would not want to sacrifice money for full declaration.*

*(Teo, 28)*

Again, the interviewee admitted not having any moral problems with receiving one part of his wage in cash. From Teo's perspective, the evasion resulting from his work was nothing in comparison to all the billions that politicians and companies had stolen during the last 25 years.

Some other respondents went even further saying that they would always choose more money regardless of how high the overall wage was and how large the difference between the two offers was. Again, those were people with low trust in the state institutions, low tax morale and commonly those in financial difficulties. One such example was 41-year-old economist Katarina, who had been working on an under-declared basis for more than a decade. She had changed several employers in this period, working mainly as head of finance. As she elaborated:

*Given that my husband has just got fired and I am the only one who is earning money in our family at the moment, I would even be ready to work completely undeclared if this would bring more money. For instance, I have no problems saying to my employer: "Fire me fictionally and start giving me my gross salary in cash. I do not care about the state, the pension funds or anything else. You are giving this amount anyway, but currently you are giving a significant part of it in some black hole where it disappears. It would be better if you give everything to me. Yes, I would be officially unemployed and without any social security, but I would get more money".*

*(Katarina, 41)*

These stories inevitably confirm that the motives for entering the quasi-formal sphere go far beyond those introduced by the dualist school of thought. As shown above, some people will accept such jobs after assessing the (quasi) cost-benefit ratio, thus

indicating that certain aspects of the voluntarist school of thought might indeed be valid. On the other hand, some will do it out of defiance, which is in line with the ideas of the legalists. Finally, quasi-voluntarism and conditional cooperation beyond doubt play a significant role since low trust in institutions and other members of society (and consequently low tax morale) provided enough of a rationale for some people to work quasi-formally. Still, in most cases the decision to enter this realm was a complex combination of numerous factors explicable within the arguments of different schools of thought, which endorsed the necessity for a holistic approach to an explanation of the nature and causes of the phenomenon.

#### ***6.2.4 Pure voluntarists***

The importance of the holistic approach became even more evident when trying to grasp the rationales of some other individuals. This particularly applied to the participants who joined this sphere completely out of choice. Such individuals, who can be denoted as 'pure voluntarists' given their unconditional readiness to participate in the quasi-formal realm, were commonly those in the upper tier of the hierarchy in their companies or those in lower tiers but with an extraordinary level of trust between them and their employers. The ease of finding such individuals suggests that this type of entrance into the quasi-formal sphere should not be perceived as something completely rare and atypical in Croatia, thus confirming the findings of the GREY Survey on the matter.

It also ought to be mentioned that once contacted, the people from this group expressed outstanding readiness to participate in the study. His curiosity awakened, the researcher decided to explore the reasons behind this peculiarity and the explanation appears vital in understanding the viewpoint of such people. Namely, individuals from this group not only saw their activities as completely normal, but also as necessary and desirable. In that light, they found this practice fully reasonable and did not feel uncomfortable talking about their experiences. As a matter of fact, people from this group were those who most frequently expressed surprise that someone might earn their Ph.D. title so easily, by writing about such a common thing.

According to a 52-year-old goldsmith, Filip, who had been continuously working under-declared since 1982, quasi-formal employment is a rational choice of both employers and employees in his domain. As he argued, full declaration of workers would make his profession completely unprofitable due to the high costs of running the business. For

that reason, under-declared employment gives an opportunity to earn more for both the worker and his employer. Filip was hence quite content with receiving only HRK 3,600 officially and the rest of his HRK 10,000 wage in cash. However, one should not neglect another important factor which underlay his behaviour and attitudes. Namely, on several occasions the participant pointed to the high mutual trust and the friendly relationship between him and the current employer, for whom he had been working since 1992.

Another similar case is that of Petar, now a retired director of one small company from the education sector<sup>94</sup> who had been working on an under-declared basis for the last 14 years of his career. After Petar had worked completely declared for two years in the company, the owner came one day and said that it would be both practically and financially desirable for the firm if all workers started receiving one part of their wages off-the-books. Since this had not significantly changed their take-home pay, all employees had agreed that it was a wise and necessary choice. Petar explained his decision to accept under-declaration:

*I had nothing against that change. This was a standard way of running a business, not only in our branch, but in all private companies. We all understood that we were cheating the state by this, but we did not consider it a serious offence or a sin.*

*(Petar, 67)*

Due to his quite high overall wage of some HRK 11,000, one third of which remained under-declared, the moral issues were brought to light later in the conversation. The participant maintained:

*Everything was so logical and there was no reason for someone to say: "Wait people, in this way we are cheating the state". Who would even start thinking about that? I mean, that would be silly. For us it would have been a more serious offence if someone inside the firm had stolen an eraser or pencil. Yes, that would have been more problematic behaviour from our standpoint. How should one say this - cheating the state is one completely abstract wrongdoing.*

*(Petar, 67)*

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<sup>94</sup> Education is not the best option to describe the business of his company, but this description was given so as to secure the anonymity of the participant.



Again, this story should also be looked at through the lens of mutual trust which existed between the interviewee and his employer, as well as between all employees inside the company. Actually, the role of mutual trust appears to be a very important facet of the phenomenon. This brings us to a specific subgroup of the pure voluntarists, who seem to be quite prevalent in Croatia. These are young, often highly educated entrants to the official labour market who accepted (or even suggested) quasi-formal employment first and foremost so as to keep working for the same employer they were working for as students. Most of them had started working via student contracts, which are quite popular among employers in Croatia given some tax deductions, although in some cases the respondents had even been working completely undeclared prior to switching to under-declared employment.

In any case, the scheme was quite straightforward: after realising that a worker was competent and trustworthy, an employer would offer them a long-term post. On the other hand, workers who liked their job and saw the employer as trustworthy were commonly willing to accept the offer. In some such cases encountered during the research, the participants were actually not very happy with their wage, but they did not see it as the crucial factor since for them mutual trust and the quality of the job were more important facets. In most cases, they perceived their job only as a temporary opportunity to gain valuable experience and work with nice people, which explains why the financial aspect was not so important.

One such example was Ivan, a 25-year-old construction engineer who had changed three types of employment inside the same company. To be more precise, the terms of his employment had changed, while the job itself remained the same. During his postgraduate course Ivan had started working on a student contract for a firm specialised in drawing building plans. After graduating, the employer had offered him a permanent post, but since Ivan was not a student anymore the two agreed for him to work on undeclared basis.

Yet the respondent soon expressed a desire to switch to under-declared employment. This was principally because he wanted to be officially employed so as to have a record of work experience on the labour market. On the other hand, Ivan found quasi-formal employment superior to completely legitimate employment as in this way his take-home pay was sufficiently abundant (i.e. much higher than if he had been completely declared). The employer agreed with his request and offered him official payment of HRK 4,000 plus an additional variable amount in cash depending on his performance.

Again, there was high mutual trust between the two parties and therefore no problems during the interviewee's 2-year-long overall employment were encountered. Yet, from the very first moment he saw his quasi-formal job solely as a temporary opportunity to gain some official experience, as well as to earn some extra money. Some six months after switching from undeclared to under-declared employment the respondent had decided to find a completely legitimate job, which he managed to do soon after.

After the enumeration of these stories, it is not hard to realise that the rationales of the pure voluntarists can be found among the ideas of the legalist, voluntarist and quasi-voluntarist schools of thought. Indeed, while some of the individuals from this group saw the over-intrusive state as the main justification (legalism), others chose to be under-declared because the benefits of quasi-formal employment outperformed costs (voluntarism). On the other hand, some saw it as a completely reasonable practice and due to low tax morale did not consider their behaviour to be a serious offence (quasi-voluntarism). However, given the complexity of decision-making processes in each individual case, again the holistic approach is necessary to fully understand why a certain individual accepted the quasi-formal job.

In any case, the reader must be aware that the reality is much more complicated than the presented classification of quasi-formal workers would suggest. Yet, even though one could argue that a more refined classification of under-declared workers according to their rationales for entering this sphere may be desirable, it should be stated that all attempts to do so failed since every single case was so specific that it would be impossible to place it solely into one category. As a matter of fact, the part of the interview in which every participant was asked to enumerate their rationales for accepting quasi-formal jobs was regularly highly demanding for both the interviewee and the researcher. For some participants this topic resulted in an endless process of self-questioning, which made it hard for the researcher to get a congruent answer. The general impression was that many of the interviewed workers had actually never earlier reassessed their decision.

What should also be made clear at this point is that even though the entrance rationale was a good guide for predicting future experience for many workers, this was not always the case. On some occasions encountered during the fieldwork the way individuals had entered the under-declared realm had little or even nothing to do with how their employer treated them during the employment. For instance, although one would expect that the employers who applied the 'take it or leave it' strategy were the

most prone to breaking a verbal contract, the findings from the fieldwork show this did not necessarily hold true. In fact, a significant portion of employees with negative experiences were those who were not reluctant voluntarists.

In reality, the compliance of employers with the unwritten agreement appeared to be also dependent on many other factors, the most important among them being the financial dimension of the deal. To understand the conditions under which breach of the verbal contract commonly happened, it is thus first necessary to understand the role of cash payments in quasi-formal employment. The quantitative analyses, we may recall, pointed exactly to this aspect of under-declared jobs as a vital factor shaping attitudes of workers (alongside tax morale). Yet, as the following discussion will show, the state of affairs is much more complicated than expected, given that the role of envelope wages can go far beyond that captured by the Special Eurobarometer Survey.

### **6.3 The role of cash payments in under-declared employment**

In general, the overall net amount an individual receives from under-declared employment appeared to be a salient factor (alongside tax morale) influencing their attitude towards this type of work. To be more exact, most interviewees heavily based their opinion about their current and future prospects on two different comparisons. Explicitly, they assessed how high (or low) their overall take-home pay was in comparison with other people working on similar jobs, as well as in comparison with the general standard of living in Croatia. The final answer to the question of whether they are happy with the remuneration itself was commonly a subjective combination of the two comparisons, but in general more money typically entailed greater levels of happiness<sup>95</sup>.

Being aware of that, some employers used yet another mental accounting game so as to increase the willingness of workers to collaborate. In some instances, workers were offered variable take-home pay in the long-run, whereas the size of the envelope wage for every month depended on their performance during that particular month. In other words, performance-related envelope wage payments were in place.

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<sup>95</sup> Still, it should be stressed that even though the level of overall income is a dominant factor in this respect, it is by no means the only one. As will become clear through the following sections, one's satisfaction with under-declared employment is a compound outcome of multiple factors, with the weights ascribed to each factor being highly susceptible to subjective valuation.

Still, apart from solely motivating purposes, a small number of employers relied on a variable cash payment strategy for some additional reasons. For instance, companies dealing with inconsistent demand, as well as those sporadically facing short deadlines, often found short-term under-declared employment with variable cash payments very attractive. In other words, if they faced a temporary necessity for increased labour, some employers chose to offer their existing employees full remuneration in cash for essential overtime work, rather than to search for additional workers. This was primarily done to avoid the procedural hassle of firing redundant workers in the future<sup>96</sup>. This rationale, which could elucidate why jobs in the construction sector and accompanying branches are highly prone to under-declaration, once again confirms the relevance of the legalist school of thought in explaining the mechanisms behind under-declared employment.

Yet, sometimes non-constant envelope wages resulted simply from workers being entitled to various occasional and special payments. Such cash payments commonly assumed the 13<sup>th</sup> wage (which was usually given during summer), Christmas and/or Easter bonuses, as well as various premiums for outstanding achievements and contributions.

On the other hand, in some cases encountered during the fieldwork, variability in take-home pay was completely outside the control of a worker as the size of the overall wage was highly dependent on the will of their employer. However, it seems that most employers in Croatia prefer fixed take-home pay, which keeps labour costs constant and facilitates business planning.

This section provides a detailed description of the various payment strategies, with particular emphasis on the numerous traps for both workers and employers, which are hidden behind some of the strategies. In addition to this, we also discuss the types of jobs and workers for which each of the payment options is most common.

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<sup>96</sup> Recall that previous studies also emphasised this peculiarity of quasi-formal employment (see for instance Meriküll & Staehr, 2010).

### ***6.3.1 Variable cash payments***

#### ***6.3.1.1 Percentage of individual's profit-making achievement paid in an envelope***

In situations where the income of a company is highly correlated with the efforts of its workers, employers frequently choose to stimulate their employees by offering some sort of top-up on the declared wage. This type of agreement usually assumes a worker being promised in cash a certain percentage of the company's revenue that resulted directly from their personal performance. In theory, both parties are benefiting from such an arrangement. While an employee is motivated to work harder given that the overall take-home pay is directly proportional to the invested efforts, the very nature of the deal guarantees that all additional labour costs for the employer are redeemed by the increased revenue of the company. Such extra payments seem to be quite common among people working as online or telephone salesmen, commercial travellers, street vendors, etc.

It should be stressed that in most such instances encountered during the fieldwork, the interviewees were more or less happy with their position. Although frequently dissatisfied with some other parts of their employment (for example duration of the contract and constant disputes with colleagues), many expressed contentment with the fact that their hard work was being recognised and properly compensated. One such example is 28-year-old Tihana, who had been working as a financial intermediary for the last 3 years. Her company developed an internal system of profit distribution in which an employee earned a certain number of points for every single contract they personally arranged with clients. The number of collected points determined the 'profit level' each individual was placed on, which then in turn determined the cash commission they get from every transaction. As Tihana explained:

*When you start working, you are placed on level 2 and you can progress up to level 8. After collecting a certain number of points, a person is promoted to a higher level, which brings higher personal profit. For instance, for an equal number of collected points [during the same month], the third level brings some HRK 2,000 more than the second level.*

*(Tihana, 28)*

Following this, the scheme encouraged an individual to try acting as an intermediary in as many transactions as possible in order to increase their share from every single

contract<sup>97</sup>. In addition to this, the system also had hierarchical interdependency which ensured that individuals on higher positions in the company helped, encouraged and monitored those on lower levels. According to Tihana:

*Everybody in the company is interested that you do well because the colleagues who are higher in the hierarchy are earning based on your performance. Therefore, it does matter for other people that you earn as much as possible as they are automatically earning from your sales.*

*(Tihana, 28)*

All 30 employees in the company were officially declared on two or four hours per day (depending on work experience), although in practice they were all working six to eight hours per day. Tihana's official net wage was only HRK 700, reflecting 2 working hours per day she was declared on, but on average she could earn additional HRK 4,500 in cash every month. Despite not being particularly happy with several aspects of the contract, she found this arrangement more attractive than full declaration. When asked whether she would accept being fully declared if offered, she answered:

*Well, not really. It is much better this way because the system stimulates you to work harder. I earn more this way. If I were completely declared, I could work much more than now and get the same wage.*

*(Tihana, 28)*

A similar case is that of Lea, a 25-year-old sales representative for one manufacturer of specialised design equipment<sup>98</sup>. Her company employed some 50 people, but only 20 of them were working on a quasi-formal basis. These 20 were directly involved in production and sales and thus the income of the company was heavily dependent on their efficiency. For that reason, the owner was stimulating the workers in production for every piece of equipment finished before the deadline, while those in the sales segment were stimulated with a percentage of the trade.

Resembling the previously described example, each employee in the sales section was also entitled to a certain percentage of the trade. However, instead of personal sales,

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<sup>97</sup> The respondent was dealing solely with life insurance, even though the company undertook transactions involving many other types of financial assets, such as short-term loans, mortgages, etc.

<sup>98</sup> Again, since it was the only such company in the country, no further details are given. Yet, it is worth mentioning that the company exported their products to more than 70 countries worldwide, which suggests that under-declaration of workers was not confined solely to those business units operating on the local markets.

the base for calculation in this particular case was the overall sales of the team. According to Lea, this was done to foster collaboration among employees, as the promotion of teamwork was the central philosophy of the company. Still, to eliminate those who would rely on the achievement of other members of the team (i.e. freeloaders), the percentage each person was getting from the overall revenue was dependent both on the duration of their service in the company and their own recent efforts. In that way, the system encouraged maximum engagement of each individual, as well as cooperation of all employees. As Lea explained:

*When I came to the company two years ago I was entitled only to 0.5% of the overall sales. After signing the contract<sup>99</sup>, my share was increased to 0.7%, and it has been increased additionally meanwhile to 1.3%. [ ... ] The director decides about your share, and it mainly depends on how efficient you are. For instance, he would come and say to a person: "I am going to increase your percentage because you have worked really hard during the last six months and you are a really good worker".*

*(Lea, 25)*

Despite recognising numerous possibilities for manipulation with individual shares (given that the scheme depended on the subjective judgement of the director), as well as some other problems (such as difficulties in predicting exact take-home pay), Lea was quite happy with her current position. When asked if she could keep working at this particular job in the long run if her share continued to increase, she answered positively. However, this viewpoint was not shaped solely by the respondent having sizeable potential to increase earnings in future, but also reflected professional and social standards inside the company. As Lea argued:

*It would not be great if we [sales representatives] were competitors. No, I would not feel so good in that case. At the moment, the atmosphere is really motivating. We have an incentive to give our best, both individually and as a team. This is really positive because we are all doing our best since we want to earn as much as possible.*

*(Lea, 25)*

Still, due to uncertainty regarding overall monthly income, not all workers would be happy with receiving variable envelope wages. This is particularly pronounced if the business has a seasonal character and accordingly the take-home pay of a worker

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<sup>99</sup> The participant had started working for the company before finishing her university education, and hence first she had a student contract.

appears insufficient in some months. In addition, it seems that socio-demographic characteristics of an individual play a vital role in their attitude towards quasi-formal jobs with variable income. This can be best exemplified by the viewpoint of Lea's colleague Tina, who was working in the same team but did not share her enthusiasm. Along with being more experienced<sup>100</sup>, Tina was also freshly married, which she emphasised several times during different phases of the interview. Despite being aware of the positive sides of such an arrangement, the respondent maintained that the advantages were just of a temporary character, while the long-term consequences were much more profound. Tina commented on her situation in a quite ironical way:

*Given the situation in the country, all people can say is: "Anything is better than nothing". Yes, I know this is really miserable, this is why I play EuroJackpot.*

*(Tina, 29)*

Tina was not the only example showing how perceptions can modify with increased experience and changes in lifestyle. Her statements are in line with those of Karlo, a 38-year-old sales manager who was working for a small company selling office equipment. He had been working on an under-declared basis his whole career, and did not find it unusual as he believed there was no alternative in this sector. Still, after receiving variable envelope wages for several years, the respondent had decided to find a job with fixed take-home pay. Despite recognising all the merits of variable payments mentioned by other respondents, Karlo admitted that at the moment he did not find such an arrangement as attractive as it had seemed at the beginning of his career. Namely, the principal advantage of quasi-formal employment with fixed wages relative to that with non-constant wages became evident for him after he had got married:

*I indeed saw some benefits of a variable wage in my previous company where I had been receiving a share of the income from my sales in cash. However, even though I was able to earn quite a lot at those times, there were some unstable parts of a year when I was getting only the declared wage. This was because you could not earn any extra money in certain months as there was no sale at all. Now I always earn a fixed amount regardless of the sales, which is certainly better when you have a family.*

*(Karlo, 38)*

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<sup>100</sup> Although the difference in age was not so significant (Tina was 29, while Lea was 25), their work experience did differ substantially. While for Lea this was the very first employment in her career, Tina had had several jobs during the last eight years.



These stories suggest that under-declared employment with variable payments is most attractive for new entrants to the labour market. Alongside the fact that most of them are usually not married at the moment they start working, and thus have more flexible time and work schedules, there are also some other explanatory factors for this. First of all, as inexperienced individuals often want to explore their capacities and limits, they are commonly more ready to work overtime if they see potential benefits from it. In addition, younger people usually demonstrate a higher inclination towards risk taking than older age cohorts, and therefore they find it less problematic to have unstable earnings. By contrast, upon getting married, and particularly when they become parents, people start seeking more control over their income and time in general. This shows that, although not detected as an important determinant of satisfaction during the quantitative phase of the study, the role of marital status in the process should not be neglected.

Still, in spite of being recognised as the most beneficial type of under-declared employment (not only by the respondents who were working at that moment or had worked before in this way, but also by individuals who never had an opportunity to work under such an arrangement), employment assuming interdependency between take-home pay and efforts is at the same time the type of under-declared work in which most problems with payment were found. This is not surprising bearing in mind the two important aspects of such schemes. Firstly, this type of under-declaration complicates labour cost management for employers. This is especially pronounced if they agree to pay the commission based on the amount of the sales during a particular month, rather than based on finalised transactions<sup>101</sup>. However, problems could also arise if the employer underestimates the ability of their workers or sets too high premiums. A more detailed elaboration of such situations is given in Chapter 7.

### ***6.3.1.2 Payment according to the exact number of working hours***

Yet another strategy for stimulating employees to put in more effort is payment according to the exact number of working hours during a month. As already mentioned before, this scheme is inherent in activities that are dependent on seasonal variations, as well in those for which time management is of vital importance.

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<sup>101</sup> This is to say, the employer has to pay a commission before they receive money from the transaction if the customer is given a grace period.

The arrangement is as follows: instead of negotiating the monthly net wage, the two parties decide to set the exact remuneration for each working hour. After this part of the agreement is made, in the second phase they have to agree on the size of the declared wage. Once everything is settled, the number of working hours in a particular month is simply multiplied by the price per hour, which gives the total take-home pay. It is then divided into two parts: the agreed declared wage is to be paid into the bank account, while the rest is given in cash.

The negotiation about the declared wage is actually the point where the real power of this strategy from the perspective of employers comes to light. Explicitly, as they become aware that the size of their income is directly under their own control, workers usually pay much less attention to the size of the declared wage. This puts employers in a favourable position and therefore they commonly offer quite a low declared wage. In this way they motivate an employee to work as hard as possible during periods of high demand, while in the same time protecting themselves from negative finance balances during 'poor periods'. In other words, this game of mental accounting enables business owners to put at least one part of the adverse effect arising from business cycles on the back of their employees.

Knowing this, one can once again assume that younger individuals are most prone to such an arrangement. Indeed, lack of experience on the one hand and a much larger inclination to risk on the other probably make new entrants to the labour market the best candidates for this type of under-declared employment. However, this is only an assumption which can hardly be confirmed by findings in the field. Namely, construction worker Josip, whose story was introduced earlier, was the only respondent found to be working under this scheme at the time of the interview<sup>102</sup>. He had been working in the same company for the previous 7.5 years, and this was his first job. Josip found this arrangement quite attractive as according to his belief he was able to earn much more this way than under a fixed wage agreement. Since take-home pay was the most important thing for him, the fact that he was receiving the minimum wage officially was not a significant problem from his perspective. He clarified:

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<sup>102</sup> Nevertheless, it should be stated that many research participants were familiar with this scheme as they had relatives, friends or acquaintances working under such an arrangement. What is more, several people were even able to give quite a good depiction of this practice given that some of the under-declared workers in their company were being paid per hour.

*If I work every day, I can easily earn some HRK 6,500-6,700. Once my wage even reached HRK 7,000, but for that you really must work like a dog. Yet, I am deciding about my take-home pay on my own. On the other hand, we usually need to spend some two to three days on each building and therefore it is also much better for the boss if I stay longer every day as in that way we can finish the job earlier. As a result, the company can arrange more contracts with buyers.*

*(Josip, 25)*

Nonetheless, despite sharing a similar rationale with the previously described strategy (i.e. the one focused on stimulation of sales), there is one significant difference between the two schemes that can help explain why cash-in-hand compensation based on the number of working hours might be much less preferable from the perspective of employers. Namely, while it is easy for an employer to hold records of the workers' performance in the case of stimulation (for instance by checking invoices) it is much harder to do so when the worker is paid per hour. The latter strategy requires either a high level of trust between the two parties or the constant presence of the employer (or at least their representatives) on the working premises. If neither is in place, then the worker could easily falsify the number of working hours. An additional problem with this strategy lies in the fact that efficiency cannot be measured by duration of work. Since remuneration depends on the number of working hours, rather than on efforts, this scheme thus provides an incentive for workers to abuse the system.

Following this, mutual respect appears to be the central prerequisite for this payment strategy. This was indeed confirmed by Josip, who was the only one of four employees in the company working under such conditions:

*The boss trusts me. If I submit a record with 300 working hours at the end of a month, he knows that I really have worked that much. The thing is that we have known each other for some ten years. I always keep the records of my working hours on my own and I never cheat. But all the others that come to the company - you can frequently hear them saying: "Sit a bit, rest for a while, have a coffee and just write down as if you had worked". They are cheats. This is why he always gives them fixed wages.*

*(Josip, 25)*

### ***6.3.2 Fixed take-home pay***

As discussed in the previous sections, employers are likely to consider a variable take-home pay strategy only if there is an evident link between the performance of a worker and the revenue of the company. However, this is just a vital precondition and does not necessarily imply that all such workers would be offered variable envelope wages. Indeed, some of the research participants had never been offered variable take-home pay, even though their under-declared jobs without a doubt displayed a clear link between the results of the company and their efforts. What is more, in some cases there was even a high level of trust between the two parties, but variable payment had never even been considered by employers. This notion gave rise to some other important elements in the process that are worth considering.

In fact, there are two mutually interdependent aspects of every single job that significantly seem to influence the decision of an employer regarding the payment scheme. The first, and presumably more important of the two, can be labelled as 'the ease of substitution'. That is to say, if there is a critical mass of the unemployed whose skills match the job requirements, an employer will be less willing to bargain about variable payment with a chosen worker regardless of any possible benefits that may arise from such a deal. This is because they are certain that some other individuals will be willing to accept the offer, whichever it is, if the chosen candidate declines it. On the other hand, the negotiation power of each individual worker is significantly reduced, given that there is an army of the unemployed fighting for a few jobs in a particular profession. In short, it is the 'take it or leave it' strategy that dominates in this case, which explains why it is not common to find reluctant voluntarists receiving variable take-home pay.

Yet, there is also the second element to consider, which can be termed 'the ease of adaptation'. Namely, certain jobs by their nature require some sort of training or at least a longer adjustment period for a worker. Substituting an employee in such circumstances inevitably implies some expenditure for the company, as there is either a financial cost (if training is needed), or a time cost (in the case of adjustment), and sometimes even both<sup>103</sup>.

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<sup>103</sup> Consider for instance manual workers handling some special and/or expensive machines. While such individuals might be replaced easily, both training and an adjustment period could be required for a new worker to meet all the requirements regarding safety and efficiency.

As appeared evident from the experience of the research participants, if neither of the two above factors was relevant for an employer they would commonly opt for fixed take-home pay and strive to find other solutions in situations where additional effort by a worker was needed. Generally speaking, a fixed take-home pay strategy is quite simple in its core. In short, the two parties most frequently agreed on the total net wage in the first stage, and the agreed amount was then divided into two parts. The latter was mainly done by the employer, although some exceptions from this rule were also encountered during the fieldwork.

To illustrate the solution for situations in which additional effort by a worker is needed, we can consider in more detail the case of horticulturist Teo, whose most recent under-declared employment lasted for some 6 years. Even though Teo preferred payment per hour, his employer had not found that option attractive. Being aware that it was neither hard nor costly to replace his employees, the boss rather chose to take advantage of the existing personnel. To be exact, all the employees except one had been under-declared with fixed take-home pay. Yet, since there had been a constant need for overtime work during spring and summer, they were expected to work almost every Saturday during the season. As one would anticipate, all that overtime work was unpaid<sup>104</sup>.

However, one of the employees was lucky enough to be completely declared. This was because the firm had been hired for gardening by one foreign institution. As the contract assumed one horticulturist being placed at the premises of that particular institution, its representatives demanded all the statutory rights for the worker. Following this, one can see that the story of Teo inevitably confirms the relevance of the structuralist school of thought in explaining the phenomenon.

Judging from the experience of the interviewed under-declared workers, fixed take-home pay seemed to be the most common payment strategy in Croatia, which is understandable as it significantly facilitates business process for employers. Still, apart from giving business owners more control over their total wage cost than if the payments were variable, this scheme at the same time also eliminated at least some uncertainty for workers. As already discussed before, experienced workers found this payment strategy preferable to other available options.

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<sup>104</sup> Exploitative nature of quasi-formal employment inherent in businesses facing fluctuations in demand was also described by earlier studies (see Meriküll & Staehr, 2010).

Yet, due to the lack of mental accounting (i.e. no financial motivation for a worker is present), the workers receiving fixed payments appeared to be more thorough in the assessment of their own position than those with variable wages. This is simply because it was much easier for such workers to draw a line between their under-declared job and a completely regular counterpart (in terms of mode of payment). Indeed, when asked to evaluate their situation, the workers from this group commonly applied the following approach: first they assessed how high (or low) their take-home pay was in comparison to those of other people working in a similar, but completely declared job. If they held that their personal income was higher than that of their counterparts (i.e. if a worker believed that she or he was benefiting from under-declaration), they were more likely to express a higher level of satisfaction. Likewise, if they believed that completely declared individuals working on a similar job could earn more, under-declared workers with fixed take-home pay were commonly highly dissatisfied.

To illustrate this, we can compare the viewpoints of two individuals receiving fixed take-home pay. Both had similar work experience and had been receiving comparable take-home pay, but had different professional and educational backgrounds. The first one was Tomislav, a 31-year-old waiter who had quit his last under-declared job some five months before the interview, after 7.5 years of continuous service for the same employer. Alongside being paid significantly below the national average, another potential reason for him to be unhappy was the fact that his declared wage was exactly on the minimum. Moreover, he had to work overtime on a daily basis, but had never received any remuneration for these additional working hours. Yet, in spite of that he found his total take-home pay of HRK 4,500 more than satisfying, in the first place because he believed this was a quite high wage for his vocation. When asked to comment on his earnings, the respondent expressed a high level of contentment:

*Yes, this was a quite good wage. I know many waiters who earn up to HRK 3,500. And what is more, these people have more responsibilities than I had, such as annual revenue accounting, etc. They work like dogs and have nothing, just some pathetic little tips. I was completely alone in my shift. Yes, sometimes I had to work a lot, but on some other occasions there were no guests at all. I really cannot complain as I was really happy with my earnings. I have many friends working as waiters and when I hear their stories I must say my job was excellent.*

*(Tomislav, 31)*

It is worth adding that he terminated his employment after a dispute with the employer, which had nothing to do with the arrangement. This was not the case with Marta, a 34-year-old lawyer whose dissatisfaction with her wage was the primary reason to quit the job. After finishing a three-year trainee period in one small law office, which was partially paid by the state, she passed the bar exam and obtained her licence. Following an explanation that he could not afford full declaration, Marta's employer at the time offered her a quasi-formal post with declared payment of HRK 3,100 and an additional HRK 1,900 in cash.

The respondent found the offer completely unsatisfactory given her educational background and the job requirements. As she believed, the take-home pay of HRK 5,000 was much below the average for this profession and thus she perceived herself as a victim of the greedy boss. According to Marta, the employer was the only one to benefit and thus her under-declaration had been a pure result of the boss's desire to "increase his personal wealth". For that reason, Marta was determined to find another job even though she accepted the offer in the first place. Despite having mostly positive opinions about the employer, which were based not only on three years of pleasant experience in the company prior to under-declaration but also on firm social ties between the two (the boss was a brother of her friend's), she had started looking for better paid opportunities. Indeed, she had managed to find a completely declared job in her profession after six months.

Yet if an individual believes that there is no significant difference in take-home pay between them and their completely formal counterparts, they will put more emphasis on some other aspects of their employment. This assumes evaluation of various side-effects that quasi-formal work exhibits on their present and future wellbeing, as well as a reconsideration of the ethical and social aspects of their behaviour<sup>105</sup>. In general, the attitudes and perception of such individuals are the hardest to foresee as the evaluation takes into account a large number of components. What is more, the evaluation process is highly prone to subjectivity regarding the importance of each individual factor. For instance, while the fact that they are cheating the inefficient and unfair state appeared enough for some respondents to be happy with their position, others found their involvement in tax evasion the main reason to be extremely unhappy. More about the role of non-financial aspects of under-declared employment

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<sup>105</sup> Of course, all other participants also took these factors into account, although finding them somewhat less relevant.

is given in the next chapter. Before that, we are going to discuss some other interesting payment options encountered during the fieldwork.

### ***6.3.3 Some hybrid cases***

There are also some instances of under-declared jobs which do not fit in any of the above described categories or are in between them. In this section we give a brief description of such cases which again open some new horizons about the phenomenon.

The first interesting case is Luka, the manual worker whose story was introduced earlier. He was unique as he was the only respondent receiving two different types of envelope wages. Yet, in order to understand each of the two, one first needs to understand the scheme under which his take-home pay was calculated. Luka's company introduced a payment system which was a combination of price per hour and time quotas. That is to say, the starting value of one working hour, which was set at HRK 23 for all employees, was adjusted in accordance with the efficiency of a particular worker. In other words, the management determined the processing time required for every single product and if the worker failed to finish it in a given period, her or his hourly wage would be decreased by a certain percentage.

In addition, the final remuneration for every single hour also reflected the quality of the products manufactured during that particular hour. According to the respondent, the assessment of quality was highly dependent on the subjective judgement of the supervisors and thus the whole system provided considerable room for manipulation. All this actually made it impossible for workers to predict their wage at the end of a month. What is more, time constraints were causing constant pressure, which commonly resulted in stressful situations and poor social relationships in the workplace. As Luka described the atmosphere in the firm:

*We always have to work faster and faster, and it is normal for a person to make mistakes in such conditions. And of course, when the mistake is made, then they are yelling at us. [...] Alongside the fact that the job itself is quite exhausting, there is also a constant pressure from the director, supervisors, etc. We are always in a hurry, and sometimes it can even happen that we run out of tasks because we finished previous tasks too fast. Considering how much we work and how much we produce, we are significantly underpaid.*

*(Luka, 26)*



At the end of the month, the management calculated remuneration for each worker based on the above described criteria. Luka was being officially declared on HRK 3,000, but he actually never knew how much above that he was going to get before the moment he was given an envelope. As he confirmed, it was not rare not to get an envelope at all if an individual's performance was below that expected according to the supervisors.

However, besides the 'monthly envelope', every third month Luka and other employees also received an additional payment, the so-called 'quarterly envelope'. That envelope contained remuneration for all overtime work during the previous three months. From Luka's perspective, this was the only bright aspect of his job, as every single overtime hour was recorded and paid later. Given that in his case both formal and informal payments were being made on the same day, once in three months he was getting two envelopes alongside HRK 3,000 paid into the bank account. The quarterly envelope was usually the most pleasing source of income as it commonly could contain up to HRK 5,000.

Another case of a worker who never knew how much her wage would be was teacher Linda, whose story was also introduced earlier. Alongside an unpredictable work schedule, the problem lies in the fact that she was supposed to work for some 25-30 hours a week, which was approximately 2.5-3 times more than stated in the contract. Above that, Linda was highly frustrated by the lack of any link between the real number of hours worked during a particular month and her take-home pay. Since it was common for her to be paid less in some months regardless of a more onerous time schedule, it is easy to understand Linda's dissatisfaction with her position.

As the respondent explained, this mismatch was due to the endeavours of her boss to address variability in revenues. That is to say, since no children were attending the school in July and August, and accordingly there was no revenue for the school during the summer period, the employer deliberately decreased cash payments during spring so as to have enough money for declared wages in summer. Therefore, although Linda's declared wage was constant during the whole year, she was actually paid only for ten months. The money she was getting into her bank account in July and August was nothing more than the cash-payments she had earned during April, May and June, but which were relocated by her employer in order to seemingly comply with the legislation.

According to Linda's belief, this was just one of many frauds her employer had been engaged in. She commented shortly: "Everything is obscure in that institution". Since

she was to get married a few months after the interview, the inability to predict even an approximate take-home pay was the chief problem from her perspective. As a matter of fact, the respondent kept reiterating that issue several times during the interview, which further confirms that marital status indeed should not be neglected when scrutinising factors shaping one's attitude in this respect.

Yet another specific case was goldsmith Filip, who had arranged with his employer to be paid in euros, not in kunas. Following this, he was repeating the same routine every single month: after receiving an official net wage of HRK 3,600 in his bank account, Filip was supposed to go to the bank and withdraw the whole amount. Then he gave the money to the employer, who in turn gave him the envelope with the agreed wage in euros. It is important to note that a double manipulation was being done in this way. First of all, as according to the respondent many customers paid for their jewellery in euros 'under the table'<sup>106</sup>, the employer was transferring that hidden revenue directly to Filip. In the same time, the employer was extracting kunas from the system, which he could then use in other illegitimate transactions.

Certainly the most extreme case was 51-year-old Toni, who had worked for 12 years as a director of logistics in one company in the catering sector. He got fired together with the remaining 60 workers when the company went bankrupt in 2013. Toni's take-home pay was constant, but it was the continuous variability of the declared wage that made him unique. Namely, since the business of the company was seasonal (with peaks in summer and low levels of activity during winter), the employer opted to adjust payments of taxes and contributions in accordance with the fluctuations in revenues. For that reason, the declared wages of workers were variable, even though the total take-home pay was fixed.

According to Toni, there were some months when he only received the minimum into his bank account, while in some months he had been paid officially more than HRK 7,500. Yet, his total take-home pay had been set at HRK 16,000 during most of the employment<sup>107</sup>. When asked why the employer had not been afraid to manipulate the

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<sup>106</sup> Except for some particular cases (such as the reimbursement of travel expenses for international trips, trade in foreign financial assets, etc.) euros are not permitted as a means of payment if both parties involved in a transactions are residents of Croatia (Official Gazette, 2015). Therefore, it is not hard to conclude that all trade of Filip's employer that was paid in euros inevitably remained undeclared.

<sup>107</sup> His total wage was reduced to HRK 12,000 shortly before the termination of employment as a result of the financial problems of the company.

declared wage given that such behaviour sends a signal to the tax authorities that some illegitimate activities may be in place, the respondent explained: “This behaviour was a result of a good relationship of the employer with the key people in the Inspectorate”. Following this, at that time Toni had not been finding his situation overly problematic. He maintained: “It had not bothered me as long as I was getting my money”. However, his perception changed after being fired. As he admitted, this practice had been just one of the bad strategic policies of his employer, and certainly an obvious indicator that the company had also been involved in many other illegitimate activities. Therefore, he was not surprised that the company collapsed.

### ***6.3.4 Occasional and extra payments in cash***

Apart from remuneration for regular work, employers can also use a cash-in-hand approach for some occasional or additional payments. The most common such payments are lunch allowances (given on a monthly basis), holiday allowances (once or twice a year), the 13<sup>th</sup> wage (usually given during the summer period), and Christmas or Easter bonuses. While they express the inclination to reward their employees with extra income, some employers choose to give money ‘under the table’ purely for tax evasion purposes. For instance, according to the Croatian legislation the 13<sup>th</sup> wage is subject to the same rules regarding taxation as regular wages (Official Gazette, 2014b). On the other hand, all other occasional payments (holiday allowances, Christmas and Easter bonuses, etc.) given during a certain year are treated as different subparts of one single remuneration and are therefore accumulated and then taxed jointly. More precisely, up to HRK 2,500 of the total of such extra payments during one year is tax-free, whilst everything above that amount is subject to personal income tax (Official Gazette, 2014b).

Being aware that workers are not likely to complain since in Croatia such additional payments are mainly perceived as the generous acts of an employer, some companies opt to give these occasional and extra amounts in cash so as to circumvent the legislation. Given this, it is reasonable to assume that even many of those Croatian workers who are not classified as under-declared according to our definition would every now and then receive an envelope with such extra payments. In other words, there is a rational basis for the existence of a group of workers who can be classified as ‘sporadically under-declared’. However, this cannot be confirmed by the findings from the fieldwork. This is due to the sampling strategy, as solely those individuals receiving one part of the agreed wage in cash on a monthly basis were sought during

the fieldwork. For that reason, occasional and extra payments in cash detected during the fieldwork were just supplemental amounts given together with the under-declared part of the wage.

Even though non-standard payments in cash do not seem to be particularly frequent among companies practicing under-declared employment, they do indicate that this type of work may be much less exploitative than one would expect<sup>108</sup>. No legislation in Croatia obliges employers in the private sector to pay any of the things just mentioned. For that reason, such occasional and extra payments by companies are usually seen as a sign of respect towards their workers. Since after the onset of the economic crisis any kind of non-obligatory payment is a really rare thing to see in Croatia, the companies that still make such payments are typically perceived as highly desirable employers from the perspective of workers. It is therefore not surprising that most of the respondents receiving occasional and extra payments were quite happy with their jobs.

Among several such cases encountered during the fieldwork, certainly the most interesting one was that of 26-year-old Irena, who had worked under-declared in a notary public office for six years. Alongside receiving a generous wage, she had been regularly given the 13<sup>th</sup> wage, as well as Christmas and Easter bonuses. While the 13<sup>th</sup> wage was equal to the take-home pay of the particular employee, Christmas and Easter bonuses came to between four and five thousand kunas each. In addition, all overtime work was also paid in cash and each employee was entitled to HRK 35 of lunch allowance per day, which was also paid in an envelope. Since all these were given in a single envelope, together with the undeclared part of the wage, according to the respondent sometimes envelopes were so overfilled that it was impossible to close them.

As Irena admitted, such generous payments completely spoiled people in her office. This had become clearly evident when some employees started cheating on their lunch allowance, which forced the employer to stop subsidising that expenditure. In addition, as one year the 13<sup>th</sup> wage had been somewhat reduced due to a decline in revenues, several employees unexpectedly found themselves in financial trouble. The respondent briefly commented on this situation:

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<sup>108</sup> As explained before, the existent research literature depicts under-declared employment as a highly abusive practice (see Round et al., 2008; Williams, 2013a; Woolfson, 2007).

*It was a huge disappointment for some people when we got only HRK 5,000. A few of them had to cancel their vacation because they were counting on - who knows what they were counting on [ironically].*

*(Irena, 26)*

Still, even though most of the workers receiving occasional and extra payments were happy with their position, there were some exceptions to this rule. Take for example dentist Helena, who was regularly receiving both Christmas and Easter bonuses, but argued that these two extra payments were far from being able to compensate for all the negative aspects of under-declared employment. Despite being reasonably paid given her experience, the respondent firmly believed that the employer was the only one benefiting from under-declaration. Therefore, in her opinion this non-obligatory payment was nothing more than an attempt by the boss to fool his workers. As Helena reasoned, the amount of money given under the two bonuses was much lower than the actual gain of the company resulting from under-declaration.

Yet, there were also numerous other reasons for Helena to be displeased with her employment. Besides expressing a low level of tolerance towards tax evasion, which explains her unhappiness at working under-declared, she kept repeating several key things that were particularly bothering her. For instance, she was continuously complaining about overtime work, which was completely unpaid even though it was abundant and conducted on an everyday basis. Alongside this, she also added that the employer had not paid her two-week probation. Still, what made her especially dissatisfied was the fact that the declared wage was not recorded as 'wage payment', but as a regular payment into the bank account<sup>109</sup>. In consequence, she was not eligible for an overdraft on her current account.

Therefore, even though Helena was among the rare private sector workers in Croatia that were receiving Christmas and Easter bonuses during the recession period, this did not give her any satisfaction. Since the negative sides of her employment overcame the few positive ones, she kept dreaming about finding a completely regular job. In any case, the story of Helena is just one illustration of how individuals' attitudes towards their own under-declaration arise as a complex outcome of a number of intertwined factors.

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<sup>109</sup> More detailed discussion on this issue is in section 7.1.2, which explains the strategies of employers to avoid or postpone payments of social security contributions.



## 7 WORKING ON AN UNDER-DECLARED BASIS – EVERYDAY EXPERIENCES OF QUASI-FORMAL EMPLOYEES

In the previous chapter we looked at reasons for entering the under-declared realm and different types of payment that are common for quasi-formal jobs in Croatia. The next step in this comprehensive insight into the phenomenon is to analyse how this practice works on an everyday basis. This primarily applies to occurrences of oppression and manipulation, as well as to various problems with payment. In that light, the first part of this chapter gives a more detailed discussion about professional standards inherent in under-declared employment in Croatia.

This is followed by an overview of another important aspect, namely the social climate inside companies that under-declare their workers. This considers not only the relationship between under-declared workers themselves, but also between under-declared individuals and those workers inside the company who do not receive envelope wages. As will be shown, the social climate inside the company was an even more important factor for some interviewed workers than the way they were treated by their employer.

After this, we focus on three fundamental matters that every quasi-formal worker has to constantly bear in mind. The first of the three is deterrence, which was found in earlier statistical analyses not to have any significant effect on the development of this practice. To get a more in-depth picture of the state of affairs in this respect, we shall discuss the effectiveness of repression and its potential to combat this practice. The second important aspect to scrutinise is general sentiments towards own behaviour, i.e. individual's own judgements about the social consequences of their decisions. Even though the issue of tax morale has already been addressed in previous chapters, it is worth dissecting it separately given its importance for the development and sustaining of this practice. Finally, we come back once again to the financial sphere of under-declared employment, which was earlier detected as the vital element shaping one's attitudes and opinions. The discussion in this chapter will be centred on the clash between current financial benefits/losses and future financial benefits/losses inherent in such jobs. More precisely, apart from illuminating the role of expectation regarding future pensions, we also address some other important financial aspects of under-declared employment, such as benefits in the case of unemployment and access to loans and mortgages.

## 7.1 Professional standards in the workplace

It was pointed out in the previous chapter that the structuralist school of thought might indeed be of help in endeavours to conceptualise under-declared employment. The relevance of the structuralist approach was particularly apparent when recounting stories of workers whose abundant overtime work remained unpaid. Yet, it must be said that unpaid overtime work in Croatia should not be perceived as something specific to quasi-formal jobs since similar occurrences can be commonly found in all other (legitimate and illegitimate) types of employment. As a matter of fact, unpaid overtime work seems to be one of the most frequent types of misdemeanour by employers in Croatia, and as such is also highly prevalent in completely formal jobs (Bilić, 2011; Ministry of Labour and Pension System, 2015; Učur, 2014).

Yet, besides unpaid overtime work, which was frequently encountered during the fieldwork, other types of exploitative conduct described in the literature on quasi-formal employment<sup>110</sup> seem not to be as frequent in Croatia as expected. In general, the majority of respondents did not see substantial differences between their jobs and completely formal ones regarding professional standards. In most cases the participants described under-declaration solely as a practical (sometimes even survival) strategy of the business owners. What is more, no respondent mentioned manipulation or oppression as the likely primary motivations of their employers to hire workers on an under-declared basis. In other words, even though employers were commonly those who initiated such an arrangement, the general perception of the interviewed workers was that this is mainly done so as to decrease labour costs, not in order to oppress or exploit workers. Nevertheless, this does not mean that misbehaviour in Croatia does not occur at all and in this section we describe the circumstances in which it can occur.

Before doing so, it is important to clarify one issue. Although they were unified in identifying evasion of taxes and social security contributions as the central function of quasi-formal employment from the perspective of the business owners, the interviewed workers did not agree on the underlying motivation behind this. While some believed this practice was the only way the company could survive, others maintained that greed is what drove their employers.

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<sup>110</sup> See for instance Williams and Padmore (2013b) and Woolfson (2007).



Most of those who stated that under-declaration was nothing more than a survival strategy justified it by the fact that even their employers were under-declared themselves. Such a situation was highly frequent in small companies, in which the business owner was commonly on a payroll. In fact, for the majority of the respondents working in companies employing up to four or five people the employer was also one of the quasi-formal workers. Yet, one must be careful here as there is another potential reason for such employers to under-declare themselves, which has more to do with greed than with pure survival. Namely, since certain social benefits in Croatia are dependent on the size of the wage, eligibility for such benefits might have also been a motivator for self-under-declaration<sup>111</sup>.

When it comes to the respondents who pointed to greed as the principal rationale of business owners for under-declaration of workers, we can divide them into two different subgroups. The first subgroup is those with a fixed monthly wage who believed that individuals working in similar, but completely declared jobs were earning more than themselves. In other words, those were the individuals who were certain that the employer was the only one to benefit from this practice, and whose reasoning process was described in the previous chapter. The second subgroup is the respondents who faced various problems with payment. Given the variety of reasons for delays or non-payment of envelope wages and/or social security contributions, such cases will be examined in more detail later in this chapter.

In any case, one should make a clear distinction between manipulative behaviour and failure of the employer to pay envelope wages. As will become obvious, the two were most commonly not interrelated nor did they occur in the same context. On the whole, breach of the 'verbal contract' on the part of employers in Croatia commonly happened in situations which had nothing to do with their desire to oppress workers. Judging from experience of the interviewed workers, problems with payment are probably even less of a salient issue in Croatia than manipulative behaviour by employers. However, most interviewees generally expressed higher readiness to tolerate manipulation than to tolerate delays in payment of envelope wages. In order to clarify why this is so, we analyse the two types of misconduct separately.

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<sup>111</sup> It is interesting to note that while some interviewed workers indeed pointed to this as a potential reason for their employers to under-declare themselves, none of the participants recognised eligibility for social benefits as their own rationale to accept under-declaration.

### ***7.1.1 Manipulation and oppression as minor issues***

Cases of employers using the agreed cash payments to mistreat and blackmail their quasi-formal workers seemed to be a rarity in Croatia. The majority of respondents, in fact, confirmed that their bosses had never tried to manipulate them or other employees by making informal payments conditional upon certain things being done. This applied to all identified subgroups, regardless of how they entered the realm and which payment strategy was in place. In fact, it seems that employers are generally aware that workers could always find a way to harm the company if their elementary rights are violated. Probably the best clarification of the 'balance of power' inherent in quasi-formal employment was given by headwaiter Dado, who explained why exploitative behaviour by employers commonly did not go beyond unpaid overtime work:

*They are afraid to do that. All of them know that the worker can call the inspectors and disclose illegitimate activities of the company if the employer violates an agreement. That is to say, the worker can disclose not only the fact that the employer hires people on an under-declared basis, but also all other things that usually go alongside. [ ... ] The worker could for instance call the inspectors anonymously and then deliberately fail to issue a bill. In that way they can cause significant harm for the firm and the owner. [ ... ] I mean, even though they hold the employees in the palm of their hands, the employers also have to be really careful.*

*(Dado, 40)*

In short, despite many of them being in inferior positions (and this particularly applied to reluctant voluntarists), it seems that under-declared workers do have their cards to play if oppressed. Indeed, the viewpoint of Dado was shared by many others, regardless of their professional and life experiences, which suggests that quasi-formal workers were actually highly familiar with the 'rules of the game'.

In fact, when asked what they would do if any type of manipulation occurred, most respondents immediately went on to talk about numerous possibilities they had for causing serious harm to the company. Apart from the strategies mentioned by Dado, the interviewees also came up with some other interesting undertakings that would have serious financial consequences for the owner. Some of the most commonly mentioned methods were making adverse business deals, delivering defective products or simply deliberately damaging expensive equipment. Being aware of that, employers in Croatia seem to rather choose to play fairly in the way they treat their employees.

Besides, some respondents believed they were too important to the company given their skills and knowledge of the business and thus it would be silly for the employer even to try breaking the agreement. Such individuals were most commonly found among pure voluntarists and monetary rationalists, although this reasoning was not confined solely to these two groups. One such person was 28-year-old mathematician Rafael, who had never seen any type of misbehaviour by the employer as a possible threat. The respondent had been working as a retail manager in a large chain store for the last two years and during that time he had not witnessed any unpleasant situation. As a matter of fact, Rafael requested an increase in his overall wage several times, and it was always approved by the employer.

When asked whether he was concerned that frequent requests for pay rises could result in his employer being more prone to breaching the agreement or start oppressive behaviour, Rafael replied:

*I am not afraid of that because I know how important I am for him. He is the only one who could lose in that situation. I can easily find another job tomorrow and therefore I am not worried that something like that will happen.*

*(Rafael, 28)*

This viewpoint was also shared by several other respondents. For instance, goldsmith Filip, who kept reiterating during the conversation that it would be easy for him to find another job, or even to start his own business given the lack of people with his skills, gave a similar answer when asked about the risk of his employer abusing the scheme:

*No, no, this is not an option. If this happens, then GOODBYE, NO MORE; GOOD NIGHT, I AM LEAVING. He clearly knows that I have that 'know-how' in this company. All the products he sells were made by me.*

*(Filip, 50)*

Still, despite its occurrence being rare, instances of employers blackmailing or manipulating their under-declared workers did exist in Croatia. For instance, this type of employer's misbehaviour was experienced by Martina, a 23-year-old dental assistant who worked on an under-declared basis in one private dental clinic for some two years. During the job interview she had accepted all the terms of the employer because she simply wanted to start working on something she really liked and what she was educated for in the first place. In addition, this under-declared job provided at least some level of social protection, given that all her previous jobs (including the one she

had been working on at that time) were completely undeclared. Martina was actually a typical example of a reluctant voluntarist, since the lack of opportunities for completely formal employment was the main reason for her to accept under-declaration.

However, soon after commencing the job Martina realised all the pitfalls of this type of employment. The real problems started some six months after signing the contract, when she decided to renegotiate her position. She had found the overall wage of HRK 4,000 insufficient for her lifestyle and in line with this she asked for a pay rise. This was something her employer did not receive with particular enthusiasm, but he eventually accepted the request provided that the additional amount would be paid completely in an envelope. Even though this was not what Martina was aspiring to or had asked for, she was rather content at first as at least her overall take-home pay had been increased that way.

Following this change, the terms of the verbal agreement remained unchanged until the moment Martina decided to take out a bank loan. After being told she was not eligible for any long-term loan, given that her declared wage was exactly at the minimum, she requested both an increase in the declared wage and a reduction in her working time<sup>112</sup>. Although the employer again agreed to fulfil both requests, this time their relationship significantly worsened. Namely, according to Martina the employer suddenly changed his behaviour after this and started seeking out every single mistake made by the respondent so as to punish her. When asked whether there was any explicit case of mistreatment, Martina replied:

*You will not believe, but I had one such situation today. He called me in his office and said: "This is your envelope wage. I was thinking of reducing it by HRK 500 because of that error with the whitener, but I will forgive you this time"<sup>113</sup>. He went on to say that he hopes he will not have to do it in future - I mean, he wanted to say that he decided to tolerate it in this occasion, but the very next time he will penalise my mistakes by giving me less in cash. [ ... ] There was also one more situation earlier when I unintentionally threw a drill into a bin during the surgery. The price of the drill is HRK 600. He said that next time this happens he will have to decrease my envelope wage. And the best thing is that I took it out from the bin. I was digging through the trash and took it out.*

*(Martina, 23)*

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<sup>112</sup> The respondent was declared as a part-time employee, while working ten to twelve hours every day. As she admitted, this was an even more salient problem for her than the size of her take-home pay.

<sup>113</sup> The interviewee failed to order a new shipment of whitener, which caused a shortage of that substance in the clinic.

As Martina argued, this sudden change of the employer's behaviour was an evident indicator that he was not happy with her trying to continuously improve the terms of the contract. An additional reason for the employer to be dissatisfied can be found in the fact that these changes resulted in Martina being paid considerably more than the other two employees. Following this, the interviewee expressed concern about her position as she believed this was just a beginning. Indeed, her hunch was correct. Some two weeks after the interview, Martina informed the researcher that she had been fired. She had made another mistake, which was enough for the employer to fire her.

Although this was the only example encountered during the study in which the employer used payment of envelope wages as a means of manipulation, this is not the only case of oppression by employers. In two other instances interviewees also complained about disrespectful treatment by their employers. Before recounting these two stories, we must stress one important characteristic of theirs. Namely, unlike the case of dental assistant Martina, whose story was specific to under-declared employment, the following two cannot be perceived in the same light. Given that the reasons for the oppression in these two cases were not confined solely to under-declared employment, it is reasonable to assume that even fully declared workers in Croatia face similar problems. Following this, the main rationale for recounting the two stories is not to describe some new features of under-declared employment, but rather to further elucidate general labour conditions in Croatia. This in turn can help explain why illicit economic activities are so prevalent in this new EU member state.

Let us start with the story of Marija, a 28-year-old commercial traveller who worked for one supplier of marketing materials during 2014. Her job was to find new customers in the capital, where her company had not been operating before<sup>114</sup>. Alongside the fact that the company was not renowned in Zagreb, another problem was in the fact that the respondent was completely new to the business and therefore it was difficult for her to take the first steps. Even though she was motivated to work as hard as possible, given that the employer promised to give her a certain percentage of income from each sale she made in an envelope, the interviewee admitted things had not gone as she planned. After failing to find a sufficient number of clients during the first few weeks, one day she was phoned by the employer:

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<sup>114</sup> The company headquarters was placed in another part of Croatia.

*He called me one day and said: "Marija, where are you? Are you working? We have not sent you any offer today". You see, he thought you can make 10 deals each day just like that. And then he continued: "You must put more effort, otherwise we are going to quit this". Basically, since I was struggling during the first month, he was announcing...*

*(Marija, 28)*

The employer also failed to fulfil some important parts of the verbal agreement. Namely, Marija was promised a mobile phone, laptop and after a while even a car. Not only was nothing of the promised given, but also no travel costs and mobile phone expenditures were remunerated during her employment. Despite that, she had never stood up and fought for herself during that period.

A similar passive and subservient approach was that of Marijana, a dental technician whose work contract contained several discriminatory paragraphs. When asked how many of 20 employees in her company were receiving envelope wages, the participant first answered that all of them were working under the same scheme. However, then she corrected herself by saying that she believes this is so, as she saw the secretary distributing the envelopes once a month. Then she clarified this, saying that she actually had never talked about that matter to anybody in the company because it was stated in her contract that any conversation about wages with other employees would automatically result in dismissal. According to the interviewee, this was just one of the problematic stipulations in her contract. When asked why she did not stand up for herself, she replied pessimistically: "To whom should I complain?!" Later she added: "If you do not want to work, someone else will", which clearly illustrates how she perceived her position.

Yet, this was nothing in comparison to her previous experiences. This time she was at least asked to sign a work contract, which was not the case with her former job. To be more precise, even though Marijana had been officially declared on her previous (quasi-formal) job, she actually had never signed the contract. According to the respondent, she did not bother with that fact as long as her social security contributions were being paid. Problems thus arose only after dismissal, when she wanted to apply for unemployment benefits. Since the unemployment service requested her to submit the work contract as a precondition for unemployment benefits, she contacted her ex-employer for help. The company indeed supplied the contract, but her signature had been forged. An additional problem was the fact that this forged contract was dated five months before her dismissal, although the

interviewee had worked for the company for some 15 months. Still, social contributions had been paid for all 15 months, which was a clear indicator that some illegitimate activities by the employer had been in place. When asked why the employer had committed such an obvious forgery, Marijana replied: "I think he had some sort of protection in the inspectorate".

Although these and similar experiences should not be perceived as being specific to under-declared employment, they are quite important as they illuminate one important peculiarity. Explicitly, the findings from the fieldwork suggest that women were generally more ready to tolerate misbehaviour by employers. Women seemed rarely to oppose their superiors, which was not the case with men who were apparently more prone to disputes in the workplace. Katarina, an economist with more than 10 years of experience in this realm, explained the main difference between the genders:

*Women are generally paid less for identical jobs, it is much easier to blackmail them, and they are less arrogant and perky than men. A man can easily say: "There is no way I am going to do that, therefore I am quitting the job and I do not care". And then he would simply come home and calmly say that he was fired. On the other hand, a woman who has children cannot afford that. If her employer starts decreasing the payment, she will probably be ready to humiliate herself and keep working regardless of that because she knows that she must bring home at least HRK 1,000 for her children. Males are much stronger in this respect.*

*(Katarina, 41)*

These standpoints were indeed confirmed by some other stories from the fieldwork. Although men also considered their families before reacting to certain conflicts in the workplace, women seemed to be more determined to keep working regardless of professional and social conditions, at least until they found another job. And this was not only true for women with children, but also for those who supported other members of their household (parents, grandparents, siblings etc.).

One such example was Irena, a former administrative worker in a notary public office. Although highly satisfied with the wages and all other benefits she had had from her under-declared job (see section 6.3.4), she was extremely disappointed with the social conditions in the workplace<sup>115</sup>. However, the interviewee kept working because she knew her family was highly dependent on her income. Yet, as Irena explained, poor

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<sup>115</sup> More details about Irena's experience in this respect will be given in section 7.2.

social conditions culminated in a huge fight between employees which resulted in her being fired together with other five colleagues. Irena commented on the situation:

*I am really grateful to her [the boss] for firing me because I would have never quit the job on my own - simply because the wage was great. I would put up with everything for a long time. Yes, I would have destroyed myself physically, but I would have put up for that wage - Yes, I am sincere.*

*(Irena, 26)*

The difference between genders will become even more evident in the next section, which describes how people reacted when problems with payment occurred<sup>116</sup>. Yet, before that it is necessary to emphasise one important feature of every single company employing workers on an under-declared basis, but which was recognised only by a few research participants. Although most interviewees seemed not to be aware of its existence, this property can in some circumstances indeed have a significant impact on professional standards and dramatically alter the position of workers. That feature was best described by Tiho, a 38-year-old salesman with experience from two under-declared jobs. When asked to point to the main differences between quasi-formal and completely licit jobs, the interviewee explained:

*First of all, when you are receiving a part of your wage in cash, you must be aware that the company is not striving to be completely legitimate. I mean legitimate in terms of obedience with legislation and all other rules of the game. Therefore, even a modestly intelligent person understands that soon or later your rights as a worker will be violated.*

*(Tiho, 38)*

As a matter of fact, the interviewee was talking from his own experience as he had been fired two weeks before the interview. We postpone more detailed discussion of Tiho's story to later parts of this chapter, but at this point it is important to understand the full meaning of his words. Namely, even though the majority of research participants did not face any problems at the time, this could have easily changed in the future. As will become obvious after presenting the stories of those who

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<sup>116</sup> Note that the presented arguments do not imply that women are more prone to accepting under-declaration, as the discussion refers solely to situations when employment has already started. As a matter of fact, the interviews with under-declared workers did not reveal any plausible reason why gender would be a relevant factor in explaining motivations for entering the under-declared realm, which supports the validity of findings on the matter presented in Chapter 5.



encountered problems with payment, it was workers who were the first to be hit when the financial situation of the company worsened. However, it seems that the majority of workers are not aware of that hidden trap of this type of employment until they find themselves in such a situation.

Yet there were some workers who immediately became aware of another trap with the same roots. These were commonly individuals higher in the hierarchy of the company, i.e. those who were in charge of making business decisions. For such under-declared workers their freedom to act in accordance to the law was substantially undermined by the fact that their own employment was not completely legal in the first place. Consider for instance economist Sara who had worked on an under-declared basis as a financial director. She was regularly requested by the owner to sign documents supporting transactions that were not legitimate, and she could not decline such requests by alluding to moral principles. As the participant explained:

*By accepting this payment scheme I showed a significant lack of seriousness and consequently I lost any right to refer to moral values in all other aspects of my work. As soon as I agreed to be under-declared, I fell into the palm of his hand. I mean, I could not say that something was against the law because I was against the law myself. [...] I simply could not influence that my signature says the truth. Yet, when the inspection comes, I will be held accountable, not my boss.*

*(Sara, 62)*

This interesting case shows that manipulation can go beyond standard ways of conduct. For instance, the respondent had actually never faced any verbal threat from her employer nor had there been any problem with payment. The employer had been fulfilling his part of the verbal agreement all the time, thus seemingly showing his determination to respect his employees. Yet, in this case there was an indirect effect given that the decision of the worker to accept under-declaration brought her into a highly unfavourable position. Knowing this, one can understand why Sara was determined to change her job as soon as possible, which she eventually managed to do.

In any case, the stories presented in this section show that quasi-formal employment indeed provides many options for misbehaviour by employers, as suggested by previous studies (Hazans, 2005; Round et al., 2008; Williams, 2013a; Woolfson, 2007). However, it seems that instances of direct manipulation are not as common as many scholars assumed, since workers also have cards to play.

### ***7.1.2 Problems with payment***

As mentioned, only few interviewees complained about the failure of employers to pay envelope wages and/or social security contributions, while all others never actually had to fight for their money. What is more, there appeared to be no link between the entrance strategy of a worker and the compliance of their employers with the financial part of the agreement. For instance, although one would expect individuals who were deceived into entering the realm and those who unconditionally accepted all the terms imposed by employers (i.e. reluctant voluntarists) to face problems with payment more frequently, this was not the case. Essentially, given the importance of take-home pay for the willingness of a worker to collaborate, most employers tried to avoid non-payment or delays in payment. This was not only because short-changed workers might do some sort of harm for the company in revenge (by applying some of the methods described earlier), but also because problems with payment seem to inevitably lead to a worker quitting their job.

Findings from the fieldwork indicate there are two not mutually exclusive situations in which an employer might decide not to pay the promised amounts. The first of them is directly linked to the exact function of the cash-in-hand payment, as workers receiving variable take-home pay appear to be the most susceptible to this type of misbehaviour by employers. This is understandable given that variable wages make it hard for the employer to predict labour costs on a monthly basis, which can result in a shortage of cash at the moment of payment.

Yet, there is another, seemingly more important reason for a failure to pay the promised amount, whose origins can be found in the greed of the employer. Namely, some business owners in Croatia commonly use the revenues of the company to finance their private lifestyle, which can lead to a poor financial situation for the firm and consequently to lack of cash for envelope wages.

In this section we explain in detail the circumstances in which problems with payment usually occurred. First we discuss the rationales behind a decision by employers to avoid or postpone payment of social security contributions and the strategies to do so. After that, detailed stories of the individuals who faced problems with payment of envelope wages are revealed.

### ***7.1.2.1 Non-payment and delays in payment of social security contributions***

There is one interesting behavioural pattern by employers failing to meet the financial part of the agreement. Specifically, for every single case encountered during the fieldwork in which problems with payment occurred, the employer actually first started delaying payments of social security contributions. That is to say, they first opted to deprive the state, rather than their workers. Delays in payment of envelope wages followed only if this 'saving strategy' was not enough.

It should be stressed that as of 1 May 2012 it has not been possible for employers in Croatia to pay the wages of their employees without simultaneous payment of social security contributions, since banks are obliged to stop the transaction and inform the authorities if this happens (Official Gazette, 2012). This change was part of a broader package of policy measures focused on restricting the possibilities for the exploitation of workers. However, it seems that employers in Croatia found a way to circumvent that piece of regulation, at least to the extent that enabled them to postpone payment of social security contributions. Namely, some research participants complained that their wage transaction was not being recorded properly at the bank, as their employers were manipulating the reference number system in bank transactions.

In short, the employer simply went to the bank and stated that the particular transaction was a mere payment of one private person to another. Such a transaction would be recorded under some other reference number, not under the number 67 which is required for wage payments. In that way the employer would (temporarily) fool both the worker and the state. The worker would usually be unaware in the beginning of what really happened since the amount corresponding to their declared wage will be in their bank account. On the other hand, it is hard for the authorities to detect the problem as there is nothing inherently suspicious in a payment of one private person to another. In order for the fraud to be detected, the surveillance body first needs to find out that a person is still officially working for that particular employer, even though not being formally paid. As long as neither the authorities nor the worker realise what is going on, employers can keep practising this fraud.

Such an experience befell cook Kristina, whose boss had never failed to give the promised take-home pay, but apparently from the very first day had decided not to pay social security contributions for his workers. The interviewee gave her account of the situation:

*He always pays my wages, but for instance these contributions - I found out after one year that he was not paying them at all. I went to check to Regos<sup>117</sup> and they gave me the listing - nothing. There were just some HRK 200. Then I asked them what to do and they told me that this is actually not my problem - I mean, they said that I will get this money anyway. The question is just who is going to pay it - I guess the state will charge him somehow.*

*(Kristina, 23)*

Following this, the interviewee expressed no concern about the issue. She maintained that there was no reason for stress as long as she was receiving her take-home pay. A similar attitude was expressed by waiter Tomislav, who explained:

*There were situations when he had not been paying social security contributions for several months. In that period, he was paying me through private payments, not as a standard wage. In other words, it was not recorded as a wage in the bank, but as if a private person paid something to me. It was not stated on my bank account listing that it was the wage for a certain month. [...] He would simply suspend payment of social security contributions several months. Only after the Tax Administration got him, he paid everything for all the employees.*

*(Tomislav, 31)*

Still, the interviewee showed very little concern about that problem. Even though he believed that not all social security contributions were paid for him at the time of the interview, he did not plan to do anything about this. As a matter of fact, despite his employment having ended in a not particularly friendly way, Tomislav had a positive opinion about his position at that time<sup>118</sup>. Apart from the fact that his wage was much above the average in this vocation according to his belief, the participant also pointed

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<sup>117</sup> REGOS stands for 'Središnji registar osiguranika' (Eng. The Central Registry of Insured Persons). It is the central institution for technical support regarding the second pillar of pension insurance. The Croatian pension insurance system is composed of three pillars, with participation in the first two being compulsory for every new entrant to the labour market. The first pillar is the so-called 'inter-generational solidarity pillar' and contribution to it accounts for 15% of the gross wage. The second pillar is personalised funded system and even though the contribution to it is obligatory (accounting for 5% of gross wages), each individual worker is free to choose the pension fund into which to put their money. The third pillar is completely voluntarily funded system and every single payment into it is additionally subsidised by the state.

<sup>118</sup> As already mentioned, the respondent had quit his job some five months prior to the interview for reasons that had nothing to do with the arrangement. In short, he had decided to leave the job after a fight with a member of the owner's family.

out some other aspects of the employment which were apparently more important to him than whether contributions for him were paid or not:

*You will not believe, but in those seven and a half years he [the employer] even had never asked me to empty the ashtray. In this regard, he was a great boss. He had never even entered the tap-room. We [workers] were our own bosses in our shifts. He would just come to take the revenues and bring you the money. Basically, he was a boss most people can only wish to have.*

*(Tomislav, 31)*

This standpoint, which was shared by many other participants, brings us to the issue of perceptions regarding long-term benefits from employment. In this particular case, the interviewee placed more emphasis on the employer-employee relationship than on the mere fact of whether his contributions were paid or not. As Tomislav stated, contributions are nothing more than an intangible financial asset, whose eventual impact on his wellbeing was not so certain. For that reason, he did not bother complaining to his boss about this issue.

However, when asked what would have happened if the employer had done the same with the envelope wage payments as he had been doing with social security contributions, the respondent replied: "Well, I would have stood up for myself in such a situation". This viewpoint is understandable having in mind that most Croatian workers principally care about their take-home pay, while all other parts of the remuneration are perceived as something 'stolen' from them. What is exactly meant by the phrase 'stand up for myself' in the Croatian context will become evident in the following section, which describes three cases in which employers started delaying payment of envelope wages.

### ***7.1.2.2 Delays in payment of envelope wages***

Failure to remunerate a worker at the agreed time entails more baneful consequences for the employers than any other type of misbehaviour. This is because such wrongdoing has an irreparably deleterious impact on the trust between the two and inevitably results in the termination of employment. According to the findings from the fieldwork, this unavoidable outcome could happen for two reasons. The first scenario assumes an under-declared employee refusing to work all until the debt is paid and then eventually quitting the job upon realising that things will not improve. On the other hand, there is also a more indirect scenario where problems with

payment first worsen the relationship between the two, which then in turn leads to conflicts that are not necessarily linked with the original problem.

To illustrate the circumstances in which delays in payment or non-payment of envelope wages can occur, a detailed account of the only three research participants experiencing such problems will be given. The first case to examine is that of 29-year-old Robert, who had worked for a year and a half on an under-declared basis in a company selling special cleaning products. His decision to leave the company, in which he was working as a commercial traveller, some two months prior to the interview, was the outcome of a series of conflicts that were triggered by problems with payment of envelope wages.

Explicitly, the respondent had agreed with the employer to be officially declared on a minimum wage level, but receive 10% commission of his monthly net sales in cash. That is to say, Robert worked under a variable take-home pay arrangement, with envelope wages being dependent on his own performance. He admitted to have found the agreement motivating and consequently he had been doing his best to sell as much as possible. Although the job involved travelling all around the country, it was not a problem for the interviewee. His job entailed frequent absences from home for several days, but Robert found this highly beneficial as in this way he could compensate for overtime work with free days when needed. Namely, he had many gigs with his music band, and thus a flexible working schedule was the preferred option for him. Alongside this, Robert was confident in his skills and thus he was sure he would be able to earn a lot.

As the interviewee reasoned, he was doing much better than expected, which actually made his boss think the agreement was too generous. Since problems with payment of the commission started in the very beginning, this eventually forced the worker to offer a revision of the initial agreement. This resulted in a shift from variable envelope wages to fixed cash-in-hand payments. From the perspective of Robert, this change had an adverse effect for both stakeholders. He compared the situation before and after the modification of the verbal agreement:

*The boss probably underestimated the amount of money I could earn this way. I mean, he realised that he had to give me quite a lot. Still, if he had left my share on 10% of the sales, I would have had more stimulation. I would have been motivated to sell more and to work more. Of course, he would also have earned more - and this is a closed circle. [ ... ] However, then we agreed that he will give me a fixed amount in cash every month, simply to avoid me chasing him and him chasing me. And in this way I was again officially declared on a minimum, and he again continued with his practice of not paying my envelope wages. I mean, he was paying it every now and then, but I was continuously earning more in every single month than what he gave me in that particular month.*

*(Robert, 29)*

Although the employer later also started delaying the payment of the official wage, Robert decided to keep working as this job was just an additional source of income for him<sup>119</sup>. Yet, he changed his mind after one event:

*And then suddenly I realised he [the owner] had bought a BMW 5. What is more, he had not showed me that car, nor has he ever officially said that he had bought it. I simply saw him by chance one day while driving the car. The other day I asked my colleague if he had admitted buying the car and she said he had not. The office is here nearby, but he parks the car a bit farther. He comes to the office on foot, as he simply does not want to leave it in front of the office.*

*(Robert, 29)*

Their relationship became conflictual following this discovery, and everything culminated one day with a verbal dispute that was not directly linked to the problems with payment. More precisely, the dispute started after the two could not agree on who would follow up one customer. Robert continued:

*After the conflict I said to my colleague that I was going to quit the job because I could not stand his behaviour anymore. I said I was going to go home immediately. I went out and in that moment it came to my mind to call and check whether he was paying my social security contributions. And guess what, nothing was paid since August<sup>120</sup>.*

*(Robert, 29)*

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<sup>119</sup> According to the respondent, more than a half of his yearly income had been coming from the gigs he had had with his band.

<sup>120</sup> The interviewed worker quit his job in April, which means that the employer failed to pay his contributions for the last seven months.

This was too much for Robert as he then came back to the office and informed the boss that he was quitting immediately. Although the employer promised to pay the rest of the debts, he still owed Robert some HRK 15,000 at the time of the interview. Nonetheless, there is yet another aspect of this story which is worth mentioning. Unlike many other research participants who identified trust between the stakeholders as the main precondition for this scheme to function, Robert actually recognised trust as the main reason for his employer to delay payments. As he maintained, the employer had been continuously looking at the existing debt through the lens of their friendship, thus putting professional standards aside:

*Our relationship was perhaps a bit too friendly. He took me to some parties – Oh, how many times the two of us got drunk - I guess the boundary was moved upwards a bit too much. I mean, we were more like friends, as there was no real professional relationship.*

*(Robert, 29)*

A similar experience befell horticulturist Teo, who also identified greed as the main reason for his boss to under-declare workers, as well as to breach verbal agreements. Yet, unlike Robert who terminated his employment unconditionally, Teo applied a different strategy. He first temporarily suspended his service until the employer paid the debt, but that suspension was later converted into a permanent state of affairs given that the employer failed to fulfil the obligation. Teo described the situation in the company and his strategies to deal with successive problems regarding the payment of envelope wages:

*Well, he was extracting too much money for himself from the company. The guy started building a new house. Then he bought new cars for himself and his wife, and that is it. [ ... ] He always eventually paid our envelope wages, but in instalments. One month we got a thousand, then a thousand one week after, two thousand in one more month and so. We got money in the end, but we had to fight for it. However, a year and a half ago he dismissed us all<sup>121</sup>, but did not pay all the amount he owed us. He said he was going to pay it as soon as possible and I did not complain because I believed he would really do that. The following spring he called me to come back to work, but I said I was not going to return until he pays all the debt. And I indeed have not gone back.*

*(Teo, 28)*

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<sup>121</sup> This was a result of financial problems the company was facing at that time.



However, the debt had not been paid by the time of the interview, although one year had passed since then. Basically, both Teo and Robert explained that their employers were actually using the revenues from their firms to increase their personal wellbeing at the cost of their employees. This attitude of business owners indeed seems not to be so rare in Croatia. Many other interviewed individuals brought up that their employers saw the bank account of the company as if it was their personal bank account. According to economist Sara, some people in Croatia “open the company solely to extract money from it”. In her opinion, such greedy people resort to under-declaration of workers because “they believe this is how the things should be done”. In other words, since those individuals solely sought to increase personal profit, they saw under-declared employment as a perfect strategy to accomplish this aim.

A similar opinion was shared by salesman Tiho, who had faced problems with the payment of both declared wages and envelope wages. Once again, the delays in payment negatively affected the relationship between the two, and everything culminated in a fight that was not linked with this issue at all. However, Tiho’s case is also quite interesting from one other aspect. Namely, his employer had already been severely penalised for tax evasion, but this had not stopped him in endeavours to outwit the state. As the participant explained, his ex-boss simply kept establishing new companies and always maintained the identical tax evasion strategies. Tiho gave his explanation for this behaviour:

*It is simply such a mind-set, which sees nothing wrong in that or feels bad when doing that. He thinks he is smarter and more resourceful than others and in his opinion things should be done exactly this way.*

*(Tiho, 38)*

Yet it is worth recalling once again that the majority of participants had no problems with payment. Although many were certain that the employer was the only one benefiting from this practice, most interviewed workers did not see significant differences between their jobs and completely regular ones in terms of job security and professional standards. For the majority of under-declared workers, this type of employment was simply a strategy of employers to evade taxes and social security contributions, not a scheme developed for the exploitation of workers. Still, as the above examples showed, misbehaviour can indeed occur in certain circumstances.

## 7.2 General social conditions in the workplace

The role of inter-employee cooperation and solidarity in the process of under-declaration has already been mentioned in several places in the thesis. For instance, one might recall the story of sales representative Lea whose employer openly promoted teamwork, or that of financial intermediary Tihana who was supported and encouraged by her superiors. As both respondents confirmed, a praiseworthy social 'climate' in the workplace was one of the most important factors in their being happy with under-declaration. Although they were not pleased with some other aspects of their jobs, the two were ready to keep working under such an arrangement largely because of the positive atmosphere in their companies.

On the other hand, we also described the case of dental technician Marijana, whose employer explicitly prohibited the employees to talk to each other about the financial aspects of their jobs. As the participant elaborated, this particular detail from her work contract had had a really harmful influence on the social situation inside the company since every single word in conversation between colleagues had to be thought about twice before being uttered. This completely eliminated any sort of spontaneity in social interactions in the workplace, which was especially problematic from Marijana's viewpoint.

Some employers went even further in their endeavours to destroy social relations inside the company. This brings us back to the case of economist Sara, who complained that every corner of their company was under video surveillance. As she explained, this atmosphere of continuous control had a disastrous effect on social interactions because "everyone was really cautious what they were going to talk about". In such circumstances, discussion about envelope wages was not an option as everybody was afraid of being punished by the owners. Since it was not possible for the employees to develop trust among themselves given the state of affairs, stress and anxiety were a common occurrence. This matter was yet another reason for Sara to be unhappy with her position, which eventually resulted in her quitting the job.

Generally speaking, the atmosphere in the workplace was a good predictor of attitudes towards their own position. Research participants that were happy with their relationship with other co-workers were at the same time more likely to express a greater level of contentment with their employment in general. Indeed, since under-

declared employment principally relies on mutual trust and cooperation, it is understandable why this matter appears to be so vital.

Nevertheless, it is important to realise that the link between the atmosphere in the workplace and one's attitude is not as direct as one would assume. As obvious from the stories of Lea, Tihana, Marijana and Sara, the way employers were treating their staff undoubtedly exerted an influence on both social relations inside the company and the perceptions of workers. Employers therefore seemed to be the central players in the process, substantially directing social conditions in the company while at the same time controlling other aspects of the employment that were crucial for the attitude of the workers<sup>122</sup>. Using statistical terminology, one can say that both satisfaction with the social situation and overall attitudes towards under-declared employment were endogenous variables, i.e. they were simultaneously influenced by professional standards.

Nevertheless, social relations in the workplace seemed to be only partially influenced by professional standards. As the findings from the fieldwork suggest, there were numerous external factors that exerted an effect on the general atmosphere among workers. This is understandable given that human relationships are to a great extent defined by the personal characteristics of the stakeholders. Indeed, in some examples encountered during the fieldwork there was a great mismatch between professional standards and social standards, which made it quite hard for a worker to formulate their attitude. To illustrate this, we can go back to the story of Irena, a former administrative worker in one notary public office. As already explained, this interviewee had been regularly receiving the 13<sup>th</sup> wage, Christmas and Easter bonuses, as well as lunch allowances, alongside quite generous take-home pay of HRK 7,000<sup>123</sup>. What is more, she had actually started working on a student contract and then shifted to quasi-formal employment, which reflected high mutual trust between her and the employer.

Still, the problem in her case lies in the fact that the owner put one of the employees in charge of internal affairs. Since she was absent from the workplace most of the time, the employer let her most trusted worker deal with all administrative and

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<sup>122</sup> It is worth remembering that Sara was deceived into entering the under-declared realm, while Tihana and Lea had shifted from student contracts to permanent employment. Moreover, while Sara and Marijana had a fixed wage, Tihana and Lea were receiving variable cash payments.

<sup>123</sup> The participant recognised this as a high take-home pay given her age at that time and qualifications. In her opinion, she was earning substantially more than her friends and peers.

professional matters. However, instead of promoting collaboration and teamwork, the office manager (which was the official title of the owner's trustee) was basically constantly causing all kinds of disputes among co-workers.

As Irena elaborated, the office manager, who was in fact also one of the under-declared workers, was openly favouring some colleagues. These were mainly individuals prone to gossiping, ready to report every single mistake of their peers and in turn enjoying the protection of the manager. This resulted in the formation of two 'clans' (as Irena labelled them) inside the office: the privileged individuals and all the others. The situation culminated when one employee decided to quit, since he could not stand the constant conflicts. According to Irena, this was an excuse for office manager to get rid of those who did not share her opinion. Accordingly, five people were fired, with the interviewee being one of them. Although disappointed to lose her job, Irena admitted actually feeling huge relief after this. She gave her account of the situation in the office:

*I was not allowed to sit and spend four hours at lunch [exaggerating], as was the case with the manager's clan. I had to eat while working. Yet, they would say you are lazy anyway. This is how things were going on in our office. Complete disaster - maltreatment. [ ... ] You work like a dog for eight hours, and then one moment you raise your head and realise they are still sitting and talking about shoes. After four hours! Yet, when they talk to the owner, they would say they were working really hard.*

*(Irena, 26)*

A similar explanation of the state of affairs was given by Mia, Irena's ex-colleague who was also fired the very same day. Although extremely satisfied with the financial aspects of the employment and professional standards in the company, Mia found it hard to cope with the social relations in the office:

*There were different clans in the office. That is to say, there were people who were 'licking the feet' of the office manager and the rest of us who did not want to do that because - simply for the reason that we did not want to do such things. We wanted to come to work and simply conduct our tasks. We did not prefer sitting and talking about shoes and some other stupidities.*

*(Mia, 31)*

Yet, both respondents had decided to tolerate this as long as possible, due to the quite high take-home pay and all the other financial benefits they had from that employment. And they managed to do so for some five years, until they were fired in spring 2014 for the reasons described above.

In any case, having known the situation in this particular company, one can understand why envelope wages were not a taboo theme among workers. As a matter of fact, envelopes were given out publicly: every first day in a month the office manager selected one of the employees to distribute them. Although the issue of the exact amounts in the envelopes was not something workers talked to each other about, this did not prevent people from drawing parallels between the earnings of the office manager's favourites and those of the individuals from the opposite clan. As explained by Mia:

*We always assessed one's income upon the thickness of the envelope. If it was your turn to bring the envelopes, you would simply feel each of them with your hand to guesstimate how much the person gets.*

*(Mia, 31)*

It should be said that the office of these two interviewees was not an exception in this regard. In fact, most other research participants confirmed that this subject was a type of a 'public secret': everybody knew what was going on, but nobody asked questions about it, nor were there discussions among the employees on the matter. This can be exemplified by the story of now retired director Petar, who was earlier labelled as a pure voluntarist. According to the interviewee, the main reason for this practice functioning in his company during all those years was the high mutual trust between the owner and the employees, as well as among employees themselves. Yet, even though everybody was aware of the agreement<sup>124</sup>, all stakeholders were determined to keep it quiet. Petar explained it simply:

*Those were things we did not discuss among ourselves. It existed, we all knew about the arrangement, but nobody ever talked about that. It simply was not a topic for conversation.*

*(Petar, 67)*

As the interviewee implied, this was because all the people in the company were highly aware that things were not as they should be. Accordingly, the employees supported

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<sup>124</sup> As discussed above, envelope wage payments in this case were introduced following a meeting and open discussion by the owner with all employees.

the practice and voluntarily agreed to participate, had no moral problems with doing it, but still preferred not to raise this topic.

Although similar thoughts were shared by most other respondents, there were some interviewed individuals who had quite a different experience. One such case was that of Marina, a 50-year-old manager in a distributor of office and bank equipment. Marina, who had been working in the company since the mid-1990s, was not under-declared at the moment of the interview. However, she was an active participant in a well-established system of solidarity among employees, which was developed so as to extract enough cash for those workers who were still under-declared.

In order to understand the circumstances in which this scheme was working, it is important first to familiarise the reader with all the changes that happened in the company from the very beginning. The story dates back to 1998 when all the workers were offered by the owner the option to shift from completely formal to quasi-formal employment. According to the interviewee, this had been a completely normal way of running a business at the time, and thus she had not seen anything problematic in it. As a matter of fact, since this change had no impact on their take-home pay, all 20 workers accepted the offer. According to Marina:

*People were not forced to do that, but they all tacitly accepted the offer.  
The only important thing for us was to get the take-home pay.*

*(Marina, 50)*

It should be stated that the company was owned by a Croatian citizen at that time. The same practice continued after the company had been sold to another Croatian investor. However, when it was bought by a foreign company in the mid-2000s, the new owner abolished this practice. As the interviewee explained, under-declaration of workers was not in line with the business and moral standards of the foreign owner, as thus they wanted everything to be completely legitimate. In consequence, Marina and other 19 employees shifted back to completely formal employment, but their take-home pay did not change at all.

However, the company soon faced serious financial problems following the onset of the economic crisis, which forced the owner to consider under-declaration as a

survival option<sup>125</sup>. Eventually, the decision was made to under-declare only workers in the production section, while Marina and others in management remained completely declared. Nonetheless, all employees were actively involved in the scheme, regardless of their payment status. For instance, workers in other sections of the company (i.e. those that were not directly involved in production) who had a private car and whose business trips could be justified based on their job description, regularly brought receipts for gasoline and tolls (obtained during private journeys of themselves or other members of their family) to the finance section. Then the finance section would just fictitiously reimburse them, as they did not actually retain the money. Instead, the cash was later given in an envelope to the workers in production.

Following this, one can realise that the whole system of under-declaration in this particular company heavily relied on solidarity among employees. Still, it should be repeated once again that such stories are probably not so common in Croatia, given that many other research participants maintained that under-declaration was a matter of agreement strictly and solely between an employer and a worker.

After enumerating these stories from the everyday experience of quasi-formal workers in Croatia, we turn to discussion about three important aspects of under-declared employment that every worker has to constantly bear in mind: the issues of deterrence, various moral and social implications of quasi-formal employment and the financial consequences of under-declaration (both short- and long-term).

### **7.3 The role of deterrence**

On the whole, the qualitative insights into the prospects of repressive endeavours to combat under-declared employment confirmed our earlier findings from the quantitative analyses. Namely, the interviewed individuals widely saw deterrence as a quite negligible aspect of this practice from their perspective. This was actually the topic in which the research participants reached the greatest level of agreement.

Explicitly, no respondent could recall any occurrence of the authorities discovering the fraud. Nonetheless, differences did exist among the participants regarding their explanation for such a state of affairs. Many interviewed individuals were for instance sure this was due to the very nature of the arrangement. They believed that the

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<sup>125</sup> This is in line with the theory by Williams and Padmore (2013a), who argue that in some circumstances quasi-formal employment can be used as a pure survival strategy.

inspectors had no means of tracing the transaction since there was no written document evidencing payment of the envelope wage. While they knew that the authorities could expose other illegitimate transactions by the company (i.e. those that were essential for the creation of cash for envelope wages), such individuals were certain there was no way to prove that the money was later transferred to the workers. As one of the interviewees argued, this could be done only if one of the stakeholders disclosed the agreement:

*I think it cannot be detected. I have personally never heard that someone was caught in under-declared employment. The only way this would be possible is if I had the audio or video record of meeting with my boss, which I then could bring to the Labour Inspectorate and report everything.*

*(Tomislav, 31)*

Indeed, many other interviewees also maintained that the only irrefutable strategy to prove this practice was to have the record of the exact moment when the employer (or other responsible person in the company) gave cash to the worker. Once the transaction was accomplished, most respondents believed the money could not be traced anymore. Such a reasoning provided an interesting starting point for interviews with representatives of the regulatory apparatus in Croatia, which were conducted in the last stage of the study. In line with this, this particular characteristic of quasi-formal employment will be comprehensively discussed in the next chapter.

However, alongside the very nature of the payment, some under-declared workers perceived deterrence to be a negligible factor in Croatia for another important reason. Many interviewed individuals actually admitted their employer had friends and acquaintances among responsible individuals in the Labour Inspectorate and the Tax Administration, who either prevented inspectors from scrutinising the business transactions of the company or at least let the owner know when the company was to be audited. What is more, several interviewees stated that their employers were even proud of that and commonly used this fact not only to make their employees feel comfortable, but also to show them that it would be futile for workers to report any sort of problem to the authorities. As one of them clarified:



*She [the employer] always knew when they might come. Somebody always informed her. Probably the Minister of Justice called her and said: "The inspectors are coming" [ironically and not seriously]. Let us say she had some sort of power to know things in advance. And honestly, I was never, but really never scared of such things because I knew she would always sort things out. Besides, she had been constantly reiterating that she is capable of doing that.*

*(Irena, 26)*

Yet, even the interviewees whose employers did not have any sort of shelter were actually not afraid of being detected in this practice. Namely, many believed that their employers were engaged in some other illegitimate activities, which could easily be noticed during an audit, and therefore the issue of envelope wages would not even be in focus for the authorities. One of the people with such reasoning explained his viewpoint:

*Besides, I think that if the inspectors came, the last thing on their mind would be to scrutinise this. There are so many other things in that company<sup>126</sup>, so this is basically - Why would I be afraid of such stupidities.*

*(Rafael, 28)*

What is more, some participants even believed that the authorities played a significant role in dispersing and so increasing the practice. From their viewpoint, the inspectors in Croatia put most emphasis on social protection and the labour rights of workers and therefore it was mainly undeclared work that was in their focus. As under-declared workers had at least some sort of protection, the authorities were believed to tacitly tolerate this practice. This can be illustrated by the experience of headwaiter Dado:

*They [the inspectors] know what is going on. They just check whether people have a contract and that is it. I had one experience in my previous workplace where a girl told her full income by mistake. Nothing happened in the end: the inspector started writing things in his notebook and then she interrupted him: "Well, no, no, you know - I made a mistake". He replied: "Yes, I know, you confused the amounts". And then he wrote down: "She changed her mind. The first amount was incorrect. Probably this was her wage from the previous workplace".*

*(Dado, 40)*

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<sup>126</sup> The respondent was referring to other illegitimate activities by the employer.

Indeed, several other interviewees confirmed from their own experience that nobody had ever tried to dig very deeply into their work contract and other irregularities that might point at the persistence of envelope wages. In general, the inspectors would just check if the worker had a valid contract and whether all the obligations of the employer towards the worker and the state were (seemingly) fulfilled. Many employers presumably found such a permissive attitude of the authorities towards under-declared employment as a sufficient rationale to act as they acted. This was another issue to which special attention was paid during the interviews with representatives of regulatory apparatus and therefore it will be further elaborated in Chapter 8.

A few of the interviewed individuals did actually believe that the inspectors could detect the fraud if they really wanted to. These were mainly workers whose employers did little or nothing to make things 'look normal'. One of them was Toni, a former director of logistics whose case was never detected by inspectors even though his declared wage had been variable. As he confirmed, the company had several audits during his employment, but none of them found any irregularities. According to Toni's opinion, such extreme cases of under-declared employment remained undetected in practice because:

*... the majority of inspectors do not even have the required level of knowledge to realise something like that, while the rest find it easier to take bribes and not bother with reading documents at all.*

*(Toni, 51)*

Indeed, some interviewed workers went even further pointing to corruption as the central force behind unregistered economic activities in Croatia, as well as behind all types of criminal behaviour. The general view on the matter can be best summarised by the following statement:

*Let us be honest, this is Croatia. Am I wrong? This is how the inspectors operate in this country, and the police and all other institutions operate in the same way. Everything is corrupt.*

*(Robert, 29)*

Knowing this, it will be easy for the reader to understand the opinions of interviewed individuals regarding any expected sanctions. Yet, it is first important to examine the legislative framework on the subject of economic activities that remain hidden from the authorities. Namely, the Prohibition and Prevention of Unregistered Activities Act, which came into force in 2011, prescribes fines between HRK 10,000 and HRK 30,000

for every person carrying out any sort of unregistered activities (Official Gazette, 2011). To make it more illustrative, it is better to say that every individual in Croatia that works on an undeclared basis is risking a financial fine ranging between some two and six times the average net wage<sup>127</sup>.

Yet, not only were the majority of respondents not familiar with these quite harsh penalties, but also many of them were not even aware that they could be prosecuted. In most cases the interviewees did not think they would be held responsible at all, which again can provide an important clarification for the pervasiveness of practices of under-declaring in Croatia. In short, the findings from the fieldwork show that under-declared workers in Croatia were substantially unaware of the potential legal consequences, which significantly skewed their assessment of the cost-benefit ratio.

In general, the question about potential sanctions if prosecuted was the one that ignited the greatest spectre of reactions from the participants. For instance, some of them were completely surprised by the question as they had never thought about this matter. When asked about potential sanctions, such people commonly first started hesitating, which was followed by a short period of thinking about this sudden possibility that they had previously neglected. In the most extreme cases, the interviewees could not come up with any logical conclusion and then started asking the researcher about what the legislation in Croatia says on the matter. In one such occasion the participant replied:

*Well - I am not familiar with that subject. I really do not know whether I would be prosecuted because of that. He [the employer] would be prosecuted for sure, but I think I - Can I be held responsible for that? I cannot, am I right? Or can I?*

*(Martina, 23)*

This is just one typical form of reasoning that was commonly heard from individuals whose final answer to the question was 'Do not know'. The other large group encountered during the fieldwork in this respect were indifferent individuals, i.e. those who found this question not worrying at all as they believed they personally were not doing anything wrong. According to them, since the whole arrangement was

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<sup>127</sup> However, after the interviews with representatives of the regulatory apparatus it remained unclear whether this Act really applies to under-declared employment. As they reasoned, this type of employment is approached strictly from the perspective of evaded taxes and social security contributions, and therefore in practice has different treatment than other means of undeclared work. More about this quite complicated and vague issue is given in Chapter 8.

initiated by the employer, there was no logic in the authorities punishing the worker. One of them explained her logic quite simply:

*The boss defined all the terms of my employment and therefore I think he is to be held responsible.*

*(Kristina, 23)*

Of course, individuals from this group completely neglected the fact that they gave their consent to the arrangement and accordingly they were direct accomplices in this illegitimate practice. Yet, a particularly interesting subgroup of those who believed only the employer would be punished were the individuals perceiving prosecution of a worker as a complete absurdity. Their reasoning was commonly accompanied by a high level of anger:

*Let me see the one who would try to fine me. Come on - We live in such a country - You are going to fine me because I was compelled to - Come on - It is out of the question.*

*(Irena, 26)*

Individuals with such an attitude considered themselves victims and therefore thought the state should protect them, not punish them. Still, it should be pointed out that what distinguished these two groups of individuals (i.e. those who did not know anything about the danger of being prosecuted and those who thought they would not be held responsible at all) from the rest of the participants was first their age. It was mainly young people who most commonly were neither aware of their role in the arrangement nor knew what the legislation said about the matter.

Indeed, more experienced workers generally recognised their role in the arrangement and accepted their responsibility. Yet, even though they saw the possibility of being penalised as a real threat in normal circumstances, such individuals still did not believe this would happen in Croatia. As one of them reasoned:

*I can always defend myself by saying that I had no choice, that I would otherwise be penniless, etc.*

*(Marta, 34)*

The term 'defend oneself', which was frequently heard during the fieldwork, is used in Croatia to point to the weaknesses of the system. In the case of the judiciary, it refers to numerous possibilities to avoid an unwanted verdict by finding loopholes in

the legislation. Indeed, some respondents were quite creative in their explanation about how they would escape penalties, suggesting that they were quite aware how the judiciary in Croatia worked.

There was also a group of workers who expected to be penalised financially in the case of detection, but did not consider themselves responsible for paying that fine. While being aware of the legislation, such individuals also perceived themselves as victims and thought that the employer should pay the fine for them:

*Why should I as a worker pay the fine because my employer decided to give me one part of the wage in cash? [ ... ] If that happens, then she [the employer] should pay the fine for me.*

*(Mia, 31)*

On the other hand, some more experienced individuals, while aware of their responsibility and the possibility of being prosecuted for working under-declared, maintained they would stand up for themselves from the very beginning. They were ready to confront the inspectors and defend their decision straightforwardly. As one of them explained:

*They would probably fine me too. But I do not have other options. I would ask the inspectors: "Are you going to pay my bills at the end of the month. I have no problem with that, you just pay them and I will not accept such arrangements". I mean, if there is no labour market, if there are no other jobs I can find, then what are we talking about? I have to accept this because I have to feed my family somehow.*

*(Tiho, 38)*

Finally, there was also a minority who knew they would be fined if detected and were ready to take the consequences of their decision. Yet, as already explained, under-declared workers in Croatia did not expect to be detected in the first place and therefore potential sanctions were not an important feature of their decision-making process. A further elaboration on this matter given in Chapter 8, which contains the most important findings from the interviews with representatives of the regulatory apparatus and social partners, will confirm that this reasoning of Croatian workers is indeed correct.

## 7.4 Personal and social norms

The research findings presented so far in this thesis have indicated that cultural factors are far more important for the development and sustaining of this practice than suggested by previous research on the phenomenon<sup>128</sup>. Although the importance of norms, beliefs and values in the process has already been addressed in several places throughout the thesis, it is worth examining this matter separately so as to further deepen our understanding of this complex practice.

Generally speaking, the qualitative research confirmed the results from the quantitative analysis regarding the effect of tax morale. In-depth insights into the multifaceted nature of quasi-formal employment revealed that tax morale was indeed one of the two central factors (alongside the size of take-home pay) jointly determining attitudes and overall satisfaction of under-declared workers with their position. To illustrate the intricate interweaving of tax morale and take-home pay, we can examine once again the stories of economist Sara, architect Ana and dentist Helena, who all expressed a very strong distaste for and unwillingness to engage in noncompliant behaviour.

Alongside satisfactory take-home pay and some other financial benefits (one should recall for instance that the dentist was entitled to Christmas and Easter bonuses), none of the three had ever witnessed any problems with payment nor had been openly mistreated by the employer. Yet, as all three participants explained, the fact that they were personally engaged in something illegitimate made them really anxious and therefore all positive aspects of their employment were irrelevant. Due to their extremely high tax morale, all three respondents had decided at the very beginning to seize the very first opportunity to switch to completely regular employment.

Yet, these three respondents were not the only ones sharing such an attitude, as a few other individuals had similar reasoning. One of them was dental assistant Martina, who was highly aware that nobody actually benefitted from this practice in the long run:

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<sup>128</sup> As a matter of fact, the role of workers' tax morale in this respect was evaluated only in studies by Sedlenieks (2003), and by Williams and Horodnic (2015).

*This is really awful. If I could, I would have reported everything to the authorities. Yes, I would report everything because I think it is harmful for society, for myself, for the state, for everyone.*

*(Martina, 23)*

The phrase 'If I could' in the above statement refers to the fact that the interviewee was actually trapped inside this practice, just like many other reluctant voluntarists. Still, it should be admitted that Martina's standpoints were somewhat foreseeable given the way she had been treated by her employer (see section 7.1.1). Certainly a more unbiased insight into the role of tax morale was given by sales manager Karlo, who was highly satisfied with all but one aspect of his employment. Karlo was working for a close friend of his, which he referred to as being an important peculiarity given that the fear of facing problems with payments and other types of misbehaviour by the employer was almost negligible in these circumstances. In addition to a decent overall take-home pay, a further positive thing emphasised by Karlo was that the envelope wage was always given a few days before the declared wage, which was quite motivating for all employees. What is more, he had only positive things to say about all six colleagues, whom he described as "outstanding staff".

Yet, the interviewee admitted that all these positive sides of his employment were shadowed by the recognition that he was involved in an illicit activity. For that reason, Karlo expressed a desire to find a completely legal job one day. As he explained:

*I mean, I am aware that this is not right at all. But then again, I do not have any other choice at the moment. If I could find a better job, I would quit this one. If you understand what I am trying to say. [ ... ] The situation is such as it is at the moment.*

*(Karlo, 38)*

Following these viewpoints, one can understand why all the interviewees with high tax morale were either reluctant voluntarists or had been deceived into entering the realm. Since moral issues heavily dominated in the assessment of their employment, those individuals were all determined to exit this realm.

This cognition actually explains why quasi-formal workers with high tax morale seemed to be a rarity in Croatia. Namely, the above were the only workers interviewed who expressed regret at doing this, while all others found their behaviour highly reasonable and justifiable. Actually, for many of them low tax morale was the principal

reason to enter this realm in the first place. As expected, most of the interviewed individuals for whom there was a clear link between tax morale and satisfaction were found among monetary rationalists and pure voluntarists. Those individuals maintained that their behaviour was not only acceptable, but also desirable.

They were essentially emotional agents who believed that the psychological contract between the state and citizens had been breached and therefore there was no point in paying taxes<sup>129</sup>. This can be exemplified by the viewpoint of economist Katarina, who did not see anything wrong in her behaviour. As she explained:

*The state is taking too much from me without clear reason. Really too much. Therefore, there is no solidarity towards the state. [...] This cannot be just one-way solidarity - I mean, that we are giving to the state, while in the same time not being supported by the state when we need something. [...] I do not see any solidarity here. I can just see that our contribution to the state budget goes on salaries of numerous public officials that were employed by their relatives.*

*(Katarina, 41)*

Yet, it must be admitted that the link between tax morale and the willingness to participate in this realm was more complicated than one would anticipate. In general, it was not always the case that individuals with low tax morale were necessarily happy with their position. Even though the interviewees with low tax morale emphasised the fact that they were cheating the inefficient and corrupt state as a positive aspect of their behaviour, their general opinion about their own position was also substantially affected by many other elements, the most important of them being the size of their take-home pay.

To illustrate this, we go back to the story of teacher Linda, who was highly dissatisfied with almost all aspects of her employment, but expressed absolute tolerance towards noncompliance. First of all, Linda admitted accepting her current job out of desperation, which placed her in the group of reluctant voluntarists. Alongside unpredictable work schedules and substantial overtime work (which was unpaid) she was also particularly dissatisfied with the size of her take-home pay. In addition, the take-home pay was highly variable due to the endeavours of the employer to address the lack of revenue during the summer break. Logically, these matters dominated

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<sup>129</sup> This is in line with the study by Sedlenieks (2003), which also identified the lack of trust in state institutions as an important rationale for many workers to under-report their wages.



Linda's reasoning. Nevertheless, when asked to scrutinise her employment through the lens of moral cost, the interviewee replied:

*I have no moral problems with this. Only if anyone was paying their taxes would I agree to pay my own taxes.*

*(Linda, 29)*

Her explanation points to the importance of conditional cooperation in the process. Since the respondent believed that tax evasion was highly prevalent in all aspects of society, she did not see her evasion as problematic. Although unhappy with her position, the interviewee stated that she would be ready to keep working in this particular job if other aspects of the employment improved. In any case, Linda found justification for her behaviour in that of others, which certainly confirmed the proposition that social norms are also highly important for the development of this practice. Quite similar reasoning was given by horticulturist Teo, who could also be classified as a reluctant voluntarist. According to Teo:

*If someone is allowed to steal billions just like that, then my evasion of HRK 500 annually is a completely negligible moral problem. This is how things are going on in our country. When it comes to the employer, if he was normal he would not offer such things [under-declaration] to workers at all.*

*(Teo, 28)*

The last sentence of Teo's brings in yet another interesting and quite prevalent viewpoint among under-declared workers in Croatia. As already revealed during the discussion about deterrence, many under-declared workers thought their employer was the only one who was responsible for under-declaration. In line with this, some research participants argued they personally did not have any legal or moral concerns. Such reasoning was best summarised in the statement of sales representative Lea:

*I am aware of the moral issue, but I do not care. This is because I feel that I am not doing it personally. [...] It is a psychological thing. I think that one half of the people in my company are not aware of that. I mean, we are not aware that we are indirectly cheating the state. [...] If I had my own company, I would not do that. Yet, I do not have it and thus I do not care what my employer is doing - and some 75% of Croatians think the same.*

*(Lea, 25)*

Finally, the most extreme group of interviewed individuals in this respect were those who had never even considered the moral aspects of under-declared employment. For such people, moral costs were a completely irrelevant issue, as money was the only thing that mattered from their perspective. In other words, a certain segment of under-declared workers in Croatia seems to perceive take-home pay as the ultimate goal of employment and in line with this they praise every form of behaviour that brings more money. As explained by manual worker Luka, a reluctant voluntarist who was highly dissatisfied with his job:

*Well, it is how it is. As long as you can earn some money - everyone is welcome to fight for themselves the best they can.*

*(Luka, 26)*

This brings us once again to the monetary aspect of under-declared employment and its complex interrelation with tax morale. On the whole, the overall impression gained during the fieldwork was that high tax morale automatically entailed dissatisfaction with the worker's own position, regardless of take-home pay and all other aspects of their employment. However, the opposite did not hold true given that low tax morale solely paved the way for other factors to determine one's level of satisfaction. And this is where the importance of size of take-home pay came to light, as it seemed to be a highly dominant element in such circumstances.

In any case, enumeration of the findings from the qualitative research so far has been focused mainly on the current state of affairs regarding the importance of money in the process. In the next section we extend this by examining the role of expected future benefits from employment and some other monetary problems inherent in quasi-formal employment.

## **7.5 Take-home pay versus short- and long-term financial consequences of under-declaration**

The importance of overall take-home pay in the perceptions of every single worker additionally came to the fore during the part of the interview dedicated to the drawbacks of under-declared employment related to future financial inflows. In general, most workers in Croatia seem to prefer having more money now and are therefore willing to sacrifice future income in order to increase their current earnings. Yet, while such an attitude is somewhat understandable given human nature

(since people always tend to put more emphasis on the present state of affairs than on a distant and uncertain future), in the case of quasi-formal workers in Croatia there are some other reasons for this. As each interviewed worker was confronted with the plausible financial consequences of under-declaration, some interesting new perspectives on the matter were discovered. In this section we discuss three central issues in this regard, namely lower benefits in the case of unemployment, constrained access to loans and credits and lower income from the pension system.

Starting with benefits in the case of unemployment, these were a completely irrelevant aspect for most of the interviewees. In fact, this was also one of the few topics in which a wide consensus among interviewed workers was reached. The participants generally maintained that unemployment benefits in Croatia are definitely insufficient and therefore one should not even count on them. In their opinion, the problem is not only in the size and duration of benefits, but also in all the conditions that have to be met in order to be eligible.

Indeed, the legislation for instance prescribes that a person has to be in active employment for a minimum of nine months during the last two years to qualify for the benefits (Official Gazette, 2013). There is also a range of other requirements to be met: the request for the benefits must be submitted not later than 30 days after finishing employment, a person has to prove that he or she is actively seeking for a job, and must accept education or training offered by the Croatian Employment Service, etc. Knowing this, one can understand why only 16.8% of the unemployed in Croatia receive unemployment benefits (Croatian Employment Service, 2015).

On the other hand, the duration of state support is determined by total work experience and therefore ranges from 90 days (for individuals having between nine months and two years of experience) up to 450 days (for those with more than 25 years of experience). Moreover, the benefit amounts to 90% of the average of take-home pay (based on the last three months prior to dismissal) solely for the first 90 days of the period, while after that it comes to only 35% of take-home pay. In line with this, the interviewed under-declared workers generally agreed that unemployment benefits are completely irrelevant to their decision-making process. Even if a person qualifies, the amount of money the under-declared worker will get is only slightly smaller than if they were completely declared prior to losing the job.

Surprisingly, access to loans and credits was also much less important for the interviewed workers than one would expect. Even though several interviewees indeed complained about this issue, the majority did not see it as a significant obstacle. The latter can be roughly divided into two groups: those who relied on family members in this respect and those who had a strategy to outsmart the system in collaboration with their employers. The reasoning of the first group was best summarised by sales manager Karlo:

*All people in my company have some sort of alternative for this. Basically, everybody has someone in their family who is eligible for long-term loans and mortgages. You see, my wife for instance works in the public sector: if she takes a loan, then I can help her return it with my own income. But, I personally would not be able to get a loan based on my declared wage.*

*(Karlo, 38)*

Yet, not all people have somebody on whom they can rely. Indeed, many interviewed individuals admitted they had a problem with non-eligibility for loans at some point of their career. Eventually, most of them came up with an interesting solution, which seems to be quite prevalent among quasi-formal workers in Croatia and their employers. Namely, since banks in Croatia usually assess eligibility for loans based on the last three net wages, workers would simply ask their employer for a temporary increase in the declared part of the wage, up to the required threshold. As many of the participants confirmed, employers generally accept that appeal provided that the declared wage is returned to the initial level upon getting the loan.

This is done simply by diverting one part of the cash from an envelope to the bank account. However, although several participants stated that their company defrayed the financial cost of such a change (i.e. increased taxes and social security payments), in most cases it was the employee who had to deal with the additional expenditure. One participant summarised the state of affairs quite concisely, based on the experience of his ex-colleague:

*When my ex-colleague for instance wanted to take a loan, he managed to agree with the boss on the matter. The employer increased his declared wage so he would be entitled for the long-term loan, but the colleague had to give back that difference. I mean, he had to refund the cost of that increase. Since contributions were higher after the rise of the declared wage, the worker had to recompense that difference to the employer.*

*(Tomislav, 31)*

In any case, such temporary increases in the declared wage inevitably send a message to the authorities that some sort of illegitimate activity is in place. However, when asked about this potential threat, most participants once again pointed at the problems with the inspection service and judiciary in general, as discussed above, as the main reason why employers were not afraid of doing this.

Certainly the most tangible long-term drawback of under-declared employment from the perspective of workers is a lower pension. This is not surprising given that in its ideal form the pension system ensures a firm correlation between the future pension of an individual and their contribution to the fund during their career. In other words, an efficient pension system assures its contributors that an increase in payments towards the pension fund today will result in a proportionate increase in income from the system after retirement.

Here we need to recall that the quantitative findings on the data from all EU countries, which were given in Chapter 4, indicated that the quality of the pension system does not have any effect on the propensity of workers to participate in under-declaration of their wages<sup>130</sup>. Indeed, the qualitative inquiry suggests that this probably holds true in Croatia, as the expected return from the pension system seems to be quite low on the priority list of quasi-formal workers in the country. Generally speaking, most surveyed individuals were certain that their income from the pension system will be somewhat lower due to under-declaration, but not many cared about this. Each individual had their own explanation for neglecting this factor.

For instance, the youngest age cohorts mostly shared the opinion of commercial traveller Marija, who explained: “Who knows what will happen by the time I am retired”. Since she had just entered the labour market after finishing her university education, this participant admitted that at the moment she was not particularly worried about some distant financial consequences of her behaviour. She was concerned primarily with her current wellbeing and therefore needed more money at the present time. As Marija argued, there will be enough time in future for her to earn a decent pension.

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<sup>130</sup> The role of pension in the process was also evaluated by Round et al. (2008), as well as by Sedlenieks (2003). For a detailed discussion on this issue, see section 2.2.

Some other participants from the youngest age cohort did not agree with Marija, but went even further in their thinking. Their standpoints can be best reflected by the statement of horticulturist Teo:

*To be honest, given that the retirement age will probably be increased to some 80 years by the time I am to be retired [ironically], I simply do not care about the pension.*

*(Teo, 28)*

Even though this sentence was said in rather a sarcastic way (i.e. the respondent amplified the retirement age on purpose so as to emphasise his disapproval of the current trends in this respect), it does point to one salient issue that will probably become even more important in the near future. And this applies not only to Croatia, but also to other member states. Namely, due to the ageing of the population, governments in many European countries are actively seeking efficient solutions to keep the ratio of workers to pensioners at an acceptable level. As in other member states, the authorities in Croatia are thus also considering increases in the age limit to receive a full statutory pension as the most viable strategy to accomplish this aim.

The current plan is to gradually increase the age limit in Croatia from the current 65 to 67 years of age by 2034. Even though this reform is widely supported by the academic community and politicians in general, it has been strongly criticised by trade unions. Judging from the perception of many participants in this study, this intention of the government has had quite an adverse effect on their willingness to contribute to the system. This is somewhat understandable given that the increase in the age limit extends the period during which a person has to contribute to the system, while at the same time decreasing the time period during which they will benefit from the same system. Accordingly, the idea of personal wealth transfer has become less attractive for many workers in Croatia.

Some older participants, on the other hand, were primarily worried about the poor link between what they are expected to pay now into the pension fund and the amount they will get when they retire. As many argued, under-declaration of their income will result in a negligible decrease in their pension, given that the system is far from being efficient. The most pessimistic participants went even further, stating that current payments into the pension fund are nothing more than money thrown in a garbage bin. As one of them explained:

*I have never found it important whether my pension will be HRK 2,000 or HRK 2,100 in thirty or forty years. In general, there is prevalent opinion nowadays that you - I mean, when you look at old people that are begging all around because they do not have enough money to survive - there is an increasing awareness that you need to take care about your pension on your own. Following this, I only care about current net earnings, and I do not think how my present-day decisions will be reflected in my pension in some 30 years.*

*(Katarina, 41)*

One can therefore see that our findings are in line with those from the study conducted in Latvia (see Sedlenieks, 2003), which also identified distrust in the long-term viability of the pension system as one of the key motivations for people to under-report their wages. Nonetheless, it should be reiterated that a certain proportion of the interviewed individuals were, in fact, concerned about the effect of under-declaration on their future pension. However, none of them really considered this as a vital factor since the principal emphasis was always placed on take-home pay, as well as on professional standards and the social climate inside the company.

## **7.6 Summary of the findings from interviews with quasi-formal workers**

This first part of the qualitative insight into the nature and causes of quasi-formal employment demonstrated that what has been known so far about this illicit practice is just one piece of a perplexing puzzle. Although interviews with under-declared workers confirmed that the lack of formal employment opportunities and risk of poverty really are important drivers of this practice from the perspective of workers (as argued by many scholars<sup>131</sup>), it is certain that the roots of the phenomenon go beyond the dualist perception.

First of all, findings presented in this part of the thesis clearly showed that under-declared workers are far from being a homogeneous group. In fact, every interviewed worker appeared to be unique in their perception, attitudes and the importance they placed on each of the numerous factors shaping their behaviour. In any case, people placed more emphasis on the psychological contract between them and the state, as well as on the social contract they had with other members of society than on classical

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<sup>131</sup> See for instance Hazans (2005), Round et al. (2008), Williams (2009), and Woolfson (2007).

cost-benefit analysis<sup>132</sup>. Since the decision-making process of many under-declared workers was strongly imbued by subjectivity, they can be better described as emotional rather than rational agents.

Based on the dominant factor leading to entry into quasi-formal employment, we roughly classified quasi-formal workers into four groups: reluctant voluntarists, monetary rationalists, pure voluntarists and those who were deceived into entering the realm. Reluctant voluntarists were predominantly driven by the lack of employment and fear of poverty, and therefore their entrance into this realm can be described as a decision out of desperation. Monetary rationalists, on the other hand, saw take-home pay as the ultimate goal of employment and accordingly they were always ready to accept receiving more money regardless of all short- and long-term consequences.

Pure voluntarists, who were more frequently encountered during the fieldwork than expected, expressed unconditional readiness to participate in the quasi-formal realm. They perceived under-declared employment as something completely normal, necessary and desirable. Finally, some workers were pulled into under-declared employment against their will, as their employers chose to withhold this information in order to trap the candidate they wanted.

On the whole, this in-depth qualitative insight into the multifaceted nature of quasi-formal employment from the perspective of workers has illuminated tax morale and the size of take-home pay as the two central factors determining attitudes and overall satisfaction of under-declared workers with their own position. High tax morale seemed to automatically entail dissatisfaction of a worker with their own position, regardless of take-home pay and all other aspects of their employment. However, the opposite did not hold true given that low tax morale only paved the way for other factors to determine one's level of satisfaction. And this is where the importance of size of take-home pay came to light, as it seemed to be highly dominant element in such circumstances.

Being aware of the importance of take-home pay, some employers offered their workers variable envelope wages, where the size of cash payments depended on worker's performance. This was done by promising a worker they would receive in cash

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<sup>132</sup> This is in line with the main conclusions of the qualitative research conducted in Riga (see Sedlenieks, 2003).



a certain percentage of the company's revenue resulting directly from their personal performance or by payments according to the exact number of working hours.

Variable take-home pay was considered by employers solely in situations where the income of a company was highly correlated with the efforts of its workers. However, not every such worker would be offered variable envelope wages, even if this vital precondition was met. This is because there are two additional elements to consider, namely the ease of substitution and the ease of adaptation for each worker. If neither of the two is relevant for an employer, they would commonly opt for fixed take-home pay and strive to find alternative solutions in situations where additional effort by a worker is needed (with unpaid overtime work being the most common such option). In line with this, one should not be surprised that employers typically preferred fixed take-home pay, given that it keeps labour costs constant and facilitates business planning.

Although under-declaration was most commonly (but not always) agreed on at the initiative of employers, the general perception of the interviewed workers was that this was done principally to decrease labour costs, not in order to oppress nor exploit workers. Yet, despite being united in identifying evasion of taxes and social security contributions as the chief function of quasi-formal employment from the perspective of the business owners, the interviewed workers did not agree on the underlying motivation behind this. While some believed this practice was the only way the company could survive on the market, others maintained that greed is what was driving their employers.

Instances of employers using the agreed cash payments to mistreat and blackmail their quasi-formal workers were rarely encountered during the fieldwork. The majority of respondents confirmed that their bosses had never tried to manipulate them or other employees by making informal payments conditional upon certain things being done. Employers rather chose to play a fair game, since they were aware that workers could always find their way to harm the company if their elementary rights were violated. This outcome therefore challenges the prevalent notion in literature, as employers were so far believed to perceive this type of employment first and foremost as an efficient strategy for exploitation of their workforce (see for instance Round et al., 2008; Williams, 2013b; Woolfson, 2007).

Nevertheless, this does not mean that misbehaviour by employers in Croatia does not occur. A particularly problematic issue in this regard seems to be the failure to

remunerate a worker at the agreed time, as such wrongdoing commonly leads to the termination of employment. Knowing this, one should not be surprised that in every single case encountered during the fieldwork in which problems with payment occurred, the employer actually first opted to deprive the state of its dues (by postponing payments of social security contributions), rather than their workers. Only if this saving strategy was not enough did delays in payment of envelope wages follow.

This brings us to the role of mutual trust between employers and their workers, which appears to be a very important facet for the development and sustaining of this practice. This is not surprising having in mind that the scheme depends on the verbal contract between the two stakeholders. In addition, many interviewed workers also said that the social situation in the company was the vital precondition for them to be happy (or not) with their position.

When it comes to deterrence, it seems to be a quite negligible factor in the decision-making process of workers. While some interviewed individuals believed the authorities would not be able to prove the existence of this practice unless one of the stakeholders disclosed it, others referred to bribery and string-pulling as the main reasons for the limited role of deterrence in this respect. Some participants went even further, stating that the authorities are also highly responsible for the development of this practice. Since under-declared workers have at least some level of social protection, labour inspectors in Croatia were believed to tacitly tolerate this illegitimate arrangement. Whatever the case, it suffices to say that no respondent could recall any occurrence of the authorities discovering the fraud.

In general, most interviewed workers principally cared about their take-home pay, while the slice that goes to the state was typically perceived as something 'stolen' from them. This viewpoint resulted not only from prevalent corruption in the public sector, but also from the widespread recognition that the state does not give enough to taxpayers in return for their taxes. As a matter of fact, some people found cheating the inefficient and unfair state to be a sufficient rationale to engage in this practice. Having seen this, one can understand why the workers whose employers postponed payment of social security contributions were not particularly worried about that, as long as they received their take-home pay.

Generally speaking, quasi-formal employment in Croatia was found to be a type of a 'public secret'. As many interviewed workers confirmed, people in their companies

usually knew what was going on, but nobody asked questions about it nor were there discussions among employees on the matter. The overall impression was that quasi-formal employment is not only an economic issue in Croatia, but also a social one. Actually, many respondents did not see this type of employment as some minor and temporary disturbance of the labour market, but rather as something that is standard or would become standard in the near future.

Nevertheless, it must be reiterated once again that the state of affairs discussed here is not necessarily applicable to other economies around Europe. Given the great economic and cultural diversity among countries, it cannot be claimed that identical patterns would be encountered elsewhere. For that reason, the sole purpose of the qualitative inquiry in Croatia was to broaden our understanding of this illegitimate type of employment, as well as to point to some peculiarities of its own which have not been considered so far in the literature.

A similar note of caution applies to the discussion presented in the next chapter, which refers to the findings from interviews with representatives of social partners and regulatory apparatus in Croatia. The primary role of the second part of the qualitative inquiry was additionally to elucidate vital aspects of this practice in Croatia, as well as to see how different stakeholders in the process perceive this problem from their own perspective. This in turn helped in detecting which steps should be taken for a more successful fight against the phenomenon in the country. In line with this, most of the findings from interviews with representatives of relevant institutions should be perceived as a pure specificity of Croatia.

However, the last part of the study did illuminate a few aspects of quasi-formal employment that are universal for all countries and societies, and which have not been investigated so far. This primarily applies to the issues with detection and prosecution of this practice, as will be discussed in the following chapter.



## 8 TACKLING QUASI-FORMAL EMPLOYMENT: EVALUATING STAKEHOLDER OPINIONS

The last step in this extensive insight into under-declared employment is to see how the representatives of pertinent institutions in Croatia perceive this problem. This relates not only to awareness of these institutions about the prevalence and characteristics of the practice, but also to their standpoints regarding the most effective strategies to tackle it. In line with this, special attention during the interviews was paid to the social dialogue and its importance for combating this practice.

Since the goal of this part of the study was to reflect on the most important findings from all previous stages of the research, while at the same time allowing the participants to provide some new thoughts and evidence on the phenomenon, the interviews with representatives of institutions in Croatia were unstructured. Instead, for each of them an interview schedule with broader thematic areas to be covered was developed (see Appendix 5).

As mentioned in the methodology section, this part of the study encompassed three representatives of each group of stakeholders. Starting with the state authorities, the sample included representatives of the Ministry of Labour and Pension System, Tax Administration and the Labour Inspectorate. The Ministry of Labour and Pension System has the lead role in creating policy measures to tackle unregistered economic activities in Croatia, while the two remaining institutions are in charge of the detection and prosecution of undeclared and under-declared employment.

The standpoints of trade unions were given by the representatives of the Independent Trade Unions of Croatia and the Union of Autonomous Trade Unions of Croatia. Both institutions operate as trade union associations at the highest (national) level and as such actively participate in the Economic and Social Council, which is the central body for the tripartite social dialogue in Croatia. The employers' side was represented by the Croatian Employers' Association and the Croatian Chamber of Economy. The first is the only institution representing employers in the Economic and Social Council, while the importance of the latter is reflected through the compulsory membership of all economic entities in Croatia in this organisation.

Finally, in order to obtain a richer insight into this problem area the sample also included the representatives of both employers and workers from the construction

industry, which was earlier identified as one of the sectors with the highest incidence of quasi-formal jobs in Croatia. Explicitly, the last two interviewees were individuals from the Trade Union of Construction Industry of Croatia and the CEA - Construction Employers' Association.

This chapter is organised as follows: first we give a short overview of the available data on the matter and terminology used, followed by the views of the interviewed individuals on the nature, causes and prevalence of quasi-formal employment in Croatia. The central part of the chapter is dedicated to the most effective strategies to tackle this phenomenon in Croatia from the perspective of the interviewed stakeholders. The chapter ends with a short discussion on the quality of the social dialogue in Croatia and its importance for the successful fight against quasi-formal employment.

Before moving to the presentation of findings, it should be stressed that all interviewed individuals were highly positioned in their institutions, but their standpoints on this particular phenomenon do not necessarily reflect those of the institutions they represented. As a matter of fact, most of the statements given by the interviewees were actually a result of a subjective reasoning based on a limited and partial insight into the issue, as will become evident in the next section.

## **8.1 Awareness about the question, terminology and available data on under-declared employment in Croatia**

The central thing to underline is that none of the institutions whose representatives were interviewed had official data on the prevalence and nature of quasi-formal employment in Croatia. While maintaining that their organisations perceived this type of work as being as harmful to the economy and society as completely undeclared work, the interviewees admitted that the latter was much better documented and understood. It is therefore not surprising that most of them agreed that there is a necessity to invest more effort in exploring this complex phenomenon in Croatia. As summarised by the representative of the Independent Trade Unions of Croatia:

*This segment of the labour market is certainly not negligible, but it seems to me that it is still 'under the radar'. I believe that not enough attention has been paid to this problem as it is only sporadically a topic of public discourses. Actually, I am not sure if there is any research on this matter. Nevertheless, it is very hard to get an insight into such things as they are 'hidden' by definition. [...] All in all, there are many reasons why this issue is still outside the focus. Yet, this is exactly why we should pay more attention to this area.*

*(Representative of the Independent  
Trade Unions of Croatia)*

This reasoning was largely shared by most other participants. Knowing this, one can understand why the interviewed individuals were quite happy to hear that someone decided to explore this type of employment in Croatia. The same argument probably explains their readiness to participate in the research and share their views, as well as the fact that many expressed the desire to see the final version of the thesis.

In any case, the lack of attention paid to quasi-formal employment in Croatia was further reflected by the absence of an official term to delineate this practice. The scarce literature in the Croatian language dedicated to this problem area (and these are predominantly official documents issued by the government itself and various government bodies) always descriptively referred to the phenomenon. When asked about this peculiarity, the representative of the Ministry of Labour and Pension System provided the following clarification:

*There is no official term used to denote this practice in Croatia and therefore we reside on a descriptive approach. The official documents published in English by the EU bodies always use short and concise names to label various issues. In this particular case, they use the term 'envelope wages'. However, in Croatia we do not follow such a practice. I believe this is due to the nature of our language on the one hand, as well as owing to our custom to rely on a descriptive strategy on the other. Basically, the only difference is that we usually use more words to outline something, but it comes to the same in the end.*

*(Representative of the Ministry of Labour  
and Pension System)*

Some other institutions, however, use their internal terminology for this type of employment. For instance, the Trade Union of Construction Industry of Croatia used the terms 'rad u sjeni' (Eng. 'work in shadow') and 'ekonomija u sjeni' (Eng. 'economy

in shadow'), which according to the belief of their representative best describes the semi-legal nature of quasi-formal employment. The representative of the Croatian Chamber of Economy, on the other hand, demarcated this practice as 'problem dvostrukog plaćanja' (Eng. 'the problem of a double payment'), which quite simply highlights the central difference between quasi-formal and completely formal jobs. Yet, other interviewees could not come up with Croatian equivalents of the English labels for this practice. Actually, some went even further by stating that it should not be scrutinised separately from other unregistered activities as all types of tax evasion must have equal treatment by the authorities and society.

In any case, the absence of an official terminology did not create problems in communication as all interviewees clearly understood the exact topic of the conversation. In this regard, interviews with stakeholders once again confirmed that under-declared employment was a well-known occurrence in Croatia and therefore people were commonly familiar with its basic mechanisms.

In line with the explained lack of studies and official data on quasi-formal employment in Croatia, the views of the interviewed individuals presented in this chapter were therefore mainly based on secondary insights into this problem. For the representatives of trade unions and the Ministry of Labour and Pension System, the only source of information were interactions with under-declared workers who requested advice and help on this issue. Employers, on the other hand, mostly grounded their attitudes on interactions with companies complaining about the existence of this practice among their competitors. Finally, although they had certain experience from the field, the representatives of the Tax Administration and the Labour Inspectorate did not have a particularly deep insight into under-declaration of wages in Croatia in comparison to the other two groups. The explanation for this will be given in section 8.3, which discusses the problems with detection of quasi-formal practices.

In general, the representatives of employers had the least to say about the matter given that neither employers nor workers commonly informed them about individual cases of under-declaration. All three interviewed individuals from the employers' side explained that employers indeed requested them to do something in this regard, but those were always general appeals (i.e. without mentioning the exact names of the companies engaged in this type of tax evasion). A more detailed elaboration on this peculiarity is given later in this chapter.



Reflecting such a limited insight into the practice, the interviewed representatives of social partners were only able to express their personal beliefs and standpoints about the nature and causes of this practice in Croatia, based on interactions with workers and companies. The following section gives a summary of their reasoning on demographic, social and economic specificities of under-declared employment, as well as on the most important motives for workers and employers in Croatia to engage in this practice. Their views are then contrasted in section 8.3 with the experiences of the Tax Administration and Labour Inspectorate on the matter.

## **8.2 Nature, causes and prevalence of under-declared employment in Croatia from the perspective of the social partners**

Bearing in mind the lack of official data, one can anticipate that the views of the interviewed individuals on the mechanisms behind quasi-formal employment in Croatia only partially matched the findings presented in the previous parts of the thesis. As will be demonstrated, the arguments of the stakeholders were mainly centred on the lack of formal employment opportunities, the tax burden, deficiencies in the pension system and the weak regulatory state apparatus.

### ***8.2.1 Demographic, social and economic specificities of under-declared employment in Croatia according to the stakeholders interviewed***

Given that it was low-skilled workers who predominantly complained about and reported under-declaration, most interviewees believed that this practice was at most a minor issue for highly educated individuals. Although assuming that a certain number of high income earners probably also received a part of their wages in cash, nobody was ready to guesstimate the incidence of this practice among such individuals. The explanation provided by the representative of the Trade Union of Construction Industry of Croatia best illuminates the prevalent view on the structure of under-declared workforce in Croatia:

*Well, the workers that complain about this problem are most commonly low-skilled workers. Individuals without any formal education usually get only a minimum or a bit above minimum and therefore they do not negotiate about additional cash payments. Therefore, qualified low-skilled workers are the group of workers that most often find themselves in such problems when working in small companies, given that employers see the opportunity to save some money on social security contributions in such*

*cases. [...] Probably there are some engineers working in small companies that also receive one part of their wages in cash. However, they do not usually report such things to us and therefore I could only talk hypothetically about this issue. [...] We had had some such cases, but that happens perhaps once a year.*

*(Representative of the Trade Union of  
Construction Industry of Croatia)*

Since similar reasoning on this matter was heard from other interviewed individuals, the issue will not be discussed any further. The situation, however, did not differ significantly when it came to other socio-economic characteristics of the under-declared workforce. This was actually the part of the interview where respondents had least to say as most admitted that there was a significant lack of information in this respect and therefore did not want to speculate.

In line with this, one should not be surprised that most interviewees believed that this practice is inherent mainly in labour intensive sectors, as well as in the service sector where there is a large circulation of cash. Yet, it was seen in the previous chapters that not only was under-declaration of wages in Croatia not a specificity of certain sectors, but also that this practice was far from being just a rare occurrence among university degree holders and high income earners. This mismatch between the perceptions of the interviewed representatives and the situation revealed by our study therefore clearly indicates that this problem is not sufficiently understood.

Regarding the size of the companies that most commonly engage in such practices, the interviewees agreed that it was mostly micro and small firms that under-declare wages<sup>133</sup>. The representatives of the authorities explained this by the fact that smaller companies found it much easier to extract cash from the system, which could be later transferred to a small number of workers. While agreeing with this, trade unions also argued that a part of the explanation certainly lies in the fact that larger companies commonly had organised trade unions which prevented this type of exploitation. Employers agreed with both explanations, but also pointed out that larger companies were in most cases members of the Croatian Employers' Association which strongly opposed this practice.

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<sup>133</sup> This is in accordance with the findings from earlier stages of our study, as well as with previous research on this phenomenon (see Kedir et al., 2011; Meriküll & Staehr, 2010; Williams & Horodnic, 2015; Williams & Padmore, 2013a, 2013b).

In line with their limited knowledge about the phenomenon, the interviewees were not actually certain about any changes in the prevalence of this practice over the years. While most of them were sure that the extent of completely undeclared work had been diminishing recently, they could not state whether the same applied to this particular type of tax evasion. This is somewhat understandable given that numerous policy strategies have been applied to reduce the magnitude of undeclared work in Croatia, while on the other hand there has not been any measure introduced specifically to address quasi-formal employment.

The only person who was willing to discuss the dynamics of this practice was the representative of the Croatian Chamber of Economy. Yet, the reasoning of this interviewee was limited solely to a comparison of the current state of affairs with that during the 1990s, which was a turbulent period in Croatian history (as described in section 5.4). As the respondent explained:

*My impression is that nowadays this type of employment is much less widespread than before, simply because the control mechanisms are now much better than ten or twenty years ago, and especially in comparison to the early 1990s. Our economy in the 1990s, which can be described as the period of 'wild capitalism', was strongly influenced by the war. In the time of a war all types of deviations are commonly more present than in the time of peace and therefore I am convinced that the state apparatus works much better today than in those times. It is certain that the Tax Administration and the Labour Inspectorate nowadays operate more efficiently. You cannot remember that period as you were too young, but the 1990s were a period of a total mess. The rule of law is always quite weak during war and this is reflected in social relations in general. Basically, people have to find their own strategies to make money for living in such conditions. What is more, that was a period when private entrepreneurship was emerging. At that time people were not actually aware what capitalism really was.*

*(Representative of the Croatian  
Chamber of Economy)*

After this quite scarce insight into the general specificities of under-declared employment, we move on to explore the views of the interviewed representatives on the reasons for companies and workers to participate in this practice. As one can envisage, opinions about the causes differed. While all generally agreed that under-declaration in Croatia was most commonly offered by employers, each interviewed individual had their own explanation, which reflected the group of stakeholders they were representing.

### ***8.2.2 Reasons for employers to engage in practices of under-declaring from the perspective of social partners***

The question on the most prominent motives for employers to under-declare their workers was the area where subjectivity was most evident. Each of the three groups of stakeholders tried to minimise their responsibility for this, while at the same time pointing the finger at other actors in the process. For instance, employers were certain that this practice was primarily caused by the high tax burden, thus depicting under-declaration of wages in Croatia primarily as a survival strategy. Alongside this, employers also expressed a belief that workers were in most cases willing accomplices. The view of employers on the matter was best summarised by the representative of the CEA - Construction Employers' Association:

*Causes of this practice are quite straightforward. In my opinion, social security contributions rates are too high, and there are also too many other financial liabilities that companies have to pay. In addition, workers also play a significant role in the process as they simply do not think about their future pension. The only thing workers in Croatia care about is take-home pay, and most do not think what will happen once they are old. There is a prevalent opinion that many people will not even live long enough to get their pension, and if they do get it, it is not certain that it will be sufficient for living. In line with this, workers primarily care about take-home pay, while the arrangement under which the employer will pay it is less important. However, given the current situation in the labour market, it is true that some workers simply do not have other choices.*

*(Representative of the CEA -  
Construction Employers' Association)*

The last sentence in the above statement suggests that, although they shifted the responsibility to other stakeholders in the process, the employers did recognise that the state of affairs was not as simple as one might assume on a first glance. A similar pattern was recognisable in the answers of all other interviewees, as most of them were also ready to shift the blame to other stakeholders, but acknowledged that things were very complex and therefore generalisation was not advisable. The representative of the Trade Union of Construction Industry of Croatia for instance argued that the desire of employers to make extra profit and the inefficiency of the regulatory apparatus were the most important causes of this practice, although in some cases under-declaration could indeed be a survival approach of a company:

*The greed of employers is certainly an important aspect in this regard. I realised that whenever I talked to directors and owners of small firms. But this is not always the case, particularly in companies in which the owner is also an employee at the same time. They [the owners] would commonly conduct all tasks as other employees, which also includes overtime work and all other things. I think that in such cases employers do not exploit their workers. Yet, at the same time there are many entrepreneurs employing several half-slaves that are not paid a third of what they should be paid and therefore they [the workers] serve as a profit-making resource. As I said, the state of affairs is not so simple. One should not blame strictly the state nor strictly the employers as the roots are highly intertwined.*

*(Representative of the Trade Union of  
Construction Industry of Croatia)*

The remaining representatives of trade unions, as well as those representing the state authorities also emphasised the greed of employers as a potentially important driver of this practice. Employers, however, strongly opposed this assertion. While admitting that some employers might indeed be motivated by a desire to increase their profits, the interviewed representatives of employers maintained that such individuals were a minority. When asked about this issue, the interviewee from the Croatian Employers' Association replied:

*You cannot generalise things. We are aware that not all employers are praiseworthy. However, you cannot put all of them in the same basket. For instance, we have examples of companies whose management reduced their own wages to the minimum when the company faced financial problems. I have the feeling that nowadays there is a tendency to characterise all employers as being bad. Not only is this not true, but also it is not desirable. For some reason only bad examples are accented these days, while it should be the opposite.*

*(Representative of the Croatian  
Employers' Association)*

This research participant had the same viewpoint as the other two representatives of employers, thus pointing to the high tax burden as the main motivator for employers and depicting under-declared employment in Croatia as a survival strategy by companies. The representative of the Ministry of Labour and Pension System, on the other hand, strongly disagreed with the role of tax burden in the process. As a matter of fact, the Ministry seemed to look at this problem from a quite different perspective than employers:

*I do not think that the level of taxation in Croatia is a serious problem. One should check the data on other EU member states in this regard; nonetheless I think the tax burden in Croatia is neither the highest nor lowest, but rather somewhere in the middle. I believe that business competition might be a plausible cause of this practice from the perspective of employers. What is more, the desire to make some extra profit may also be a reasonable explanation in the case of employers. In line with this, I think that there are multiple causes of the practice from the employers' side.*

*(Representative of the Ministry of Labour  
and Pension System)*

The social partners indeed agreed that competition is an important cause of this practice, but they again pointed to the state as the main creator of the problems in this respect. According to both trade unions and employers, the state significantly contributes to the expansion of this practice through the system of public procurement. As they complained, public procurement heavily relies on the final price as the dominant criterion in the evaluation of tenders, which forces companies to reduce prices below the limits of profitability. In consequence, those firms that win the bid must find cost saving strategies and under-declaration of workers is certainly one such method according to the interviewed representatives of employers and trade unions. This problem was particularly emphasised by the interviewees from the construction sector, as this sector heavily relied on state investments. According to the representative of the Trade Union of Construction Industry of Croatia:

*The system of public procurement created a vicious circle of low prices as it heavily relies on the lowest price offered. Small companies, and particularly those that operate as subcontractors, are therefore compelled to pay their workers only the minimum wage officially while an additional sum is given in cash. In that way they manage to save some money due to evaded social security contributions. This can be even a significant saving in the case of a larger number of workers. Alongside this, employers also strive to find other strategies to save money, such as paying the field allowance instead of reimbursement of overtime work, etc. In any case, such companies evade significant amounts of taxes and social security contributions so as to remain competitive on the market. This is all caused by the system of public procurement, as it only cares about the lowest price, while completely neglecting the wider consequences. In this way the state actually fosters this practice.*

*(Representative of the Trade Union of  
Construction Industry of Croatia)*

Yet it seems there is an additional dimension to this problem, which was emphasised by the representative of employers in the same sector. As the participant elaborated, the state did not even control for obedience with the extended collective agreement, the document that all companies operating inside the construction sector must comply with<sup>134</sup>. According to the interviewee, the agreement provided a valuable tool for eliminating all the companies that disobey it from public procurement, but the authorities have failed to make use of it:

*They [the state institutions] tend to consider even those applications with unusually low prices. The Association argues that the state should control for compliance with the collective agreement. Therefore, solely those companies that operate in line with the agreement should be eligible for public procurement. In other words, only the companies that can prove they obey all parts of the collective agreement in the construction industry should be allowed to compete.*

*(Representative of the CEA -  
Construction Employers' Association)*

To sum up, there is a high level of disagreement regarding the main reasons for employers in Croatia using under-declared employment. As expected, each side tried to reduce their responsibility, while pointing to other stakeholders as the ones who should be blamed. In that way, each of them actually indirectly suggested that the same reasoning will be in place once the question of the responsibility to tackle this type of tax evasion is raised. And this is indeed what happened later during the conversation in every single case. However, before discussing their views about the most efficient strategies to tackle under-declared employment in Croatia, it is important to understand how workers were perceived in this respect.

### ***8.2.3 Views on the main reasons why workers engage in under-declared employment***

It must be admitted that a slightly greater level of agreement among the interviewed individuals was reached regarding the motives of workers to engage in this practice than was the case with business owners. In short, the representatives mostly agreed that consent to receive envelope wages from the workers' side was a combination of

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<sup>134</sup> The collective agreement was signed by the Trade Union of Construction Industry of Croatia and the CEA - Construction Employers' Association, but later was extended to the whole sector by the authorities.

necessity and the lack of awareness about the short- and long-term disadvantages of this practice.

As already mentioned, employers firmly believed that many Croatian workers were willing participants, freely accepting under-declaration for two dominant reasons. The first factor according to employers was the desire of workers to increase their take-home pay, while the second was the limited understanding of the consequences this arrangement had for their current and future wellbeing. Accordingly, employers generally agreed that efforts should be invested to address the second of the two mentioned factors, and consequently the fight against the phenomenon should be primarily focused on workers, not on employers.

The explanation provided by employers was to a certain degree in line with those of trade unions. Nevertheless, the latter argued that most workers accepted this arrangement because they are 'existentially threatened'. As reasoned by the representative of the Independent Trade Unions of Croatia:

*Most people struggle to earn enough to live on and therefore in such conditions most workers do not even think about the consequences of this practice. It is hard to expect that some of them [low-income earners] would think about their pension, which belongs to the distant future. People are forced to accept these arrangements out of desperation, simply because they need money now in order to survive. Whenever we talk to such individuals, we say: "Your pension will be much lower because of this. There are also short-term drawbacks such as problems with the bank overdrafts and all other benefits that are linked to the size of the declared wage". Nevertheless, we most commonly get the identical answer: "Yes, I know everything. I completely understand what you are trying to say. However, I have to survive now and therefore it is in my interest to have take-home pay as high as possible. It will make my life much easier given that my income is too low".*

*(Representative of the Independent Trade  
Unions of Croatia)*

From the above statement, one can see that trade unions did recognise the possibility that in some cases workers were willing participants in this practice, since this way they can earn more than if completely registered<sup>135</sup>. Besides this, the representatives

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<sup>135</sup> Identical reasoning was offered by the representative of the Union of Autonomous Trade Unions of Croatia, while the representative of the Trade Union of Construction Industry of Croatia strongly opposed the idea that workers would freely engage in such activities.



of trade unions also pointed to another potential factor that contributed to such a high rate of workers accepting this arrangement. According to them, the problem lies in the high incidence of contracts of limited duration, which were often abused by employers in this South-East European country.

As they argued, people working under such contracts were often forced to accept this and other adverse arrangements simply to avoid not having their work contract extended. The interviewed individuals went even further by drawing a line between high prevalence of contracts of limited duration and pervasive unemployment in Croatia on the one hand and under-declared employment on the other hand. According to their belief, the current state of affairs resulted in a gradual dispersion of quasi-formal employment even among individuals that had a regular contract. This is because the latter often had to accept such offers as they knew that there was a huge army of people ready to accept anything simply to have any source of income.

In other words, the representatives of trade unions emphasised the fear of losing their jobs as another important motive for workers to accept under-declaration. This reasoning is generally in line with the findings from earlier parts of the thesis, as fear was indeed identified as a vital factor for a significant part of the under-declared workforce.

The role of fear in the process can be further illuminated by drawing on the experiences of the interviewed representatives who had insight into complaints from workers regarding this practice. Namely, according to all six interviewed representatives of trade unions and the authorities, it was a general rule that workers reporting this practice made anonymous complaints whenever they were employed on a quasi-formal job at the moment, although after losing their job such workers were ready to act personally against their ex-employers. As all participants agreed, this was first and foremost due to the fear of losing their job as unconcealed complaints would inevitably result in the worker being dismissed.

Interestingly, none of the interviewed individuals from trade unions mentioned a lack of trust in institutions as a plausible cause of this practice on the part of workers, despite it being identified in earlier parts of the thesis as one of the most important triggers of this practice. Actually, only two interviewees raised this issue during the conversation. One of them was the representative of the Ministry of Labour and Pension System, who explained:

*I think people in Croatia generally do not have trust in the state institutions, or in the system of social security. This not only applies to the pension system, but also to other spheres, such as the healthcare system and the system of benefits in the case of unemployment. In short, people primarily care to get as much money as possible now, thus leaving their future quite uncertain. Such an attitude is additionally supported by the prevalent opinion that one's pension will not reflect the amount of paid contributions, which is actually not true.*

*(Representative of the Ministry of Labour  
and Pension System)*

Once again, the size of take-home pay was identified as a factor of vital importance for workers, which is indeed in line with the findings presented in earlier parts of the thesis. This shows that, if nothing else, the social partners at least have a broader understanding of the underlying mechanisms that support quasi-formal employment in Croatia.

Still, despite jointly covering all the crucial reasons for workers engaging in envelope wage practices, no person individually enumerated all of them. This is quite understandable given the lack of studies and official data on the matter. The representative of the Croatian Chamber of Economy, however, came closest to providing an accurate overview of the situation, which included economic, socio-cultural and historic aspects:

*I think there are several causes of this practice. The first of them is certainly the tax burden on waged employment, as in my opinion personal income tax rates are too high. [ ... ] Alongside this, I think that this practice also strongly resides on an implicit contract between an employer and his or her worker, in which both parties agree that it is always better for the worker to receive more money now, regardless of the strategy to accomplish this. In my opinion, this attitude is a consequence of cultural heritage, as people in this part of the world do not perceive such behaviour as something socially unacceptable. Most citizens do not see anything wrong in cheating the state. If someone is a free rider in the public transport or evades taxes, this is quite acceptable [for most Croatsians]. However, if I steal HRK 10 from you, that would be a huge problem. Therefore, we have a 'double morality', a kind of a cynicism, which is a direct consequence of the cultural heritage. In line with this, many believe it is a much smaller sin if an employer gives a part of wages in cash without paying taxes than if the wage is not paid at all. Workers would simply say: "It is ok, it is only important that I got my wage". [ ... ]*

*Finally, the third reason for this practice being so prevalent nowadays should be sought in the high level of tolerance on the part of the state towards this practice during the early phases of transition. This happened because various forms of undeclared work were perceived as efficient means to fight against unemployment, poverty and social exclusion.*

*(Representative of the Croatian  
Chamber of Economy)*

It should be mentioned at the end that, despite pointing to other stakeholders when explaining the causes of under-declared employment in Croatia, all the interviewed representatives agreed that this practice was vastly harmful to all parties in the process. As explained by the representative of the Croatian Employers' Association, nobody was actually benefiting from under-declaration in the long run:

*I think that neither employers nor workers can really be happy with these arrangements. Basically, you are always in a 'grey zone' and therefore nobody benefits from this in the end. The state certainly loses as taxes are not paid on envelope wages. On the other hand, employers engaged in this practice are disobeying the legislation and therefore the negative aspects of this practice will eventually neutralise the financial gain. Finally, workers will not benefit in the long run as their pension will be much lower than if everything was declared. Therefore, I think this is not a prosperous strategy for anybody.*

*(Representative of the Croatian  
Employers' Association)*

In line with this, the interviewed individuals argued that significant steps should be taken to combat this practice. However, there was a huge discrepancy in the standpoints regarding who is responsible for dealing with this issue and which strategies should be applied to reduce this type of employment in Croatia.

### **8.3 Overview of the standpoints about the most efficient strategies for tackling under-declared employment in Croatia**

Starting with employers, their views on what should be done to combat this type of employment were quite straightforward. In their opinion, reduction of taxes and other financial liabilities would be the crucial precondition for decreasing the prevalence of quasi-formal employment. This should be followed by a strategic approach towards improvement of the business environment. From the standpoints of employers, the

state should first create fair conditions on the market, and then all other problems should be put on the table. According to the representative of the Employers' Association, repression is not a smart way forward in the current climate as it actually has the opposite effect on the compliance:

*It is not possible to resolve this individual problem [under-declared employment] without broader institutional reforms. [...] First of all, it is crucial to create all the preconditions for fair business and work. Only when these aims are accomplished can one proceed with compelling every business subject to comply with all the laws. The authorities have been so far just imposing various restrictions and increasing our liabilities, and this was all done without any pre-evaluations. This is not how the things should work and this is why the system is such as it is at the moment. Therefore, I think that a systematic change of the whole business climate is required, rather than focusing on specific problems as this one is.*

*(Representative of the Croatian  
Employers' Association)*

Besides these measures, employers also advocated awareness-raising campaigns, primarily those targeting workers. In line with this, the interviewed representatives from the employers' side were certain that the state should be the leader in the fight against this phenomenon.

When asked about their potential role in tackling quasi-formal employment, the representatives of the supreme employers' organisations explained that their power was quite limited in this case. Actually, they illuminated an interesting aspect of this practice in Croatia, which was mentioned previously. Namely, all three representatives of the employers' side confirmed that their institutions regularly received complaints from members regarding this practice. However, such complaints always assumed the form of general appeals to do something in this respect, as they never included pointing at particular companies that achieved an unfair advantage in the market by under-reporting the wages of their workers. The representative of the Croatian Chamber of Economy provided an interesting explanation for this rather unusual behaviour:

*In my opinion, there exists a 'solidarity of the second order'. Perhaps this happens because disobedience with the tax legislation has become quite prevalent in Croatia. While some companies cheat this way [by under-declaring wages of their workers], others may be engaged in some other not entirely legitimate activities. Resourcefulness has become a dominant business philosophy in this country. Many companies are cheating the state when it comes to the financial liabilities. It is a common way of running a business here. Some even say they could not survive if they obeyed all the laws. There are basically too many legislative acts and numerous obstacles for entrepreneurs.*

*(Representative of the Croatian  
Chamber of Economy)*

Like the employers, trade unions also argued that their power in tackling this phenomenon was quite limited. As the interviewed representatives reasoned, trade unions were able to act directly solely in companies where there was an organised trade union. In such companies, the trade union always reacted to the complaint of workers and therefore this and most other problems were easily resolved. However, the power of trade unions was fairly restricted in the case of companies whose workers were not organised in a union. According to the interviewees, the problem was particularly pronounced for micro and small firms, since the reach of trade unions was quite limited there (i.e. workers were most often not members of any trade union). When workers from such companies reported problems with under-declaration of wages to them, trade unions could only give legal advice and forward the report to the authorities. The representative of the Trade Union of Construction Industry of Croatia provided an explanation for this by referring once again to the aforementioned problem with contracts of limited duration:

*Most people working in small companies have a contract of limited duration. Whoever complained about this issue to us actually had such contracts. Obviously, you cannot negotiate with a company for one person, who at the same time has a contract of limited duration. If you do that, this person is written-off by the employer. I mean, any open complaint about the work conditions in Croatia typically results in a worker not having their contract extended. This is actually the most important reason why many people accept this arrangement.*

*(Representative of the Trade Union of  
Construction Industry of Croatia)*

Following this, all three representatives of trade unions agreed that the state should take the lead in tackling the phenomenon. Although they saw the potential for their involvement through awareness-raising campaigns, the interviewees pointed out some considerable problems with this strategy. For instance, one of them explained the limitations of campaigns in the light of the underlying causes of this phenomenon:

*Campaigns have limited power to change the behaviour of poor individuals who struggle to survive. No awareness-raising campaign would alter the attitude of such individuals to the extent that they will ask their employer to completely declare them, as they know that their take-home pay would be highly insufficient if this happens. Therefore, in these circumstances it is hard to expect too much from awareness-raising campaigns. However, this does not mean they should not be utilised.*

*(Representative of the Independent  
Trade Unions of Croatia)*

Following this, the representatives of trade unions mostly agreed that a combination of measures was needed for an efficient fight against this practice. Still, all of them emphasised that increased legal pressure on employers was the crucial first step forward. In line with this, from the standpoints of trade unions, the Labour Inspectorate and the Tax Administration should be the leading institutions in the fight against under-declared employment in Croatia.

However, the representatives of the two abovementioned institutions provided quite a different view on the situation. Before elaborating their standpoints on the matter, it should be said that the issue of under-declared employment in Croatia is actually under the jurisdiction of the Tax Administration. This is because the legislative framework in Croatia does not recognise under-declaration as a breach of labour law (i.e. a violation of workers' rights), but rather as a breach of laws concerning taxes and social security contributions. This implicitly indicates that under-declared workers are not actually demarcated as victims by the Croatian legislation. However, this does not match the situation in practice, as will be seen later.

In any case, although the Tax Administration is in charge for the detection and prosecution of this practice, labour inspectors also have an insight. This is due to the fact that the issue of completely unregistered economic activities is under the jurisdiction of the Ministry of Labour and Pension System and consequently detection and prosecution of these practices is under the jurisdiction of the Labour

Inspectorate, which operates as a specialised body inside the Ministry. Given that companies employing workers on an under-declared basis are often engaged in other types of unregistered activities (through which the cash for envelope wages is commonly extracted from the financial system of the company), labour inspectors in Croatia are usually the first line of the fight against under-declared employment. That is to say, they are the first to come into contact with potential offenders. However, if there is a suspicion during the audit that under-declaration might be in place, the labour inspectors will take the statements of workers and forward the case to the Tax Administration, which then proceeds with the case following the procedure that is explained below.

In general, both representatives of the abovementioned institutions highlighted workers as the central figures, without whom this practice essentially cannot be proven and prosecuted. Unlike completely undeclared employment, which is most often quite easy for inspectors to detect and verify, the authorities cannot do a lot in the case of under-declared employment if workers are not ready to cooperate. As explained by the representative of the Labour Inspectorate:

*The statement of workers is crucial. If a worker does not admit to receiving envelope wages, there is nothing the inspector can do in this regard. The inspector can for instance ask the worker several times about the exact take-home pay, which is actually what they always do. However, if the worker does not want to tell the truth, there is no way we can force him to do that nor can we proceed with further steps, despite having clear indications that under-declaration may be in place. If there are for instance 20 workers, we will take statements from at least five to ten of them. Nevertheless, if they all state that they receive solely the amount stated in their contract, there is nothing we can do about it. [...] But, you see, they [referring to workers and trade unions in general] always blame inspectors for not detecting this practice. They want us do so something, but without providing any concrete help. Who can disclose this except workers? It is simple as it is: if the employer gives you money 'under the table', you are the only one that can confirm this.*

*(Representative of the Labour  
Inspectorate)*

A similar explanation was also provided by the representative of the Tax Administration. What is more, the latter could not actually recall any case of a worker confirming the existence of this arrangement during the audit, which is quite

surprising bearing in mind the long experience this person has had in the field. According to the explanation of the interviewee, the Tax Administration had efficient methods to detect illegitimate activities utilised to create cash for envelope wages, but there was no way to prove that the cash was later forwarded to employees unless workers decided to cooperate in the process. As the respondent elaborated:

*The way the Tax Administration operates is quite simple: in order to impose financial sanctions on the audited entity, we must have a tangible proof that some breach of the legislation has taken place. In other words, it is not enough to have a clue that a tax subject relies on this practice. We must have clear evidence that shows not only this is happening but also to what extent it is happening. Basically, you cannot impose penalties without having valid argumentation that confirms the existence of this practice. The mere fact that an owner of a popular restaurant is paying their workers minimum wages is not enough for us to state that the employees are getting more than declared. [ ... ] The question is how we can prove that this is really happening? It is impossible without a statement from employees. However, it is impossible to get such a statement from a worker who is currently employed in an audited tax subject. It is simply not possible to get it.*

*(Representative of the Tax  
Administration)*

This brings us again to the problem of the non-readiness of active employees to admit they receive envelope wages. As already mentioned, trade unions also confirmed that even though workers did report this problem while still working on a quasi-formal job, they always did it anonymously. The explanation provided by the representative of the Union of Autonomous Trade Unions of Croatia indicated that trade unions were quite aware of the state of affairs, as well as that the fear of losing their job was not always the dominant factor behind such behaviour, given that some other reasons might indeed be in place:

*Workers actually have the central role in detecting and proving this matter. Employers who know that competitors are engaged in such activities should also help in combating this practice, but they do not do so. They [companies] simply do not report each other. Workers, however, are the stakeholders in the process that undoubtedly lose from this arrangement. Nevertheless, they do not have the feeling they are losing because at that particular moment they do not care about the pension in the distant future. Still, although their role is highly important, I would not say that the workers should be held responsible for this. We always argue*



*that most often this is not the choice of workers, although I must admit that in some cases it might indeed be.*

*(Representative of the Union of Autonomous  
Trade Unions of Croatia)*

Representatives of other stakeholders mainly agreed with this explanation. Namely, while recognising that fear was indeed an important factor for a certain group of quasi-formal workers, other interviewees believed that a significant part of envelope wage earners were actually happy with this practice. As already seen in the earlier parts of the thesis, this was without a doubt true for a non-negligible part of the under-declared workforce in Croatia. From the standpoints of the representatives of the authorities and employers in Croatia, some workers did have an interest in such arrangements and therefore this practice most often remained unreported even after a quasi-formal worker finished their employment.

As mentioned, some workers were ready to proceed overtly against their employers once they lost their job. According to the experience of the interviewees, those were mainly individuals who had other unsolved disputes with their ex-employers. Yet, such cases created further problems for the authorities, as explained by the representative of the Labour Inspectorate:

*Active employees almost always say: "No, I do not receive envelope wages". However, often we have a clear clue that this is really happening as one of the former employees stated during his report: "All the workers are receiving envelope wages". And then I go step by step: first I take the statement from the individual who overtly reported that this is happening in his ex-company. The person says: "Yes, my wages were paid this way, as well as the wages of all other workers". However, when I ask the current employees, they all say: "No". Nonetheless, in such situations we still forward the case to the Tax Administration, as I cannot ignore the claim of the former worker nor am I the court to decide who is telling the truth.*

*(Representative of the Labour  
Inspectorate)*

Still, the Tax Administration faced identical problems, which brought them into a quite unfavourable position. As admitted by their representative, there were many situations in practice in which the Tax Administration had a strong sign that workers were being paid more than stated in their contracts, but they could not prove this.

The interviewee explained how the Tax Administration used to act in situations when there was evidence that cash had been extracted from the financial system of the company, which was a first hunch that under-declaration might also be in place. First of all, even if they had a well-founded suspicion that at least one part of this money had been transferred to employees, inspectors would not be able to prove it without help from the workers. Since such help was commonly absent, the inspectors treated the cash that was illegitimately extracted from the system as being either the personal income of the owner or the income of the company, depending on other circumstances detected during the audit. After determining the amount and the categorisation of the evaded taxes, the Tax Administration calculated the quantity that a company (or a responsible person in the company) owed according to the accompanying legislation, alongside a financial fine. As the interviewed representative of the Tax Administration explained:

*It can indeed be the case that a portion of cash for which we determined that had been illegitimately extracted from the company was later transferred to employees through envelope wages. However, there is actually no need for us to try proving that workers later received one part of this money. The mere fact that a responsible person in the company cannot prove that this money was legitimately taken from the financial system of the company is enough for us to say to this person: "We are going to treat this money as if it is your personal income. Therefore, your monthly net wage was not HRK 3,000 last month, but rather HRK 50,000" [just an example]. And this is where the process stops. If the person later lodges an objection but fails to justify the validity of the transactions through which the money was extracted, our verdict will become official.*

*(Representative of the Tax Administration)*

In this way the Tax Administration actually indirectly penalises under-declaration as in the end the financial duties and penalties are indeed proscribed. However, this brings us to another important peculiarity that can certainly help in explaining the limited role of deterrence in the decision-making processes of Croatian workers, as discussed in the previous chapters. Namely, knowing the above elaborated problems with detection and prosecution of this practice, and the strategies of the responsible institutions to address them, one should not be surprised that neither of the two interviewed representatives of the regulatory apparatus could recall any case of a worker being sentenced for receiving envelope wages. Therefore, it seems that

deterrence was indeed an irrelevant factor for under-declared workers in Croatia, and this was not only due to difficulties in proving that under-declaration was in place, but also because it was solely employers who were prosecuted for this in Croatia.

Following this, decreasing willingness of workers to participate in this practice appears to be the crucial precondition for the successful fight against the phenomenon. As many interviewed individuals believed, the most efficient way to do this is by increasing the awareness of workers about the negative sides of quasi-formal employment. And this is exactly where the role of trade unions should come to the fore. However, trade unions complained that their competences in this respect were quite narrow. Alongside the significant fragmentation of trade unions in Croatia, which limited the range of the potential audience for each of them, the interviewed representatives of trade unions also complained about some external problems that were undermining their endeavours to educate workers. According to the representative of the Union of Autonomous Trade Unions of Croatia, many workers had become 'modern slaves' who did not have time even for some basic social things, and therefore it was hard to expect them to participate in any workshops on this or similar topics:

*Many workers in Croatia regularly work overtime, which is often neither recorded nor paid. In such conditions, many really struggle to survive on a daily basis. People simply do not have time for other things. They cannot say: "OK, I finished my eight-hour working day so now I can dedicate my time to some other things". It looks as if we have gone back to the 19<sup>th</sup> century. The lives of many Croatian workers have become a pure struggle to survive. An average worker in this country has neither free time nor money for social life, additional education or thinking about various important topics. These days we cannot even get them to attend various workshops that we organise. There is no free Saturday or Sunday for workers anymore. In line with that, we struggle to find suitable time for specialised workshops, as they have to work all the time. So, our potential to educate workers is quite limited in such conditions.*

*(Representative of the Union of Autonomous  
Trade Unions of Croatia)*

For that reason, despite agreeing that workers should be educated about the negative sides of this practice, as well as encouraged to fight for their rights, trade unions maintained that the state should be the leader in this regard. According to their belief,

only the state had the resources and tools to reach large numbers of the population and change their perceptions and attitudes.

The Ministry of Labour and Pension System did not run away from the responsibility. Still, their representative admitted that undeclared work had been predominantly their focus during the last few years, while not much had been done to combat quasi-formal employment<sup>136</sup>. However, there were plans to also address this issue in the upcoming endeavours to reduce the size of the informal economy in Croatia. As the interviewee explained:

*This part of the informal sphere where a worker is declared, but one part of the wage is given in cash is much harder to detect than completely undeclared work. In line with this, the effectiveness of repression is quite limited in this case. I believe that the emphasis should be more on awareness raising campaigns. As a matter of fact, I think this will be in the focus in upcoming years. [ ... ] As far as I am aware, workers will be the targeted population because it is evident that workers are most commonly not aware of the potential consequences of this arrangement. If a worker is for instance paid HRK 4,000 officially and further HRK 2,000 are given in cash, they will probably not get these HRK 2,000 during the annual leave. If the employer gives just HRK 4,000, the worker cannot seek legal protection as the state institutions are not aware of these additional HRK 2,000. The same problem arises in the case of sick-leave, as again solely the declared wage matters. Similar issues occur when it comes to pension and benefits in the case of unemployment. Basically, in none of the enumerated situations will those additional HRK 2,000 be visible and thus workers will be deprived of their full statutory rights.*

*(Representative of the Ministry of  
Labour and Pension System)*

Yet, while recognising that the government should take the central role in the fight against under-declared employment, the representative of the Ministry of Labour and Pension System was certain that employers and trade unions could do quite a lot in this respect on their own. Instead, as the interviewee explained, both groups of

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<sup>136</sup> For instance, the Ministry labelled 2014 as 'the year of the fight against undeclared work' (Ministry of Labour and Pension System, 2014). This assumed numerous legislative changes and strengthened deterrence, as well as the introduction of several information campaigns focused on raising public awareness about the consequences of undeclared work. For more details see Franic and Williams (2014).

stakeholders expected the authorities to solve all the problems, while at the same time not expressing the will to assist in this.

This critique brings us to the issue of social partnership in Croatia, which was the topic that all interviewed individuals had something to say about. Given the overall importance of the matter, the views of the social partners in this respect are thus further scrutinised in the next section. Before commencing the discussion, however, it must be stated that the sole intention of the following elaboration on the tripartite dialogue is to present the state of affairs and emphasise the significance of decent social partnership for an effective fight against the phenomenon, not to initiate disputes among social partners in Croatia. In that light, only summarised standpoints of each side in the partnership are given, without quoting individual statements. The researcher firmly believes that usage of direct quotations at this point would not add significantly to the comprehension of the problem, and therefore the decision to omit them certainly does not have any adverse influence on the quality of the presented findings.

#### **8.4 Tripartite social dialogue and its potential role in the future fight against under-declared employment in Croatia**

The question on cooperation between social partners was one of the rare matters in which a high degree of consensus among the interviewed individuals was reached. However, the state of affairs seemed to be completely opposite from what is desired and required for a successful fight against quasi-formal employment. In short, all the research participants agreed that social dialogue in Croatia was quite weak and significant efforts should be made to improve it. This did not apply solely to this particular issue, but also to all other spheres of tripartite dialogue.

To start with the representatives of employers, they pointed out that their cooperation with trade unions was much better than that with the state institutions. Nonetheless, even the quality of the bipartite dialogue was still far from a satisfactory level in their opinion. Apart from the fragmentation of trade unions in Croatia, another important objection of the employers to the trade unions was the lack of sensitivity about the constant changes in the market. The main critique in this respect related to the determination of the latter to preserve the current rigidity of the labour market, which was first and foremost mirrored through costly and lengthy dismissal procedures.

Trade unions, on the other hand, complained that the Croatian Employers' Association lacked any desire for a social dialogue. In their view, the Association mostly cared about the short-term financial interests of their members, while neglecting the importance of socially responsible behaviour on the part of business entities. However, the representatives of the trade unions emphasised that cooperation was much better with employers than with the state institutions. As they believed, the state perceived trade unions only as a disturbance factor and, in line with this, as the main obstacle towards a more flexible labour market.

Despite expressing moderate dissatisfaction with the bipartite dialogue at the highest level, the representatives of trade unions and employers admitted that things were much better when it came to cooperation at a sectoral level. Although in some sectors bipartite dialogue was also quite weak or even non-existent, there were some sectors in which it functioned quite well. Such examples were for instance the tourism sector and the construction sector, as pointed out by some interviewed representatives. Indeed, both interviewed individuals from the construction sector emphasised the good cooperation between the partners over the years, which had resulted in a collective agreement being signed and numerous other problems resolved.

The representatives of the authorities, however, argued that the other two sides in the social partnership were excessively demanding and overcritical. In their understanding, trade unions were wasting time and energy on irrelevant issues, while central problems remained outside the focus of their attention. Employers, on the other hand, were believed to have a skewed perception of the business, as they neglected the social role of business subjects while at the same time putting a major emphasis on profit gain.

The above summarised critiques, as well as the overall lack of sympathy expressed by the research participants towards their social partners, are not surprising bearing in mind the weak culture of social dialogue in Croatia over the past two decades. The dialogue has generally been characterised by a significant lack of trust between partners and quite inefficient conflict resolution mechanisms (Eurofound, 2012). For instance, in 2010 the trade unions suspended their participation in the tripartite body due to disagreement with the government regarding the legislation on collective agreements. The conflict, which lasted for ten months, finished after trade unions expressed their intention to organise a referendum on this matter, which forced the government to change its attitude. This was just the beginning of the strained

relationships between social partners, which additionally worsened after the left-oriented government came into power in 2011.

In such circumstances, one can understand why joint attempts to combat under-declared employment in Croatia were almost completely absent from the agenda of social partners. The only praiseworthy example of collaboration in this respect was the campaign entitled 'Fair prices in the construction industry - job security and secured future of the construction industry'. The main aim of the campaign, which was jointly organised by the CEA - Construction Employers' Association and the Trade Union of Construction Industry of Croatia, was to initiate changes in the system of public procurement.

As already discussed, both social partners complained about the adverse effects of the current scheme in which the final price was the dominant criterion for evaluation of the bids in public procurement procedures. In line with this, the idea was to increase awareness about all the negative aspects of such a state of affairs, one of which was under-reporting of wages. Yet, the campaign failed to reach its goal, in spite of hundreds of information letters sent and numerous workshops organised. As both interviewed individuals pointed out, none of the relevant state institutions expressed interest in participating in the campaign or supporting it.

In general, weak social dialogue seems to be one of the most important impediments for a successful fight against the phenomenon in Croatia. Since the potential of repression is extremely limited, or at least highly dependent on the readiness of workers to cooperate, awareness-raising appears quite an important strategy for tackling under-declared employment. Therefore, it is vital for all three partners to collaborate in this regard so as to increase the effectiveness and credibility of normative appeals.

## **8.5 Summary of the most important findings from the interviews with representatives of social partners and regulatory apparatus**

The views of the interviewed representatives on the matter that have been presented in this chapter can be best described as subjective evaluations based on quite a limited insight into under-declared employment in Croatia. This is understandable given that none of the institutions encompassed by this phase of the qualitative fieldwork had official data or access to any research studies on this phenomenon. In line with this, the reasoning of the interviewed individuals was predominantly based on their experience with workers and companies complaining about and reporting this problem.

The interviewees generally believed that under-declaration of wages in Croatia was inherent in labour-intensive activities, with low-paid individuals being the most plausible workforce in this realm. In addition, micro and small firms were believed to be the most prone to this practice in Croatia. The representatives of the authorities for instance reasoned that smaller companies found it much easier to extract cash from the system, and thus were more likely to engage in this practice. While acknowledging this explanation, trade unions and employers were certain that an additional reason for this peculiarity could be found in the fact that neither were smaller companies usually members of the Croatian Employers' Association nor were their workers organised in a trade union.

In their endeavours to explain the nature, causes and most efficient strategies to tackle this type of employment, the interviewed individuals focused on several aspects, many of which were in the previous parts of the thesis found to have quite a limited role in the process. One might recall for instance that we found no significant effect of the tax burden, prevalence of contracts of limited duration or expectations regarding future income from the pension system on the propensity to work on an under-declared basis. However, all these aspects were strongly emphasised by the institutional interviewees as potentially important factors.

On the other hand, the issue of a weak psychological contract between the state and the citizens was not identified as a significant element by the participants in this part of the study. For instance, no interviewee mentioned the prevalent corruption in the public sector, inefficient public spending or the huge and expensive state apparatus as a potential motivator for workers and business owners to engage in under-declaration.



This certainly shows that this problem was not sufficiently understood by the relevant institutions and therefore there is significant room for improvement in this regard.

According to the findings presented on policy measures, not much could be done in tackling this phenomenon unless workers were to be encouraged to contribute to this battle. To do so, it is important to make them aware that they would certainly lose in the long run, so as to reduce their willingness to participate in this practice, as well as to increase their readiness to take a stand against employers relying on this type of employment. In addition, a lot can be done by encouraging compliant companies to openly blow the whistle on their competitors that rely on this illegitimate practice. Instead of waiting for others to solve their problems, encouraged workers and compliant companies could be the leaders in this process. And this is where the role of social partnership comes to light, as joint actions by all three sides would yield the most effective results.

Unfortunately, however, the culture of social dialogue in Croatia seems to be quite undeveloped at the moment, and this has been reflected through numerous disputes among the partners in recent years. As a matter of fact, the overall impression is that there is a downward trend in this regard, which was quite evident during the interviews with the representatives. For that reason, the improvement of social dialogue should be the first thing on the agenda, as it appears to be a crucial precondition for an effective fight against the phenomenon.



## **9 DISCUSSION AND CONCLUSION**

Although this comprehensive insight into the mechanisms behind quasi-formal employment to a great extent endorsed results from previous studies, at the same time it showed that the available body of literature actually describes just one slice of the complex practice. In view of that, the findings presented throughout the thesis represent a significant step forward in our endeavours to comprehend this sophisticated tax evasion strategy.

Accordingly, this last chapter starts with a critical evaluation of the predominant theories on the nature and causes of quasi-formal employment in Europe through the lens of the results from our study. The discussion in this respect will be centred around the supremacy of the mixed-methods approach over single-method strategies when disentangling this multifaceted social and economic phenomenon. As a natural sequence of this discussion, the second section of the chapter then elaborates the four research questions which this study aimed to answer. This is followed by discussion about the most important policy recommendations arising from the research conducted. After clarifying theoretical contributions and enumerating limitations of the presented study, the thesis ends with concluding remarks.

### **9.1 Discussion of the key findings in the context of the available theories on the causes and nature of under-declared employment**

The strategic approach based on complementarity of the results from quantitative and qualitative inquiries, which was pursued all over the study whose findings were presented in this thesis, proved to be highly potent in giving a profound depiction of numerous intertwined elements underlying quasi-formal employment. Not only did such a stepwise dissection widen our understanding of the motivations for workers (as well as for their employers) to enter and stay inside (or leave) this realm, but it also illuminated many other features of under-declared employment that have been neglected so far. By unravelling novel aspects of this particular tax evasion strategy, the research thus showed that a more nuanced approach towards conceptualisation of the phenomenon is needed.

First of all, it should be repeated that this study was the very first attempt to comprehend the role of workers in the process of wage under-reporting. So far workers have been depicted as passive players, reflecting the wide belief that

illegitimate wage arrangements are strictly imposed by employers (Williams, 2009, 2013b; Woolfson, 2007). An under-declared workforce was thus assumed to be mostly a homogenous group of poor individuals who are excluded from the formal labour market (Hazans, 2005; Kriz et al., 2007; Williams, 2013b; Woolfson, 2007).

Undeniably, both quantitative and qualitative insights within our study showed that poverty and unemployment are quite important drivers of the practice, hence confirming to a large extent the validity of the abovementioned studies. However, the arguments presented in this thesis indicate that the causes of quasi-formal employment go far beyond these two rationales. Explicitly, the logit modelling on the EU-level and interviews with quasi-formal workers in Croatia revealed that there are many other factors exerting a significant influence on the behaviour of economic agents in this respect, the most important among them being the quality of the state institutions, trust (between the authorities and taxpayers, as well as among citizens) and tax morale. Yet, this cognition was just the first step in a systematic evaluation of the phenomenon from the angle of under-declared employees, which eventually showed that workers are actually central figures in the process of under-declaration, contrary to the prevalent belief among the scholars interested in this matter (see Hazans, 2005; Woolfson, 2007).

The complementariness of the quantitative and qualitative inquiries particularly came to the fore during the dissection of the way in which the behaviour and perceptions of workers depend on the exact role of envelope wages within their quasi-formal jobs. Explicitly, the logit modelling revealed that individuals receiving cash-in-hand payments strictly for overtime and extra work were far more satisfied with their position than the rest of the quasi-formal workforce. This peculiarity prompted the researcher to pay more attention during qualitative interviews on the issue of how the willingness to participate in the under-declared realm depends on monetary aspects of the agreement. This in turn highlighted the employer-employee relationship as the essential cornerstone of the practice, thus shedding a completely new light on the phenomenon. For instance, not only did the discussion with under-declared individuals in Croatia on this specific topic expose the range of strategies used by employers to make envelope wage payments attractive to workers, but it also paved the way for understanding situations in which problems with payments of envelope wages and other types of mistreatment occur.

Comprehension of the complex balance of power between these two groups of stakeholders in turn facilitated systematisation of workers into four categories according to their entrance rationale, thus revealing that under-declared employees are actually quite a heterogeneous group. This then demonstrated that the existing studies did indeed accurately describe the roots of the phenomenon, but only for one part of the quasi-formal workforce. That is to say, theories by Woolfson (2007) and by Hazans (2005), among others, completely explain the behaviour and views of the group of individuals that were in this thesis labelled as reluctant voluntarists. Yet our study offered a broader depiction of the matter by describing three additional groups of quasi-formal workers that were not considered before.

When it comes to the failure of employers to give the agreed cash payments, which was argued to be a frequent side-effect of quasi-formal employment (Round et al., 2008; Williams & Round, 2007a), our research confirmed that this does happen in practice. Yet, the study went one step further by unfolding the exact circumstances in which this problem takes place. As elaborated, this has to do with the payment arrangement, given that workers receiving variable envelope wages were found to be the subgroup that most frequently faces such problems. Namely, flexible wages make it hard for employers to predict labour cost on a monthly basis, which can result in a shortage of cash at the moment of payment. Yet, we also found that employers resolve to breach the verbal agreement only in circumstances of extreme financial troubles, as problems with payment seem inevitably to lead to a worker quitting their job. Instead, employers confronted with liquidity issues will first start postponing payment of social security contributions and only if this saving strategy fails will non-payment of envelope wages appear as an option.

The study also found that other types of misbehaviour described in the research literature do occur (see Hazans, 2005; OECD, 2003; Williams & Padmore, 2013a), but not as frequently as one would expect. As clarified, this is because workers have many options to harm the company whenever their rights are violated, which employers seem to be quite aware of. The latter thus rather choose to respect their workers, which explains why cases of oppression were not frequently encountered during the qualitative fieldwork.

However, many other patterns in behaviour of employers that were described in the previous studies appear to be fully applicable to the case of Croatia. For instance, the study presented in this thesis revealed that quasi-formal employment is a widely

preferred option by companies faced with an increase in demand, which is a behavioural pattern earlier identified by Meriküll and Staehr (2010) in their study on the three Baltic countries. By means of increasing the workload of their current employees and paying these additional efforts in cash, many employers avoid hiring new people and consequentially save themselves from difficulties with firing procedures once these new workers are not needed anymore.

Also, our study showed that under-reporting of wages is often used by companies as a pure survival strategy. This therefore endorses the inferences of the study by Williams and Padmore (2013a), who argued that envelope wages can be an efficient business-rescuing solution, given that this can provide significant savings for companies in financial difficulties. As discussed, benefits of this strategy principally came to the fore in Croatia after the onset of the economic crisis in 2009, when even some companies in foreign ownership decided to resort to it.

Nevertheless, this thesis went far beyond testing the existing knowledge on the phenomenon, as many new features of this practice were detected during the four stages of data gathering process. One of the most important of such findings is related to the limited effectiveness of repression in combating envelope wage practices. This was actually the topic in which benefits of applying mixed-methods research became especially evident, given that no previous knowledge on this aspect of the researched matter existed. A systematic evaluation of this issue from different angles enabled a continual upgrade of the collected information alongside triangulation of the findings from preceding stages of the inquiry, thus offering a more profound understanding of numerous peculiarities related to the cost side of quasi-formal employment.

As a matter of fact, this subject matter was evaluated in all four phases of the research, each of them substantially extending the knowledge grasped during previous steps. For instance, while the quantitative inquiry was only able to say that deterrence is not relevant for workers, it did give some hint about a possible explanation for this. That is to say, the statistical modelling identified effectiveness of the state apparatus, judicial independence and prevalence of corruption in the public sector as essential determinants of the practice, which raised a need to pay attention during interviews with workers to the intricate interplay between these factors and their joint effect on perceptions regarding deterrence.

Not only did the first phase of qualitative research provide a refined depiction of how the abovementioned macro-level factors shape views of workers with respect to the fear of being caught and penalised for receiving envelope wages, but it also opened up some new and unforeseen horizons. For instance, discourses with workers revealed that many of them actually did not perceive themselves as offenders as they firmly believed that only their employers were to be held responsible. That notion in turn made possible an understanding of many other viewpoints of workers, primarily those concerning the moral side of their conduct.

Additionally, and more importantly, the interviews with quasi-formal workers also highlighted the challenges inspectors face when trying to expose under-reporting of wages in a certain company. As discussed, workers mainly argued that inspectors cannot prove the existence of envelope wages if neither of the two sides involved in the hidden agreement is ready to cooperate. This perception accordingly directed the course of interviews with the representatives of regulatory apparatus, who eventually clarified the reasons for the limited effectiveness of repression in this respect. Besides confirming accounts of workers regarding the difficulties inspectors have in verifying payments of envelope wages, the representatives of state institutions also gave a detailed account of circumstances in which workers are ready to provide their help.

An insight into this particular aspect of quasi-formal employment is therefore the best indicator of how mixed-methods research can assist in the understanding of an under-researched subject. In fact, the same pattern was noticeable for many other aspects of quasi-formal employment discussed in the thesis: alongside triangulating the information obtained in the previous steps, every subsequent phase of our multi-layer research at the same time unravelled some new essentials of the matters of interest, thus constantly refining the portrait of the phenomenon.

However, the supremacy of the mixed-methods over the single-method approach above all came to the fore in situations when triangulation process resulted in divergent findings. This was for instance evident in the case of marital status, whose relevance became apparent during the interviews with quasi-formal workers, in spite of not being identified as an important element by the quantitative analyses. Many interviewed workers spontaneously brought this topic on the agenda, thus giving a detailed account on the importance of marital status for various aspects of quasi-formal jobs. To recall, the main finding in this respect was that changes in marital status actually exert substantial influence on willingness to keep working under a

hidden wage arrangement for people that are already employed on an under-declared basis, even though marital status itself is not a critical factor for workers' decision about entering the quasi-formal realm. In addition, an evaluation of this matter also clarified how marital status shapes one's preference towards the different types of envelope wages, as for instances married individuals commonly preferred to have fixed take-home pay, while singles found variable envelope wages more attractive.

The benefits of triangulation during the course of the research were not evident solely when spotting differences in findings from qualitative and quantitative inquiries, but also in cases when the identical research method applied to different data sources yielded inconsistent results. This can be exemplified on the case of gender, which was found to be significant in the two-level logit analysis on the EU-data, but not when analysing the data from the GREY Survey<sup>137</sup>. This mismatch was explained by the fact that the propensity to work on an under-declared basis is actually dependent on the economic sector in which one operates, while gender is just an intermediary variable (i.e. gender exerts significant influence on the choice of a sector)<sup>138</sup>.

Alongside confirming this reasoning, the qualitative phase of the study offered some additional details related to the role of gender. Namely, interviews with quasi-formal workers showed that despite not being essential for their entrance into the quasi-formal realm, gender does influence the readiness of employees to withstand various problems that can occur during the course of employment. As shown in this thesis, women seem to be far more ready to tolerate disrespectful behaviour by employers than men.

To sum up, this mixed-methods research utilising four sources of data showed that not only are workers central figures in the process of wage under-reporting, but also that every single employee working under such an arrangement is unique in their reasoning, decision-making process, behaviour during employment and attitudes towards this type of tax evasion. As discussed, some workers were pulled inside this realm involuntarily, while some others accepted under-declaration reluctantly owing

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<sup>137</sup> Other available studies also concluded that gender exerts significant effect on one's predisposition to engage in under-declared employment (see Kedir et al., 2011; Williams & Horodnic, 2015).

<sup>138</sup> It is worth repeating that the sector indicator was only included in the analysis of the GREY Survey data. Sequential inclusion of variables showed that gender was significant all until the sector was added as an explanatory variable.



to the constrained access to the labour market. On the other hand, there is a group of willing participants who do not see anything wrong in their behaviour.

In general, the behaviour of workers was found to be driven by a set of intrinsically interrelated factors, whereas every person assigns their unique weights to each of these individual elements. What is more, perceptions of workers constantly vary in accordance with changes in their social status, as well as with changes in the professional and social climate inside the company. These remarks on complexity of the phenomenon and diversity of participants inside the under-declared realm bring us to the evaluation of the four research question that this study aimed to answer, which is given in the next section.

## **9.2 Transforming the intricate knot of evidence into congruent answers to the research questions posed**

The central goal of this study has been to evaluate the extent to which each of the five theories of undeclared work in general can help in explaining the motivations of workers to enter and stay inside (or leave) quasi-formal employment, which is a hybrid type of work located somewhere between the formal and informal realms. The additional research aims have been to explore who actually benefits from this practice and how the legislation on the minimum wage affects agreement regarding the declared part of wage in quasi-formal employment.

Before drawing conclusions on the first two research questions, it is worth repeating the main ideas behind each of the five schools of thought. To start with dualism, its proponents argue that noncompliant behaviour is a mere consequence of the lack of formal employment opportunities and risk of poverty (Hart, 1973; ILO, 1972). If applied to the case of quasi-formal employment, the dualist theories imply that this realm is composed of the 'working poor', primarily low-income earners who accept such arrangements out of desperation (Hart, 1973). In view of that, under-declared employment is regarded as a temporary and strictly an economic problem, which can be resolved by the creation of new formal jobs.

Structuralists, on the other hand, would argue that this practice is not a temporary issue, but rather a long-lasting problem resulting from harsh competition among companies (Castells & Portes, 1989; Moser, 1978). In line with this, the under-declared realm can be depicted as a by-product of the formal economy, embracing small

enterprises and low-skilled exploited individuals struggling to survive on the market. While also suggesting that the majority of workers engaged in this practice are poor, the structuralist theories imply that poverty is a consequence, rather than the cause of this type of work (Davis, 2006).

The legalists point to the inefficient and over-intrusive state as the main origin of illegitimate economic activities (Cook et al., 2008; Rakowski, 1994b). Apart from high taxes, a poor business climate and an enormous state apparatus, they also identify some other important motives for people to deliberately choose participation in tax evasion practices. The most important such factors are the weak rule of law, prevalent corruption in the public sector and unfair distribution of income (Cook et al., 2008; de Soto, 1989). The legalists' theories suggest that entrance into the undeclared realm in economies with poor state institutions is most often a decision taken out of sheer defiance, and in line with this they describe disobedient economic agents as heroes depriving the ineffective and corrupted public officials of their undeserved earnings (de Soto, 1989).

From the standpoints of the voluntarists, people would generally engage in noncompliant behaviour whenever the benefits of such conducts are greater than the accompanying cost (Allingham & Sandmo, 1972; Maloney, 2004). Following this, taxpayers are perceived as rational agents who will enter the informal realm by choice if they assess that this will result in increased welfare (Chen, 2012). The voluntarists point to a high tax burden, complicated administrative procedures and poor pension and social welfare systems as the main reasons for people to conceal their income. From the perspective of the voluntarists, the fight against the phenomenon must be grounded on repression, given that deterrence is the most dominant aspect of the cost side of the equation (Allingham & Sandmo, 1972).

Although not neglecting the idea of rational agents, the proponents of the quasi-voluntarism and the conditional cooperation theory describe taxpayers primarily as emotional agents (Feld & Frey, 2002; Song & Yarbrough, 1978). In their view, some people will not evade taxes even if the benefits of such behaviour outweigh the cost, while some will evade them even when the cost is larger than the benefits (Long & Swingen, 1991). As explained, this happens because human behaviour is heavily influenced by personal and social norms, which jointly define individuals' willingness to pay taxes (i.e. tax morale). At its core, this school of thought defines tax compliance as a quasi-voluntary process, implying that people will obey as long as they believe that

other taxpayers obey, and as long as the authorities respect an invisible psychological contract existing between the state and its citizens (Levi, 1988). In line with this, the main causes of noncompliant behaviour from the perspective of this school of thought are unfair distribution of wealth, non-transparent public expenditure, corruption among public officials and societal approval of tax evasion (Barone & Mocetti, 2011; Frey & Torgler, 2007; Torgler, 2011).

Notwithstanding the previous research studies, which suggested that the roots of quasi-formal employment can be completely explained by the theories of the dualists and structuralists (see Hazans, 2005; Williams, 2013a; Woolfson, 2007), the findings presented in this thesis revealed the necessity for a holistic approach when explaining this phenomenon. Yet, even though none of the five theories should be neglected, it seems that the ideas of the dualists, legalists and quasi-voluntarists are particularly helpful in conceptualising this illegitimate practice.

Explicitly, we found that the risk of poverty and exclusion from the formal labour market indeed force many people to accept quasi-formal jobs out of desperation, thus confirming that the ideas of the dualists are highly applicable to this particular type of tax evasion. Such workers were described in this thesis as reluctant voluntarists, given that they participate voluntarily in this arrangement but seek the very first opportunity to escape.

As already elaborated in the previous section, our findings indicated that this practice might be less abusive in its nature than suggested by previous research (see Hazans, 2005; OECD, 2008; Woolfson, 2007), thus undermining the validity of the structuralist school in this respect (at least in the case of Croatia). The majority of the interviewed workers admitted their employers never tried to oppress them, regardless of the way they entered this realm. Most participants explained this by the fact that employers rather chose to play a fair game because they were highly aware of the numerous possibilities for workers to cause damage to the company if their rights were violated. However, this does not mean that instances of disrespectful behaviour do not occur at all, as in a few cases encountered during the fieldwork employers did threaten not to pay envelope wages or even failed to pay them. Still, given the non-representativeness of the sample, it is hard to provide any firm conclusion in this respect.

In any case, this thesis revealed that previous studies on the matter failed to recognise the variability inside the under-declared workforce, because for many quasi-formal

workers their entrance into this realm and their experiences during the course of the job cannot be explained by the theories of the dualists and structuralists. To understand the motives and behaviour of such individuals, it is therefore important to turn to other schools of thought, where legalism and quasi-voluntarism seem to have the salient roles.

First of all, in order to understand the wider roots of this practice, it appeared vital to scrutinise it through the magnitude of the gap between the state and its citizens, as well as through the social contract that exists between taxpayers. It seems that the more citizens believe that they do not get back enough from the state in return for their taxes, the more they are inclined to under-report their wages. This relates to the invisible psychological contract between the state and its citizens, which can be lessened by numerous factors, such as corruption in the public sector, an inefficient state apparatus, non-transparent public spending, unfair distribution of wealth, weak rule of law, etc. Apart from this, workers also seemed to heavily base their decision in this regard on the behaviour of other taxpayers, which suggests that quasi-formal employment is not only an economic but also a cultural problem.

Thus, for many interviewed under-declared workers, their entrance into this realm was motivated by defiance and/or by a belief that there was no point in paying taxes, which is in line with the ideas of the legalists and quasi-voluntarists (see Barone & Mocetti, 2011; de Soto, 1989; Torgler, 2011). This explains why this practice is far more prevalent in transition economies than in developed ones, given the considerable differences between these two groups of countries regarding the social and psychological contracts.

On the other hand, we found only weak evidence supporting the validity of the voluntarist school of thought. Contrary to expectations, it seems that factors such as the tax burden and the quality of the pension system are not particularly important for workers in their decisions on whether to enter the under-declared realm. What is more, deterrence appears to be completely irrelevant due to the very nature of the phenomenon. Since the ability of the supervisory institutions to prove the existence of this arrangement is highly dependent on the help of workers, which the latter seem to be highly aware of, fear of being detected by the authorities was not relevant at all for the majority of the interviewed under-declared workers. Moreover, many workers did not even consider themselves as being responsible for this arrangement and therefore did not expect to be prosecuted even if detected. The interviews with state

representatives showed that workers were indeed right, at least in Croatia, given that only employers would be (indirectly) penalised for such wrongdoing.

Yet, although the cost side of the equation seems to be irrelevant for workers, the benefit side was found to be important for some individuals. Many interviewed workers believed that they could earn more this way and therefore under-declaration of wages appeared a logical decision for them. For such people one could indeed argue that their decision to enter the realm fits inside the framework presented by the voluntarists (see Allingham & Sandmo, 1972; Maloney, 2004).

This brings us to the third research question explored in this research study, which concerns the distribution of financial gain (resulting from under-declaration) between employers and workers. As demonstrated, many interviewed workers believed that the employer retained all the financial gain and therefore were certain that under-declaration of their wages did not result in them having higher take-home pay. Still, there was also a non-negligible number who were confident they personally earned more this way. Such individuals were mainly found among monetary rationalists and pure voluntarists, and in particular among those who were receiving variable envelope wages. The latter seemed to be most satisfied with their position, primarily due to the belief that their overall take-home pay directly reflected their invested efforts, which motivated them to work harder.

Given the non-representativeness of the sample for the qualitative phase of the study, it is impossible to say whether individuals earning more under this arrangement were indeed a significant category inside the quasi-formal workforce. However, since we found a clear link between take-home pay and satisfaction, the results of both quantitative surveys utilised in this thesis can be highly indicative in this respect. Explicitly, given that 41% of surveyed under-declared workers in the Special Eurobarometer Survey and 30% in the GREY Survey stated they were happy with receiving envelope wages, it is likely that individuals achieving financial gain by under-declaration of their wages are far from being a minority. The findings thus indicate that not all under-declared workers should be perceived as hopeless victims, which was the depiction offered by most previous studies on the matter (for instance Hazans, 2005; Williams, 2013a; Williams & Round, 2007b; Woolfson, 2007).

Yet one should not forget that the aim of this thesis was not to establish universal truths about the nature and causes of quasi-formal employment, but rather to shed

new light on this multifarious practice and reveal some peculiarities of it that have not previously been considered. In line with this, if the findings on the distribution of financial gain between employers and their workers prompt future research on the matter, this thesis will have accomplished one of its objectives.

Turning to the link between the declared part of the wage and legislation on the minimum wage, the findings support the hypothesis that many employers declare their workers at amounts that are above the minimum required level. Indeed, during the qualitative fieldwork, many interviewed workers suggested that this may primarily be due to the employer's endeavour to fly under the radar of the authorities. This is in line with the results of the GREY Survey, as almost every second under-declared worker stated their wage was above the minimum.

Therefore, this thesis challenges the widely accepted belief about the role of legislation on the minimum wage in the process (see Elek et al., 2011; OECD, 2003; Williams, 2013b). It is thus hoped that the findings presented here will spark interest among scholars and policymakers in achieving a greater understanding of the link between legislation on the minimum wage and the declared part of the wage in quasi-formal employment.

### **9.3 Policy recommendations**

The findings discussed in this thesis raise some essential questions regarding the applicability of standard means of fight against undeclared work to the case of quasi-formal employment. In the thesis, both repression and regular modes of prevention (i.e. narrowing the possibilities for companies and workers to start operating off-the-books), which are the most popular options among policymakers for tackling typical forms of tax evasion (Eurofound, 2008, 2013; Williams & Nadin, 2012), have been shown to have extremely limited (if any) prospects of reducing the size of this hybrid type of employment. In other words, a comprehensive insight into envelope wage practices from the perspective of employees suggests that an efficient fight against this phenomenon cannot be grounded on direct policy measures.

Due to the multifaceted nature of the practice, it appears that only an indirect policy approach can yield desirable results. An essential first step in this respect should be shifting focus from employers to workers, since the latter were actually shown to be central actors in the process of wage under-reporting. In line with this, the emphasis

has to be on endeavours to reduce the readiness of workers to engage in this type of noncompliant behaviour. As appears from the research results presented throughout the thesis, this assumes first and foremost the need for the creation of new work opportunities, with particular accent on increasing the formal employment prospects for the youngest labour market participants. Providing more job options to workers would undoubtedly address the issue regarding under-declared employment out of necessity, therefore decreasing the number of reluctant voluntarists. However, an increased supply of completely regular jobs would certainly have a positive effect on behaviour of all other categories of envelope wage earners owing to the enhanced prospects for shifting from their under-declared job to a better paid regular job.

There are, however, some other ways to foster transfers from quasi-formal employment to legitimate employment, which do not necessary include creation of new jobs. Even in the existing situation on the labour market a significant improvement can be done by ensuring that the size of one's gross wage really matters. As illustrated through the Croatian case, if workers are certain that a decrease in their gross wage resulting from under-declaration does not entail any tangible negative consequence (e.g. constrained access to loans and mortgages, lower pension or lower benefits in cases of unemployment), they will care solely about the take-home pay. Thus, an emphasis should be on securing that an increase/decrease in gross wage indeed has an effect on one's current and future wellbeing, which would make people less inclined to sacrifice one part of their gross wage.

This brings us to the other issues impeding voluntary compliance of workers. Certainly the most important of them is a gap between the state and taxpayers, which is particularly substantial in transition countries (Bejaković, 2009; Ferrer-i-Carbonell & Gërkhani, 2011; Torgler, 2004; Wintrobe & Gërkhani, 2004). As elaborated in the thesis, improvement of the psychological contract appears a vital step in addressing the rationales of monetary rationalists and pure voluntarists. First of all, there is a need to increase the credibility of the state institutions, which requires broad reforms in various fields. For instance, a lot can be done by improving the quality of public services and increasing the efficiency of public administration, as well as by a more effective fight against corruption in the public sector and more transparent public spending. The main idea behind such reforms should be to show citizens that it is worth paying taxes.

Besides these changes, a significant impact on behaviour of workers (and their employers) can be achieved by strengthening the rule of law and increasing judicial independence, which would ensure that economic subjects whose rights are violated will be protected by the authorities. As shown in the thesis, many workers in Croatia do not seek for help from the enforcement bodies at the moment primarily because they believe that the state institutions will fail to protect them.

On the other hand, it is also important to put more efforts into changing the norms, values and beliefs of the taxpayers. Even if the formal institutions are reformed, it is hard to expect people to comply with legislation in situations where there is high societal acceptance of tax evasion. It is thus vital to educate people about the importance of paying taxes and both the personal and social consequences of tax evasion. What is more, people (in transition countries in particular) should be made aware that individuals evading taxes are neither heroes nor resourceful and smart citizens, but rather cheats whose activities have a widely negative effect on everybody. Finally, given that employees are the central figures in detection and prosecution of this practice, those who are dragged inside the under-declared realm should be encouraged to stand against their employers.

In countries facing a highly permissive attitude towards tax evasion, such as Croatia, it might be recommended to introduce tax education in elementary and/or high schools. When it comes to adults, the best way to accomplish these aims would be to rely on numerous awareness-raising campaigns and normative appeals, which would encompass both the broader public and workers in particular. Above all, it is important to educate workers about all the hidden and long-term drawbacks of quasi-formal employment so as to reduce their willingness to participate.

The issue of education measures targeting workers is where the importance of a decent tripartite social dialogue especially comes to light, as joint efforts by social partners in this respect would certainly yield more effective results. Still, the significance of tripartite social dialogue goes far beyond this aspect of the fight against envelope wage practices. Explicitly, a strategic policy approach towards eradication of this phenomenon in every country must be based on a substantial coordination and collaboration of all three sides in the social partnership. This does not include solely exchange of information and experiences, but also joint actions in many fields (such as the upgrading labour legislation, improvement of business climate, stigmatisation of undeclared practices, etc.).



Finally, the essential policy contribution of this thesis (which is at the same time also a theoretical contribution) is reflected through the recognition that under-declaration of wages has already become a standard way of running a business in some countries. As illustrated on the example of the newest EU member state, this practice has evolved from small-scale undertakings of companies seeking to decrease the total expenditures on their low-skilled employees to a pervasive tax evasion strategy embracing all types of workers, regardless of their skills and income. It is therefore hoped that this thesis will prompt policymakers around Europe to stop perceiving quasi-formal employment as a minor and benign occurrence, but rather as a serious economic and social problem that requires swift and adequate treatment.

#### **9.4 Theoretical contribution of the thesis**

However, the significance of the thesis goes far beyond the attempt to spark a broader interest of experts and scholars in this illegitimate wage practice. First of all, it should be reiterated once again that this study represents the very first attempt to understand the roots of envelope wage practices from the perspective of employees. In line with this, the research conducted offered many essential details on the workers' side of the story, which have not been considered so far but are crucial for giving an exhaustive account of the phenomenon.

The most important theoretical contribution of the thesis relates to the understanding that workers are actually active players shaping the dynamics and nature of the practice. The study thus challenges the prevalent belief of the scholars interested in this issue, who argued that workers are submissive figures fully dependent on the will of their employers (see Hazans, 2005; Woolfson, 2007). What is more, by recognising that some individuals enter this realm by choice, the thesis showed that quasi-formal employment is not all involuntary and totally employer-driven.

Another important theoretical contribution of the study, which is closely related to this one, is reflected in the detailed account of the manifold mechanisms supporting envelope wage practices on the part of workers. By scrutinising this illegitimate wage arrangement from the holistic standpoint, the study showed that quasi-formal employment is quite a complex practice, driven by a range of mutually interweaved macroeconomic and microeconomic factors. As elaborated, in order to fully understand motives of workers for participating in this realm, one must first comprehend the wider economic, social, cultural and political environment in which

they operate. However, by dissecting the fundamental macroeconomic determinants through the lens of individual-level characteristics, the thesis illustrated how these two sides of the coin mutually shape behaviour of an individual worker.

Given the stochastic nature of the micro and macro drivers and a continuous variation in the way they interact, quasi-formal employment was demonstrated to be quite a dynamic and lively practice. For instance, we illustrated how the previous experience of an individual affects their viewpoints, satisfaction with their own position and strategies to handle various conflict situations that commonly arise during this specific type of employment. Also, the presented research explicated how changes in social status influence a person's inclination toward risk, which in turn defines their preferences with respect to various types of payments within quasi-formal employment. Explicitly, it was shown that new entrants to the under-declared realm are more ready to work overtime and receive variable envelope wages, while more experienced quasi-formal workers (and especially those married with children) rather prefer a foreseeable work schedule and fixed take-home pay.

What is more, the thesis demonstrated that the inherent dynamics of quasi-formal employment is not confined solely to fluctuations related to individualities of workers, but also to the changes in the compound relationship between workers and their employers, as well as to the changes in social climate inside the company. By illustrating how professional and social standards affect one's willingness to keep obeying the unwritten agreement, the conducted study thus expounded the cultural dimension of the practice, which was not considered before.

In view of that, the thesis clearly showed that not only are the five sets of theories about the causes of noncompliant behaviour not in opposition to each other, but rather should be integrated for a better grasp of all the aspects of the studied phenomenon. As exemplified in four stages of the research, each school of thought provides one piece of the puzzle that is necessary to fully understand why and when people choose to disobey the legislation. This therefore represents a significant theoretical contribution, given that so far the roots of envelope wage practices have been believed to reside completely within the theories of dualism and structuralism (see section 9.2).

The holistic approach towards conceptualisation of the phenomenon in turn enabled to give a nuanced elaboration on different subgroups of employees within the quasi-

formal realm, thus showing that quasi-formal workers are quite a heterogeneous labour cohort. What is more, this particular part of the study also revealed how employers resort to a range of different recruitment strategies, as well how the choice of a strategy depends on the exact nature of a job, qualification of a worker and availability of substitutes for the given candidate. This psychological game of two players, in which an employer is commonly the first to play their cards, was shown not only to be substantially directing the final decision of workers regarding entrance into this realm, but also to strongly defining future behaviour of both sides (i.e. during the course of employment).

The provided information on the essential role of the recruitment phase within a quasi-formal job therefore represents a significant extension of the available theories on quasi-formal employment. Explicitly, while endorsing the importance of 'take it or leave it' strategy by employers, which was believed so far to be the only option within quasi-formal employment (see Woolfson, 2007), this study showed that there are also some other, more potent tactics. As discussed, the most common such alternative strategies are offering two possibilities (i.e. quasi-formal employment vs complete declaration on quite a low amount), envelope wage payments for overtime work, and payments according to the total number of hours worked.

Finally, it is important to reiterate that this study represents the first endeavour to conceptualise the issue of under-declared employment using the mixed-methods approach. By utilising the best of the two research perspectives under the concepts of critical realism, the research conducted was able to grasp various essential aspects of this practice that were not described before. This was done by applying quantitative analyses in the first stage so as to identify factors that might be important for the development and sustaining of quasi-formal employment. The qualitative approach then enabled a more profound insight into the exact role of these factors and the way in which they jointly shape the behaviour of workers. Combining both research perspectives thus proved to be potent in exploring the nature of quasi-formal employment. In line with this, it is hoped that the research will encourage other scholars interested in the phenomenon to follow the same strategy in order to obtain as comprehensive insight into this illegitimate wage arrangement as possible.

## 9.5 Limitations of the research

Before giving concluding remarks, we should first stress some important limitations of this study, which certainly may have influenced the findings in all phases of the research. Some of these limitations were beyond the control of the researcher, but some are linked directly to the researcher and his position in the process. Many of the problems were already mentioned throughout the thesis, but it is worth reflecting on them once again.

Starting with the quantitative part of the research, certainly the biggest problem was a substantial amount of missing data, and this relates to all three datasets used (i.e. two waves of the Special Eurobarometer Survey and the GREY Survey). Although this issue was somewhat mitigated by application of the multiple imputation technique, it is undisputable that some bias in findings remained (see Enders, 2010; D. R. Johnson & Young, 2011). As explained, such a high rate of missing values was first and foremost due to the sensitivity of the topic, as many people were not ready to honestly answer delicate questions asked by total strangers (i.e. by interviewers) (see Fegatilli, 2009). In view of that, there is a reasonable assumption that many of those who failed to answer questions on participation in this practice were indeed receiving envelope wages.

Moreover, it is also not unusual in surveys on sensitive topics for people to drop out at some point. This can for instance happen if they find themselves offended by some questions or if they change their perception about the potential harm their participation can have on their personal wellbeing and security (E. D. de Leeuw, 2001). This can have even broader consequences than the previously mentioned problem, since people in such situations will fail to provide answers to all the remaining questions after the point at which they decide not to cooperate anymore.

Apart from this, a certain proportion of missing values in the surveys used in this thesis was probably due to the fact that some people simply did not understand the question(s), or did not understand the concept of under-declared employment in the first place. This problem was possibly more pronounced in the Special Eurobarometer Survey, given the fact that a single questionnaire was developed for all 28 member states (European Commission, 2007a, 2014). This brings us to the issue of translation, as for instance a perfectly understandable question in English can be completely confusing in some other languages if literally translated. This can happen not only because of the inherent differences between languages, but also owing to differences

in terminology to denote this phenomenon from one country to another. Having in mind the substantial variability in the proportion of missing values between countries encompassed by the Special Eurobarometer Survey (see European Commission, 2007a, 2014), one can understand why this problem may indeed be quite important from the perspective of this thesis.

Whatever the case might be, the amount of missing data in all three datasets calls for attention in future quantitative research on the matter. First of all, the researcher's experience from the qualitative part of the study suggests that a significant improvement regarding the collaboration of research participants can be achieved if sufficient time is dedicated to the issue of clarifying details about the exact purpose of the research, confidentiality and anonymity, as well as about data storage and usage. What is more, the way respondents are approached and treated by the person conducting the fieldwork can also have a tremendous impact on their cooperation (Seidman, 2006). Accordingly, if the interviewer manages to establish decent social contact with a research participant, they will be more likely to provide honest answers.

These aspects indicate that people conducting fieldwork play a quite important role in the pursuit of new knowledge. It is therefore of vital importance for market research agencies to have properly educated individuals for this job, who will be motivated to do their best to obtain high quality data from the field. This illuminates another problem that can also play an important role in the process. Explicitly, there is a risk that some data might be completely invented by individuals that conduct the fieldwork, which can happen if they are under time pressure, underpaid, oppressed, etc. Still, since market research agencies usually apply strict control mechanisms in this respect, this problem is probably not as salient from the perspective of this thesis as the ones previously described. In any case, it is also one of the aspects that remained beyond the control of the author of this thesis, but which might have somewhat influenced the analyses conducted.

Besides these technicalities, which are inherent in every questionnaire survey on sensitive topics, the three datasets used in this thesis also have their own additional problems. These are primarily reflected in the nonexistence of some questions that are vital for a more profound understanding of quasi-formal employment. For instance, none of the surveys contained questions about the exact motivation(s) for workers to enter the quasi-formal realm, duration of their employment, payment methods, etc. Although the GREY Survey was somewhat better in this respect, given

that a few additional questions on the matter were asked, it was still quite deficient in providing a deeper insight into the practice.

As discussed earlier, this limitation resulted principally from the fact that the surveys were only partially dedicated to quasi-formal employment (see section 4.1). Since many other topics were covered, the part focused on under-declared employment was in all three surveys quite restricted. The issue is particularly emphasised in the case of the Special Eurobarometer Survey, which encompassed several completely unrelated topics.

Turning to the problems related to the qualitative part of the research, an important limitation in this respect is certainly the narrow and specific environment in which the fieldwork was conducted. Since the core part of the study relied on qualitative interviewing in Zagreb, many peculiarities of the practice presented in this thesis cannot be claimed to hold true elsewhere and thus should be perceived as a mere specificity of the capital of Croatia. However, the reader should bear in mind that the idea was not to provide a universal depiction of envelope wage practices, but rather to extend our understanding of this complex occurrence in line with the critical realist viewpoint. In view of that, it is unquestionable that the presented study displayed how the decisions and behaviour of individuals depend on the economic, social and cultural environment they operate in, and therefore the choice of the location certainly fulfilled its main purpose.

Yet, this brings us to a probably more significant problem, which arises from the mere fact that the author of this thesis operated in the same environment as the research participants, inevitably, then, introducing some of his own assumptions, prejudgments and previous knowledge about the phenomenon into this research, which could cause some bias in different stages of the qualitative inquiry. Yet, being highly aware of this, the author was determined to do his best to mitigate these problems. This was primarily done by following the predefined interview schedules, which were comprehensively discussed with supervisors before starting the fieldwork. In addition, every interviewee was allowed to freely discuss all aspects of their employment that they considered as being important. Also, no statements of any research participant were challenged if not in line with the author's own belief. Finally, every single respondent was given equal importance when the findings were being summarised.

A further noteworthy limitation of this qualitative research lies in the snowball sampling method, which yields non-random data by its nature (Faugier & Sargeant, 1997; Rapoport, 1957). There is therefore a reasonable risk that some important aspects of the practice remained undetected, or that not all subgroups of quasi-formal workers were covered. To alleviate this risk, a number of different initial 'balls' with highly distinct individuals were introduced during the course of the fieldwork, with constant and careful retrospective insight of the researcher into the finished interviews, so as to detect the possibility of the existence of some new behavioural patterns and new subgroups of under-declared workers. In addition, the total number of research participants was not predefined, and therefore the research was carried out until the saturation point, at which little new information was forthcoming, was reached. Nevertheless, it is hard to define a saturation point in such circumstances, which still leaves the possibility that some important aspects remained out of sight.

## **9.6 Concluding remarks**

In spite of the enumerated limitations, the author of this thesis firmly believes that the existing problems with datasets and applied research tools and methods did not significantly undermine the validity of the research. Explicitly, all the findings presented in the thesis should be scrutinised through the lens of the critical realist philosophy, whose concepts were followed throughout the study. It is worth repeating once again that the ultimate goal of critical realism, which resides half way between positivism and interpretivism, is neither to find generalizable laws nor to describe the beliefs and experience of social actors, but to develop a greater level of understanding and provide a more comprehensive explanation of a research matter. In view of that, the author does not claim that the presented state of affairs is universal and undisputable. As a matter of fact, the theories offered in this thesis are open to critiques and revision, which should be provided by future research on quasi-formal employment.

Alongside testing the validity of the presented findings and their applicability to other economies around Europe, any future studies are expected to further explore some important issues that were brought to light by this thesis, but which are still not completely clarified. For instance, there is a need for additional consideration of the link between legislation on the minimum wage and the declared part of the wage in quasi-formal employment. Although we found that this link is not as firm as previously assumed, there are still many missing pieces of the puzzle that, it is hoped, will be

explained in further studies. What is more, the situation encountered in South-East Europe in this respect does not necessarily equal the state of affairs in other countries. In any case, a more refined account of this matter will in turn give an answer to the question whether increases of the minimum wage should be considered as a potential strategy for reducing occurrences of under-declaration.

Besides this, future research studies are also expected to expand our findings on the distribution of financial gain between employers and their workers. It is important to realise that this study was primarily concerned with perceptions of workers in this respect, which do not necessarily match the situation in reality. In other words, it is plausible that many of those who think they earn more this way are actually in delusion, owing to the lack of information, incorrect reasoning or some other factors. Yet, in the same time it is also possible that some of the individuals who think that their employer retains all financial benefits from this illegitimate wage arrangement would not earn more if they switched to a completely formal job. For that reason, it would be interesting to have a representative sample of dependent employees and their take-home pays so as to see whether (and how) quasi-formal individuals differ from their completely formal counterparts in this respect.

Given this issue on the one hand, as well as the overall complexity of under-declared employment on the other (as described in the thesis), there is an evident need to conduct a survey that would be completely dedicated to this illicit wage practice. While somewhat complicating the sampling procedure and consequently increasing the funds required, such a survey would be highly beneficial from several aspects. Potential benefits in this case would go beyond the number of additional questions that could be asked, as for instance such an approach would also eliminate problems with sample size. A much larger sample of workers would in turn enable application of more advanced statistical methods that could help in providing an exhaustive depiction of the practice.

In view of that, and in line with a vast number of intertwined factors shaping behaviour of taxpayers, which were identified in this study, there is certainly a potential for further differentiation of the quasi-formal workforce. It is therefore hoped that the present study will spark the broader interest of scholars and experts in understanding the diversity of stakeholders inside the quasi-formal realm, which would in turn help the authorities to develop a refined policy approach towards this illegitimate wage practice.



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## APPENDIX 1 GREY SURVEY QUESTIONNAIRE

Good morning/afternoon. I am ..... from ..... We are carrying out a survey on how people are getting-by and making a living in these difficult times and I would be grateful for your help in answering some questions.

Q1	Gender.
----	---------

Male	1
Female	2

Q2	Could you tell me which of the following best corresponds to your own current situation?
----	--

MARRIED OR REMARRIED	
Living without children	1
Living with the children of this marriage	2
Living with the children of a previous marriage	3
Living with the children of this marriage and of a previous marriage	4
SINGLE LIVING WITH A PARTNER	
Living without children	5
Living with the children of this union	6
Living with the children of a previous union	7
Living with the children of this union and of a previous union	8
SINGLE	
Living without children	9
Living with children	10
DIVORCED OR SEPARATED	
Living without children	11
Living with children	12
WIDOW	
Living without children	13
Living with children	14
Other (SPONTANEOUS)	15
Refusal (SPONTANEOUS)	97

Q3	How many persons live in your home, including yourself, all adults and children?
----	--

One person	1
Two	2
Three	3
Four	4
Five	5
Six	6
Seven	7
Eight or more	8

Q4	Could you tell me how many persons aged 15 years or more live in your household, yourself included?
----	---

One	1
Two	2
Three	3
Four	4
Five	5
Six	6
Seven	7
Eight	8
Nine or more	9

Q5	Your current employment status:
----	---------------------------------

Employed (full-time)	1
Employed (part-time)	2
Self-employed	3
Unemployed (< 1 year)	4
Unemployed (> 1 year)	5
Registered unemployed but working informally	6
Retired	7
Student	8
Registered disabled, incapacity benefit etc.	9
Other	10

It is widely known that part of the population is engaged in undeclared work, in the sense of activities which partly or entirely avoid declaration of the income to the tax authorities, but which are otherwise legal. This could be people working in certain sectors of activity like home maintenance – including builders, electricians and plumbers - but also in restaurants and cafes. Undeclared work is also common in a whole range of household services – such as gardening, babysitting and elderly care, personal services – like hairdressing, and repair services for cars, clothes or computers.

Q6	What would you estimate as the share of the population in (OUR COUNTRY) that works without declaring the income or part of the income to tax or social security institutions?
----	---

(SHOW CARD – READ OUT – ONE ANSWER ONLY)

Less than 1 %	1
From 1 % to less than 5 %	2
From 5 % to less than 10 %	3
From 10 % to less than 20 %	4
From 20 % to less than 30 %	5
From 30 % to less than 40 %	6
From 40 % to less than 50 %	7
50 % or more	8
Refusal (SPONTANEOUS)	97
DK	98

Q7	Do you personally know any people who work without declaring their income or part of their income to tax or social security institutions?
----	---

Yes	1
No	2
Refusal (SPONTANEOUS)	3
DK	4

Q8	People who work without declaring the income risk that tax or social security institutions find out and issue supplementary tax bills and perhaps fines. How would you describe the risk of being detected in (OUR COUNTRY)?
----	--

(READ OUT – ONE ANSWER ONLY)

Very high	1
Fairly high	2
Fairly small	3
Very small	4
Refusal (SPONTANEOUS)	5
DK	6

Q9	In your opinion, what sanction is to be expected if the authorities find out that someone has had an income from work of 250 euros per month which was not declared to tax or social security authorities?
----	--

(READ OUT – ONE ANSWER ONLY)

Normal tax or social security contributions due, but no fine	1
Normal tax or social security contributions due, plus a fine	2
Prison	3
Other (SPONTANEOUS)	4
Refusal (SPONTANEOUS)	5
DK	6

Q10	In your opinion, who are more likely to carry out undeclared work in (OUR COUNTRY)?
-----	---

(READ OUT – ONE ANSWER ONLY)

Men	1
Women	2
Both equally	3
Refusal (SPONTANEOUS)	4
DK	5

Q11a	Which TWO of the following groups are in your opinion most likely to carry out undeclared work in (OUR COUNTRY)? First?
------	---

Q11b	And the second most likely?
------	-----------------------------

(SHOW CARD – ONE ANSWER PER COLUMN)

	Q11a	Q11b
	FIRST	SECOND
Unemployed	1	1
Self employed	2	2
Pensioners/ retired	3	3
Full-time employees	4	4
Part-time employees	5	5
Students	6	6
Illegal immigrants	7	7
Others (SPONTANEOUS)	8	8
Refusal (SPONTANEOUS)	97	97
DK	98	98

Q12a	What are in your opinion the TWO most important reasons for engaging in undeclared work in (OUR COUNTRY)? First?
------	--

Q12b	And second?
------	-------------

(SHOW CARD – ONE ANSWER PER COLUMN)

	Q12a	Q12b
	FIRST	SECOND
Bureaucracy/ red tape to carry out a regular economic activity is too complicated	1	1
Lack of control by authorities	2	2
Sanctions are too weak	3	3
In certain sectors or regions there is no real alternative	4	4
Insufficient income from regular job	5	5
Lack of regular jobs on the labour market	6	6
The State does not do anything for the people, so why should they pay taxes	7	7
Nobody would buy these goods or services at normal rates on the regular market	8	8
Taxes and/ or social security contributions are too high	9	9
It makes rational sense	10	10
Other (SPONTANEOUS)	11	11
Refusal (SPONTANEOUS)	97	97
DK	98	98

It is widely known that many people to some extent accept 'undeclared work' – i.e., activities which are not declared to the tax authorities. As mentioned, this work can include a variety of goods and services, such as gardening, babysitting, home maintenance, hairdressing and many other things.

Q13	Now I would like to know how you assess various behaviours. For each of them, please tell me to what extent you find it acceptable or not. Please use the following scale: '1' means that you find it "absolutely unacceptable" and '10' means that you find it "absolutely acceptable".
-----	--

(SHOW CARD WITH SCALE – ONE ANSWER PER LINE)

	(READ OUT)	1 Absolutely unacceptable	2	3	4	5	6	7	8	9	10 Absolutely acceptable	97 Refusal (SPONTANEOUS)	98 DK
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1	Someone receives welfare payments without entitlement	1	2	3	4	5	6	7	8	9	10	97	98
2	A private person is hired by a private household for work and he/she does not report the payment received in return to tax or social security institutions although it should be reported	1	2	3	4	5	6	7	8	9	10	97	98
3	A firm is hired by a private household for work and it does not report the payment received in return to tax or social security institutions	1	2	3	4	5	6	7	8	9	10	97	98
4	A firm is hired by another firm for work and it does not report its activity to tax or social security institutions	1	2	3	4	5	6	7	8	9	10	97	98
5	A firm hires a private person and all or a part of the salary paid to him/ her is not officially registered	1	2	3	4	5	6	7	8	9	10	97	98
6	Someone evades taxes by not or only partially declaring income	1	2	3	4	5	6	7	8	9	10	97	98

Q14	Have you in the last twelve months acquired any <b>SERVICES</b> of which you had a good reason to assume that they involved undeclared work, i.e. that the income was not completely reported to tax or social security institutions (e.g., because there was no invoice or VAT receipt or they offered you a 'price for cash')
-----	---

(PLEASE REMIND THE INTERVIEWEE THAT ALL ANSWERS WILL REMAIN ANONYMOUS)

Yes	1
No	2
Refusal (SPONTANEOUS)	3
DK	4

Q15	And have you in the last twelve months acquired any <b>GOODS</b> of which you had a good reason to assume that they embodied undeclared work, i.e. that the income was not completely reported to tax or social security institutions?
-----	--

(PLEASE REMIND THE INTERVIEWEE THAT ALL ANSWERS WILL REMAIN ANONYMOUS)

Yes	1
No	2
Refusal (SPONTANEOUS)	3
DK	4

(ASK Q16a TO Q20 IF "YES", CODE 1 IN Q14 OR Q15 – OTHERS GO TO Q21)

Q16a	Which of the following goods or services have you paid for during the last 12 months, where you had good reason to believe that they involved undeclared work (i.e. the income was not completely reported to the tax authorities).
------	---

(SHOW CARD – READ OUT – MULTIPLE ANSWERS POSSIBLE)

Babysitting in your home	1
Babysitting outside of your home	2
Healthcare/ caring services/ assistance for a dependent or elderly relative	3
Cleaning your home	4
Ironing clothes	5
Repairs or renovations to your home	6
Gardening	7
Hairdresser and/ or beauty treatments	8
Tutoring	9
Help moving house	10
IT assistance	11
Car repairs	12
Buying food (e.g., farm produce)	13
Other goods or services	14
DK	98



Q16b	IF CODE 14 IN Q16a WRITE DOWN ANSWER BELOW
------	--

--

Q17	Thinking about the most important good or service coming from undeclared work you acquired, could you please indicate roughly how much money you spent on it in the last twelve months?
-----	---

(PLEASE CODE NNNNN.NN – IF “REFUSAL” CODE ‘9999998’ – IF “DK” CODE “9999999”)
---

										EUROS
--	--	--	--	--	--	--	--	--	--	-------

Q18	Among the following, could you please indicate from whom you bought this good or service?
-----	---

(SHOW CARD – READ OUT – ONE ANSWER ONLY)
--

Friends, colleagues or acquaintances	1
Relatives	2
Neighbours	3
Other private persons or households	4
Firms or businesses	5
Other (SPONTANEOUS)	6
Refusal (SPONTANEOUS)	97
DK	98

Q19	From the following, what made you buy it undeclared instead of buying it on the regular market?
-----	---

(SHOW CARD – READ OUT – MULTIPLE ANSWERS POSSIBLE)
--

Lower price	1
Faster service	2
Better quality	3
In order to help someone who is in need of money	4
It was a favour amongst friends/ relatives/ colleagues	5
Good/ service is not/ hardly available on the regular market	6
Other (SPONTANEOUS)	7
Refusal (SPONTANEOUS)	97
DK	98

Q20	From the following, what would you have done if this good or service had only been available on the regular market?
-----	---

(SHOW CARD – READ OUT – ONE ANSWER ONLY)

I would have bought it from the regular market	1
The job would have been done by myself or another member of the household	2
I would have postponed the acquisition of this service or good	3
I would not have purchased the service or good	4
Other (SPONTANEOUS)	5
Refusal (SPONTANEOUS)	97
DK	98

ASK Q21 TO Q26 IF “EMPLOYEES”, CODE 1 TO 2 IN Q5 – OTHERS GO TO Q27

Q21	Sometimes employers prefer to pay all or part of the regular salary or the remuneration for extra work or overtime hours cash-in-hand and without declaring it to tax or social security authorities. Did your employer pay you all or part of your income in the last 12 months this way?
-----	--

(PLEASE REMIND THE INTERVIEWEE THAT ALL ANSWERS WILL REMAIN ANONYMOUS)

Yes	1
No	2
Refusal (SPONTANEOUS)	3
DK	4

ASK Q22 TO Q26 IF “YES”, CODE 1 IN Q21 – OTHERS GO TO Q27

Q22	Was this income part of the remuneration for your regular work, was it payment for overtime hours or was it both?
-----	---

(READ OUT – ONE ANSWER ONLY)

Part of the payment for regular work	1
Overtime, extra-work	2
Both regular and overtime work	3
Refusal (SPONTANEOUS)	4
DK	5

Q23a	Who suggested paying this additional salary which would not be declared to the authorities?
------	---

(READ OUT – ONE ANSWER ONLY)

It was on my initiative	1
It was a joint idea (involving both myself and the employer)	2
It was initiated by my employer	3
Refusal (SPONTANEOUS)	4
DK	5

Q23b	Were you happy getting part of your salary without having it declared to the tax or social security authorities or would you have preferred to have had your total gross salary declared?
------	---

(READ OUT – ONE ANSWER ONLY)

Happy with this	1
Would prefer full declaration	2
It depends	3
Refusal (SPONTANEOUS)	4
DK	5

Q24	Did you verbally agree with your employer to any of the following conditions in return for receiving this additional cash-in-hand payment?
-----	--

(READ OUT - MULTIPLE ANSWERS ALLOWED)

Agreed to work longer working hours than is in the formal contract	1
Agreed not to take full statutory holiday allowance	2
Agreed to do different tasks than is in the formal contract	3
No additional conditions were agreed	4
Other (SPONTANEOUS)	5
Refusal (SPONTANEOUS)	97
DK	98

Q25	Approximately what percentage share of your net monthly income from this job did you get this way?
-----	--

(PLEASE WRITE DOWN NNN WITHOUT DECIMALS – IF “REFUSAL” CODE ‘997’ – IF “DK” CODE ‘998’)

			%
--	--	--	---

Q26	Which of the following best describes your officially gross declared salary for this job?
-----	---

(PLEASE STATE THE GROSS MIN. WAGE(S) IN THE COUNTRY)

The salary equals the minimum wage	1
The salary is above the minimum wage	2
The salary is below the minimum wage	3
Refusal	4
DK	5

ASK ALL

Let's now look beyond the declared sphere...

Q27	Did you yourself carry out any undeclared paid activities in the last 12 months? Here we mean again activities you were paid for that were not or not fully reported to the tax authorities.
-----	---

(PLEASE REMIND THE INTERVIEWEE THAT ALL ANSWERS WILL REMAIN ANONYMOUS)

Yes	1
No	2
Refusal (SPONTANEOUS)	3
DK	4

ASK Q28a TO QB34 IF "YES", CODE 1 IN Q27 – OTHERS GO TO Q35

Q28a	Which of the following activities have you carried out undeclared in the last 12 months?
------	--

(SHOW CARD – READ OUT- MULTIPLE ANSWERS POSSIBLE)

Babysitting	1
Cleaning	2
Ironing clothes	3
Home maintenance or home improvement services	4
Gardening	5
As a waiter or waitress	6
Tutoring	7
Help moving house	8
IT assistance	9
Car repairs	10
Selling goods/ services associated with my hobby	11
Selling food (e.g., farm produce)	12
Selling other goods and services	13
Other activities	14
DK	98

Q28b	(IF CODE 14 IN Q28a WRITE DOWN ANSWERS BELOW)
------	---

Q29	APPROXIMATELY, how much did you get in total from these undeclared activities in the last 12 months?
-----	--

(PLEASE WRITE DOWN NNNNNN - IF "REFUSAL" CODE '999997' - IF "DK" CODE '999998')

												EUROS
--	--	--	--	--	--	--	--	--	--	--	--	-------

Q30	Thinking about the most significant undeclared work you just mentioned, did you carry out this activity only once or a few times or do you carry it out with certain regularity?
-----	--

(ONE ANSWER ONLY)

Just once	1
A few times	2
With certain regularity	3
Refusal (SPONTANEOUS)	4
DK	5

(ASK Q31, IF CODE 3 IN Q30 – OTHERS GO TO Q32)

Q31	How many weeks during the last twelve months did you work in this activity?
-----	---

(PLEASE WRITE DOWN NN – IF “REFUSAL” CODE ‘97’ – IF “DK” CODE ‘98’)

		WEEKS
--	--	-------

Q32	APPROXIMATELY, how much did you get per hour on average for this activity?
-----	--

(PLEASE WRITE DOWN NNN.NN – IF “REFUSAL” CODE ‘99997’ – IF “DK” CODE ‘99998’)

					EUROS/HOUR
--	--	--	--	--	------------

Q33	Among the following, would you please indicate for whom did you carry out this activity?
-----	--

(SHOW CARD – READ OUT – ONE ANSWER ONLY)

Friends, colleagues or acquaintances	1
Relatives	2
Neighbours	3
Other private persons or households	4
Firms or businesses	5
Other (SPONTANEOUS)	6
Refusal (SPONTANEOUS)	97
DK	98

Q34	Among the following, what were the reasons for doing this activity undeclared?
-----	--

(SHOW CARD – READ OUT – MULTIPLE ANSWERS POSSIBLE)

The person(s) who acquired it insisted on the non-declaration	1
Bureaucracy/ red tape to carry out a regular economic activity is too complicated	2
You could not find a regular job	3
You were able to ask for a higher fee for your work	4
Both parties benefited from it	5

Taxes and/ or social security contributions are too high	6
It is just seasonal work and so it is not worth declaring it	7
Working undeclared is common practice in your region/ sector of activity so there is no real alternative	8
The State does not do anything for you, so why should you pay taxes	9
In order to help someone out	10
This is the normal way in which this is done among friends, neighbours or relatives	11
Other (SPONTANEOUS – SPECIFY)	12
Refusal (SPONTANEOUS)	97
DK	98

ASK Q34a IF CODE 12 - "OTHER" IN Q34

Q34a Which others?

PLEASE WRITE DOWN ALL SPONTANEOUS ANSWERS - PLEASE CODE WHEN DOING DATA INPUT

ASK ALL

Q35 Now I would like to know your level of agreement with the following statements. For each of them please tell me to what extent you agree or disagree with the statement: '1' means "strongly disagree" and '5' means "strongly agree".

(SHOW CARD WITH SCALE – ONE ANSWER PER LINE)

	(READ OUT)	1 strongly disagree	2	3	4	5 strongly agree	97 Refusal (SPONTANEOUS)	98 DK
1	If people were better informed on how government is spending public money, they would be more willing to pay taxes	1	2	3	4	5	97	98
2	Ensuring a sense of fairness in how people are treated by the tax authorities would reduce evasion of taxes and social contributions	1	2	3	4	5	97	98
3	If people had greater trust in government, they would be more willing to pay their taxes	1	2	3	4	5	97	98
4	Telling consumers about the negative consequences of undeclared work (e.g. no insurance cover, no guarantees that health and safety regulations have been followed.	1	2	3	4	5	97	98

	no legal recourse) would reduce where they use it							
5	Specialised support and advice for those who are considering moving from undeclared to formal work would reduce undeclared work	1	2	3	4	5	97	98
6	Tax evasion would be reduced if the tax authorities made it easier for people to pay their taxes, e.g. through providing pre-filled tax returns	1	2	3	4	5	97	98
7	Making it easier to legitimately do small or occasional jobs would reduce undeclared work	1	2	3	4	5	97	98
8	Undeclared work would be reduced if people were allowed to deduct from the taxes they owe some of the costs of paying for household services (e.g. babysitting, cleaning, elderly care, cooking, gardening, tutoring)	1	2	3	4	5	97	98
9	More inspections are required at employers' premises to tackle the problem with undeclared work	1	2	3	4	5	97	98
10	Increasing penalties up to imprisonment for people caught doing undeclared work is likely to reduce its prevalence	1	2	3	4	5	97	98
11	If the Tax Office was encouraging to those who have difficulty meeting their obligations through no fault of their own the tax evasion would be reduced	1	2	3	4	5	97	98

**There is evidence to show that part of the population pulls strings and uses connections to obtain goods and services outside formal practices in different spheres - i.e. finding a job, speeding up bureaucratic procedures, obtaining a better degree, skipping queues in medical institutions, solving problems with law enforcing authorities, obtaining everyday services at better price and quality, gaining better legal services...**

Q36	In your opinion, how important are connections to achieve certain goals in (OUR COUNTRY)?
-----	---

(READ OUT – ONE ANSWER ONLY)

Very important	1
Important	2
Somewhat important	3
Not important	4

Q37	In your opinion, in which of the following sectors are connections in (OUR COUNTRY)...
-----	--

Q37a	...most commonly used?
------	------------------------

Q37b	...necessary to achieve certain things?
------	---

(SHOW CARD - CIRCLE ALL ANSWERS THAT APPLY)
---

	Q37a	Q37b
Political	1	1
Public procurement	2	2
Judiciary	3	3
Police	4	4
Media	5	5
Business	6	6
Public administration	7	7
Other/ Don't know	8	8

Q38	What is your attitude towards having things done by pulling strings/ using connections?
-----	---

(READ OUT – ONE ANSWER ONLY)
------------------------------

Very positive	1
Positive	2
Neutral	3
Negative	4
Very negative	5

Q39	Have you in the last twelve months asked anyone for a favour/ help using connections in any of the following spheres?
-----	---

(PLEASE COMPLETE THE TABLE BELOW BY ANSWERING Q39a-Q39c FOR EACH OF THE SPHERES)
--

Q39a	Have you in the last twelve months asked anyone for a favour/ help using connections?
------	---

(SHOW CARD)
-------------

No	1
Yes, to circumvent the rules/ laws/ bureaucracy	2
Yes, to make rules/ laws work	3
Yes, to reduce the final price	4
Yes, to improve quality	5
Yes, to get information	6
Yes, to be introduced to useful people	7
Yes, to receive services without queuing	8
Yes, to maintain connections	9
Refusal (SPONTANEOUS)	10
DK	11

ASK Q39b AND Q39c IF CODE 2-9 IN Q39a, OTHERS GO TO Q40
---



Q39b	How did you reward/compensate your connection for the favour/ help received?
------	--

(READ OUT – ONE ANSWER ONLY)
------------------------------

With cash	1
With a gift	2
Quid pro quo	3
Just 'thank you'	4
Refusal (SPONTANEOUS)	5
DK	6

Q39c	Who was the person who helped you/ did you a favour?
------	--

Relative	1
Friend	2
Colleague	3
Neighbour	4
Other	5

Spheres of using connections	Q39a	Q39b	Q39c
Medical services: skipping queue, getting better examination, surgery			
Solving problems with the law enforcing authorities: traffic police, customs			
Finding a job			
Education: places in higher education/ obtaining degree/ diploma etc.			
Legal services and courts			
Everyday services at better quality or better price (bank services, hairdressers...)			
Repairs (housing, garages, car)			
Tickets for events, theatre, concerts			
Hobbies and entertainment, resorts, travelling tickets			
Consumer goods excl. foodstuffs			
Communicating with local authorities in your business matters (e.g. delaying tax payment)			
Foodstuffs			
Speeding up bureaucratic procedures (e.g. at the municipal hall)			
Other (please specify).....			

Q40	Have you in the last twelve months done anyone a favour/ helped anyone in any of the following spheres?
-----	---

(PLEASE COMPLETE THE TABLE BELOW BY ANSWERING Q40a-Q40c FOR EACH OF THE SPHERES)

Q40a	Have you in the last twelve months helped anyone? Did someone a favour?
------	---

(SHOW CARD)

No	1
Yes, to help them circumvent the rules/ laws/ bureaucracy	2
Yes, to make rules/ laws work	3
Yes, to reduce the final price	4
Yes, to improve quality	5
Yes, to provide information	6
Yes, to introduce them to useful people	7
Yes, to help them receive services without queuing	8
Yes, to maintain connections	9
Refusal (SPONTANEOUS)	10
DK	11

ASK Q40b AND Q40c IF CODE 2-9 IN Q40a, OTHERS GO TO Q41

Q40b	What did you get as a reward/ compensation from the person you helped/ did the favour for?
------	--

(READ OUT – ONE ANSWER ONLY)

Cash	1
A gift	2
Quid pro quo	3
Just 'thank you'	4
Refusal (SPONTANEOUS)	5
DK	6

Q40c	Who did you help? Who did you do the favour for?
------	--

Relative	1
Friend	2
Colleague	3
Neighbour	4
Other	5

Spheres of using connections	Q40a	Q40b	Q40c
Medical services: skipping queue, getting better examination, surgery			
Solving problems with the law enforcing authorities: traffic police, customs			

Finding a job			
Education: places in higher education/ obtaining degree/ diploma etc.			
Legal services and courts			
Everyday services at better quality or better price (bank services, hairdressers...)			
Repairs (housing, garages, car)			
Tickets for events, theatre, concerts			
Hobbies and entertainment, resorts, travelling tickets			
Consumer goods excl. foodstuffs			
Communicating with local authorities in your business matters (e.g. delaying tax payment)			
Foodstuffs			
Speeding up bureaucratic procedures (municipal hall)			
Other (please specify).....			

Q41	Now I would like to know your level of agreement with the following statements. For each of them please tell me to what extent do you agree or disagree with the statement: '1' means "strongly disagree" and '5' means "strongly agree".
-----	---

(SHOW CARD WITH SCALE – ONE ANSWER PER LINE)

	(READ OUT)	1 strongly disagree	2	3	4	5 strongly agree	97 Refusal (SPONTANEOUS)	98 DK
--	------------	---------------------------	---	---	---	------------------------	-----------------------------	----------

1	Complicated bureaucratic procedures are one of the main reasons for resorting to the use of connections	1	2	3	4	5	97	98
2	Ensuring a sense of fair treatment in public and government institutions would reduce the use of connections	1	2	3	4	5	97	98
3	If people were better informed of the procedures in place, they would not resort to the use of connections to achieve certain things	1	2	3	4	5	97	98

ASK Q42 IF "EMPLOYED" OR "SELF-EMPLOYED", CODES 1-3 IN Q5, OTHERS GO TO Q43

Q42	In which of the following sectors of activity are you currently working?
-----	--

(SHOW CARD – READ OUT– ONE ANSWER ONLY)

Construction	1
Industry	2
Household services (incl. gardening, child and elderly care)	3
Transport	4
Personal services	5
Retail	6
Repair services	7
Hotel, restaurant, cafes	8
Agriculture	9
Other (SPONTANEOUS)	10
Refusal (SPONTANEOUS)	97

Q43 How would you describe your financial situation?

Very comfortable/ No money problems whatsoever	1
Just comfortable	2
Maintaining	3
Struggling	4
Other	5
Refusal (SPONTANEOUS)	97

Q44 Which of the following best describes your net income in the last month?

Q44a Net income generated from formal work

EUR 0	1
EUR 0-350	2
EUR 350-700	3
EUR 700-1,000	4
EUR 1,000-1,300	5
EUR 1,300-1,800	6
> EUR 1,800	7
Refusal (SPONTANEOUS)	97

Q44b Net income generated from informal work

EUR 0	1
EUR 0- 100	2
EUR 100-250	3
EUR 250-500	4
EUR 500-1,000	5
> EUR 1,000	6
Refusal (SPONTANEOUS)	97

Q45a Exact age (ANSWER IN THE GAP BELOW)

Q45b AUTOMATICALLY CIRCLE THE AGE GROUP

15 - 24 years	1
25 - 34 years	2
35 - 44 years	3
45 - 54 years	4
55 - 64 years	5
65 years+	6

FOR INTERVIEWER

QC1	Code the locality size appropriately.
-----	---------------------------------------

Rural area or village	1
Small or middle sized town	2
Large town	3
DK	4

QC2	Code region
-----	-------------

PLEASE ENTER REGIONS ACCORDINGLY

QC3	Would you say you that the cooperation of the respondent was:
-----	---

Excellent	1
Fair	2
Average	3
Bad	4
DK	5



## APPENDIX 2 EXPLORATORY FACTOR ANALYSIS AND ITS APPLICATION IN GENERATING THE TAX MORALE INDEX

Exploratory factor analysis is a widely used procedure in psychology and other social sciences for disclosing latent mechanisms that underlie subject's performance on a set of observed variables (Morrison, 1990; Raykov & Marcoulides, 2008; Spearman, 1904). These mechanisms, commonly referred to as 'factors', are not directly measurable, but are instead hidden constructs with the observed variables being their manifestations in overt behaviour.

Based on the coherence between the observed variables and following a set of mathematical procedures, the goal of exploratory factor analysis is to determine the exact number of these latent constructs and to describe their features (Mardia, Kent, & Bibby, 1979). In other words, the analysis seeks to explain a set of interrelated variables with as few as possible factors which can be easily interpreted.

In its general form, exploratory factor analysis is defined by:

$$\begin{aligned}
 Y_1 &= \beta_{10} + \beta_{11}F_1 + \beta_{12}F_2 + \dots + \beta_{1m}F_m + e_1 \\
 Y_2 &= \beta_{20} + \beta_{21}F_1 + \beta_{22}F_2 + \dots + \beta_{2m}F_m + e_2 \\
 &\dots \\
 Y_n &= \beta_{n0} + \beta_{n1}F_1 + \beta_{n2}F_2 + \dots + \beta_{nm}F_m + e_n
 \end{aligned}
 \tag{A1}$$

where  $Y_1 - Y_n$  represent initial variables of interest,  $F_1 - F_m$  ( $m < n$ ) are latent factors whose number and characteristics are to be determined and  $\beta_{ij}$  are loadings of the factors on the observed variables. The error terms  $e_1 - e_n$  indicate that the model is stochastic, i.e. that the hypothesised relationships are not exact.

To make estimation of the loadings possible, the following two sets of assumptions must be made:

AS1) The error terms are mutually independent and normally distributed with  $E(e_i) = 0$  and  $Var(e_i) = \sigma_i^2$

AS2) The factors  $F_j$  are independent of the error terms and of one another, where  $E(F_j) = 0$  and  $Var(F_j) = 1$ .

To illustrate estimation of the loadings based on these assumptions, let us further assume there are only two latent factors<sup>139</sup>. Applying the formula for the variance<sup>140</sup> on equations (A1), and respecting the assumptions AS1) and AS2), the following expression is obtained in the case of two factors:

$$\text{Var}(Y_i) = \beta_{i1}^2 \text{Var}(F_1) + \beta_{i2}^2 \text{Var}(F_2) + (1)^2 \text{Var}(e_i) = \beta_{i1}^2 + \beta_{i2}^2 + \sigma_i^2 \quad (\text{A2})$$

As can be seen above, the variance of  $Y_i$  consists of two parts. The sum  $\beta_{i1}^2 + \beta_{i2}^2$ , which is commonly labelled as 'communality', represents the part of the variance shared with other observed variables of interest (i.e. the part that can be explained by underlying factors). On the other hand,  $\sigma_i^2$  represents the share of the variance that cannot be explained by latent constructs and is therefore accordingly labelled as 'uniqueness'.

If the same procedure is applied to covariance of any two observed variables  $Y_i$  and  $Y_j$ , we get

$$\text{Cov}(Y_i, Y_j) = \beta_{i1}\beta_{j1}\text{Var}(F_1) + \beta_{i2}\beta_{j2}\text{Var}(F_2) + (1)(0)\text{Var}(e_i) + (1)(0)\text{Var}(e_j) = \beta_{i1}\beta_{j1} + \beta_{i2}\beta_{j2} \quad (\text{A3})$$

Yet, since variables  $Y_1 - Y_n$  are observed, the left hand sides in (A2) and (A3) can be calculated directly using empirical data. This gives a set of equations which are then used to estimate loadings  $\beta_{ij}$ .

This is the point where several decisions must be made by a researcher, and these refer to the exact method used for estimating loadings, the criterion for determining the number of factors to retain, the rotation technique (if needed), and the procedure for extracting the exact values of the factor(s). There are several options for each of the mentioned steps, which will not be discussed here. A reader interested in available options and their strengths and weaknesses is advised to see for instance Thompson (2004).

---

<sup>139</sup> This is just a provisional assumption, which is made only to ease presentation of the mathematical model behind the exploratory factor analysis. The model is straightforwardly extended to any number of factors.

<sup>140</sup> For more detailed explanation of rules for calculating variance and covariance of a variable see for instance Raykov and Marcoulides (2008).



In any case, the difference between results obtained by various methods is typically small. Having in mind the role of the extracted factor(s) in our analyses, as well as the role of the quantitative inquiry in the whole study on under-declared employment in this thesis, the final conclusions are not expected to be influenced by the exact choices at this stage.

Explicitly, the exploratory factor analysis applied in this study was based on the principal factor procedure (Thompson, 2004), number of factors to retain was determined using Scree plot and the Parallel Analysis (Horn, 1965; Thompson, 2004; Zwick & Velicer, 1986), while the values of factors were extracted following regression scoring method (DiStefano, Zhu, & Mîndrilă, 2009). Since only one factor was retained (see below), rotation was not required.

To illustrate the process of exploratory factor analysis in our case, we will examine the extraction of factor values for 2013 data. Values for 2007 were obtained in the same way and therefore the results will not be presented here. It is, however, important to state that the exploratory factor analysis was conducted on complete datasets (i.e. all surveyed individuals were included regardless of their employment status) so as to obtain representative values for whole EU.

In line with the theoretical discussion above, the process starts with examination of the correlation matrix for the observed variables. As can be seen from Table A2-1, each of the four variables is substantially correlated with remaining three indicators of interest. It is, however, noticeable that the variable designating tolerance towards receiving welfare payments without entitlement is somewhat less associated with others, with coefficients ranging from 0.45 to 0.49. Nonetheless, given that these correlations are still quite high, one can argue that many people indeed do not differentiate significantly this indirect strategy for cheating the state from undeclared work in general.

Looking at the correlations between the three variables directly referring to undeclared work, we see that the coefficients range between 0.64 and 0.78, which indicates quite a high association between them.

**Table A2-1 Correlation matrix, 2013**

	Receiving welfare payments without entitlement	Undeclared work by firm for private household	Undeclared work by firm for firm	Someone partially or completely conceals their income
Receiving welfare payments without entitlement	1.00	0.45	0.49	0.46
Undeclared work by firm for private household	0.45	1.00	0.78	0.64
Undeclared work by firm for firm	0.49	0.78	1.00	0.64
Someone partially or completely conceals their income	0.46	0.64	0.64	1.00

*Source: Author's own work based on the Special Eurobarometer 402/Wave 79.2*

To further explore the nature of association between the variables of interest, it is important to see how each of them contributes to the underlying construct(s), as well as what happens when the variable is omitted. To analyse this, Table A2-2 shows item-rest correlation, average inter-item correlation when the variable is excluded and Cronbach's alpha when the variable is excluded. The last row specifies the exact values for the case when all four variables are included, which enables to compare influence of each variable on the overall coherence.

**Table A2-2 Inter-item correlations and Cronbach's alpha, 2013**

	Item-rest correlation	Average inter-item correlation when the variable is excluded	Cronbach's alpha when variable is excluded
Receiving welfare payments without entitlement	0.52	0.69	0.87
Undeclared work by firm for private household	0.75	0.53	0.77
Undeclared work by firm for firm	0.77	0.51	0.76
Someone partially or completely conceals their income	0.68	0.57	0.80
Test scale		0.57	0.84

*Source: Author's own work based on the Special Eurobarometer 402/Wave 79.2*

Item-rest correlation, which designates the association between an individual variable and the total of all other variables<sup>141</sup>, confirms that the attitude towards receiving welfare payments without entitlement is indeed somewhat less correlated with attitudes on remaining three noncompliant behaviours. While the coefficient for this indicator accounts for 0.52, it ranges between 0.68 and 0.77 for the remaining three variables.

This peculiarity is additionally pronounced when scrutinising average correlations inside the cluster after excluding one of the variables, which is shown in column 3 above. As noticeable, average correlation raises from 0.57 to 0.69 when the variable indicating attitude towards cheating on welfare benefits is not included. This

<sup>141</sup> This step is done automatically in STATA. For more details see <http://www.stata.com/manuals13/mvalpha.pdf>

therefore suggests that omitting this indicator from the factor analysis might yield better results. On the other hand, the omission of any other variable would reduce the coefficient, which implies that they must be retained.

To make a final decision, it is important to analyse the effect of each variable on the values of Cronbach's alpha. Cronbach's alpha, whose values range between 0 and 1, measures internal consistency of a set of variables (see Tavakol & Dennick, 2011). Higher values indicate higher consistency, with threshold of 0.8 usually taken as a precondition for exploratory factor analysis to be valid.

The exact values in our case are given in the last row of Table A2-2. As noticeable, the overall alpha of 0.84 is reduced when each of the three indicators expressing attitudes towards undeclared work in general is dropped. On the other hand, it is increased to 0.87 after omitting the variable conceptualising attitude towards illegitimate receipt of welfare benefits.

Yet, although one can argue based on the presented results that it might be wise to exclude this particular indicator, the decision was made to retain it. This was done primarily because the idea was to encompass as comprehensive set of noncompliant activities potentially linked with quasi-formal employment as possible, and receiving welfare benefits without entitlement is certainly one of them.

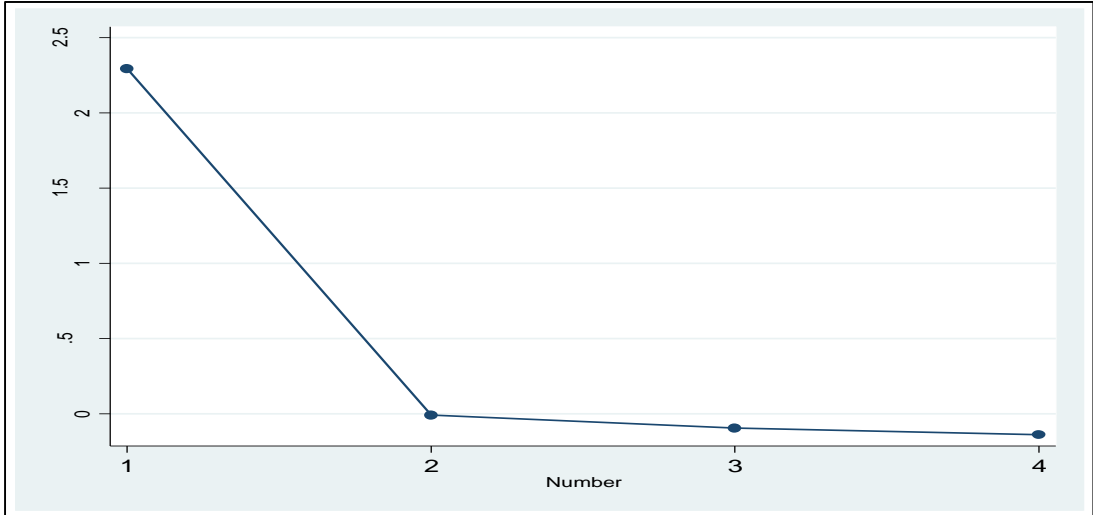
Furthermore, despite being somewhat less associated with remaining variables, the accompanying correlation coefficients are still sufficiently high. Finally, given that the overall Cronbach's alpha is above 0.80 when all variables are retained, the decision to proceed with all four variables certainly did not undermine the validity of exploratory factor analysis.

Once the factor analysis is conducted, the first step is to decide on the number of factors to retain. As mentioned, we used Scree plot and Parallel Analysis to do so, which are both based on the graphical representation of eigenvalues. However, the first is a simple visual method, while the second utilises a more sophisticated approach based on Monte Carlo simulation technique. In general, Parallel Analysis is regarded as the most accurate method in this respect (Henson & Roberts, 2006; Ledesma & Valero-Mora, 2007).

Starting with the scree plot, which is a graphical illustration showing eigenvalues on y-axis and the number of factors on x-axis, the rule of thumb is to find the point on x-

axis where the slope of the curve is visibly levelling off. This exact point gives the number of factors to retain. As can be seen from Figure A2-1, the scree plot suggests that only one factor should be retained, since all the eigenvalues except the first one are extremely small.

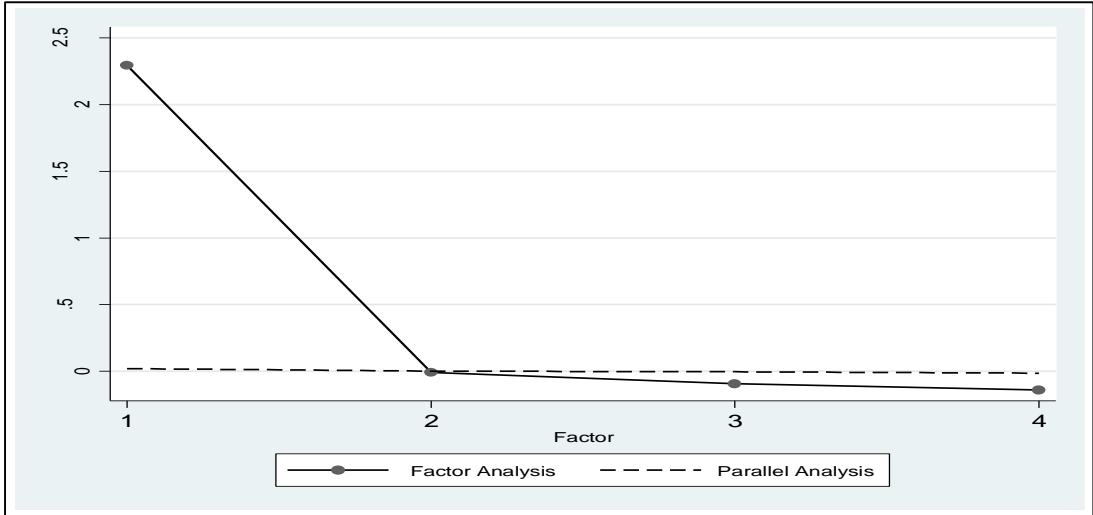
**Figure A2-1 Exploratory factor analysis – Scree plot, 2013**



*Source: Author’s own work based on the Special Eurobarometer 402/Wave 79.2*

To further evaluate this matter, we proceed with the Parallel Analysis. The Analysis, whose results are illustrated in Figure A2-2, indeed confirms that only one factor should be retained. Explicitly, the exact number of factors is determined by the intercept of the two lines on the graph: only factors for which the solid line is above the dashed line are considered. Since the cut-off point in our case (see Figure A2-2) is left to the second eigenvalue, this implies that only one latent factor underlies answers on the four observed variables.

**Figure A2-2 Exploratory factor analysis – Parallel Analysis, 2013**



*Source: Author’s own work based on the Special Eurobarometer 402/Wave 79.2*

In line with this, the final decision was to retain one factor, which is hereafter referred to as tax morale index. The next step is to determine factor loadings and uniqueness for this single factor. The exact values, which were calculated following the principal factor procedure, are given in Table A2-3. As can be seen, the factor loads highly on the two variables related to attitudes towards undeclared work by firms, accounting for 0.85 in the case of such work by firm for another firm and 0.84 for cash-in-hand activities by firm for a household.

The loading of the factor on the indicator measuring tolerance of tax evasion by individuals is much smaller, accounting for 0.74. A weaker effect of the factor on this indicator is also reflected in higher uniqueness, which shows that 45% of its variance is not shared with other three variables.

**Table A2-3 Exploratory factor analysis - factor loadings and uniqueness, 2013**

	Factor loadings	Uniqueness
Receiving welfare payments without entitlement	0.57	0.69
Undeclared work by firm for private household	0.84	0.30
Undeclared work by firm for firm	0.85	0.27
Someone partially or completely conceals their income	0.74	0.45

*Source: Author's own work based on the Special Eurobarometer 402/Wave 79.2*

As expected, the tax morale index exerted the weakest influence on answers regarding receiving welfare payments without entitlement. The results indicate that 69% of variance of this particular variable is not shared by the remaining three indicators and therefore it is not surprising that the factor loading accounts only for 0.57.

The last step is to extract the exact values of the tax morale index for each individual respondent in the survey, based on the above loadings. The extraction, which is an automatic procedure by STATA, followed the regression scoring method chosen by the author. Since the details on this extraction method are beyond the scope of this thesis, no further details on this will be given. It should be, however, mentioned that the extracted values were in the final step standardised to reflect the observed variables (i.e. values from 1 to 10) and stored as a new variable. This new variable is used as an explanatory variable in the subsequent analyses as a proxy for tax morale



## APPENDIX 3A COUNTRY-LEVEL VARIABLES - 2007

	Empl. rate	Youth empl. rate	At-risk-of-poverty rate	In-work at-risk-of-poverty rate	% of workers with a contract of limited duration	Labour market reg.	Gov. effect.	Rule of law	Perceived judicial independ.	Income ineq. ratio	Implicit tax rate	% of workers with two jobs	At-risk-of-poverty rate (65+)	Corruption perc. index	Trust in gov.	Tax morale (average)
Austria	69.9	7.0	16.7	6.1	8.8	4.6	96.6	99.5	5.9	3.8	41.0	4.2	14.0	8.1	57	2.93
Belgium	62.0	17.1	21.6	4.3	8.6	4.8	91.7	89.0	5.2	3.9	42.4	3.9	23.0	7.1	62	2.60
Bulgaria	61.7	13.0	60.7	5.8	5.2	5.9	53.9	52.2	2.5	7.0	30.4	0.8	23.9	4.1	22	2.80
Cyprus	71.0	10.2	25.2	6.3	13.2	5.6	88.3	83.7	5.2	4.4	23.9	4.4	50.6	5.3	64	1.30
Czech Republic	66.1	11.5	15.8	3.3	8.6	5.9	78.6	75.6	3.8	3.5	41.7	1.7	5.5	5.2	27	2.76
Denmark	77.0	5.4	16.8	4.1	9.1	7.4	99.5	100.0	6.3	3.7	36.6	9.9	17.7	9.4	67	2.13
Estonia	69.8	8.1	22.0	7.8	2.1	6.3	82.5	84.2	5.3	5.5	33.9	3.7	33.2	6.5	66	2.04
Finland	70.3	11.3	17.4	5.0	15.9	5.6	97.6	98.6	6.2	3.7	41.3	4.3	21.6	9.4	75	1.61
France	64.3	18.5	19.0	6.5	15.1	5.1	89.3	90.0	5.1	3.9	39.0	3.1	13.1	7.3	36	2.00
Germany	69.0	11.2	20.6	7.4	14.6	4.3	92.2	94.7	6.5	4.9	38.2	3.8	16.2	7.8	49	1.98
Greece	60.9	24.0	28.3	14.2	11.0	4.1	71.8	74.2	4.4	6.0	33.3	3.2	22.9	4.6	41	1.78
Hungary	57.0	20.8	29.4	5.8	7.3	5.9	76.7	81.3	4.2	3.7	41.0	1.7	6.1	5.3	27	2.81
Ireland	69.2	8.6	23.1	5.6	8.5	5.8	90.8	93.8	6.1	4.8	25.5	2.6	28.3	7.5	41	2.35
Italy	58.6	22.6	26.0	9.3	13.2	4.4	62.1	61.7	3.6	5.4	42.4	1.8	22.2	5.2	37	2.76
Latvia	68.1	7.3	35.1	9.2	4.1	6.9	69.4	72.2	3.8	6.4	31.1	6.1	35.6	4.8	20	3.18
Lithuania	65.0	8.1	28.7	8.0	3.8	6.2	74.8	70.8	3.4	5.9	33.1	6.3	29.8	4.8	26	2.82
Luxembourg	64.2	16.4	15.9	9.3	6.8	6.6	91.3	95.2	5.5	4.0	31.0	2.0	7.2	8.4	66	1.72
Malta	55.0	10.5	19.7	4.6	5.1	6.7	84.0	91.9	5.3	3.9	21.2	5.3	20.3	5.8	51	1.43
Netherlands	76.0	7.9	15.7	4.6	18.1	6.0	94.2	95.7	6.4	4.0	35.6	7.2	9.5	9.0	73	2.10
Poland	57.0	18.4	34.4	11.7	28.2	6.0	66.0	60.8	3.5	5.3	34.0	7.7	7.8	4.2	18	2.62
Portugal	67.6	22.0	25.0	9.7	22.3	4.5	78.2	81.8	5.7	6.5	23.7	6.7	25.5	6.5	46	2.56
Romania	58.8	17.8	45.9	18.3	1.6	4.4	45.6	51.7	2.9	7.8	30.2	3.9	30.6	3.7	19	2.45
Slovakia	60.7	19.0	21.3	4.9	5.1	6.7	77.7	63.2	3.6	3.5	31.1	1.1	7.7	4.9	42	2.76
Slovenia	67.8	12.6	17.1	4.7	18.5	5.5	80.1	78.5	4.5	3.3	35.9	3.8	26.3	6.6	36	2.21
Spain	65.8	18.8	23.3	10.2	31.6	5.0	82.0	84.7	3.7	5.5	33.7	2.6	26.1	6.7	52	2.17
Sweden	74.2	16.6	13.9	6.4	17.5	4.6	98.1	98.1	5.9	3.3	41.2	8.1	9.9	9.3	55	1.67
United Kingdom	71.5	12.6	22.6	8.0	5.8	7.4	93.2	92.8	6.2	5.3	26.1	3.8	21.3	8.4	34	1.89





## APPENDIX 3B COUNTRY-LEVEL VARIABLES - 2013

	Empl. rate	Youth empl. rate	At-risk-of-poverty rate	In-work at-risk-of-poverty rate	% of workers with a contract of limited duration	Labour market reg.	Gov. effect.	Rule of law	Perceived judicial independ.	Income ineq. ratio	Implicit tax rate	% of workers with two jobs	PSI (2011)	At-risk-of-poverty rate (65+)	Corruption perc. index	Trust in gov.	Tax morale (average)
Austria	71.4	11.0	18.8	7.9	9.2	6.1	92.8	97.6	5.2	4.1	41.5	4.6	4.5	15.4	69.0	50	2.34
Belgium	61.8	24.9	20.8	4.4	8.2	7.0	93.3	89.1	5.2	3.8	42.8	4.1	4.7	18.4	75.0	46	2.45
Bulgaria	59.5	28.2	48.0	7.2	5.7	7.4	59.3	51.2	2.9	6.6	24.5	0.5	4.6	27.9	41.0	16	2.21
Croatia	52.5	51.7	29.9	6.2	14.5	6.6	70.8	60.2	2.8	5.3	29.2	1.8	4.0	23.4	48.0	19	1.85
Cyprus	61.7	39.4	27.8	8.9	17.4	6.1	88.5	81.5	4.8	4.9	28.8	2.9	4.9	20.1	63.0	25	1.34
Czech Republic	67.7	18.6	14.6	4.0	9.6	8.1	75.6	82.5	3.7	3.4	38.8	2.3	4.2	5.8	48.0	13	2.83
Denmark	72.5	13.8	18.3	5.5	8.8	7.3	99.0	98.6	6.0	4.0	34.4	7.9	3.2	10.1	91.0	36	1.65
Estonia	68.5	17.1	23.5	7.6	3.5	6.3	78.5	86.3	5.5	5.5	35.0	5.5	3.9	24.4	68.0	36	2.21
Finland	68.9	16.6	16.0	3.7	15.5	5.2	100.0	99.1	6.5	3.6	40.1	5.3	3.5	16.1	89.0	54	1.53
France	64.1	24.1	18.1	7.8	16.0	5.3	89.5	88.2	4.9	4.5	39.5	4.2	4.7	9.1	71.0	24	1.91
Germany	73.5	6.9	20.3	8.6	13.3	6.5	91.4	91.9	6.2	4.6	37.8	4.9	4.4	14.9	78.0	44	1.90
Greece	48.8	57.1	35.7	13.1	10.1	4.6	67.0	63.5	3.1	6.6	38.0	1.8	7.0	15.1	40.0	9	1.84
Hungary	58.1	23.5	33.5	6.6	10.9	6.8	70.3	67.3	3.7	4.2	39.8	2.6	4.9	4.4	54.0	31	2.75
Ireland	60.5	24.2	29.5	4.5	10.0	7.9	89.0	94.3	6.3	4.5	28.7	2.6	4.8	10.1	72.0	18	2.44
Italy	55.5	41.5	28.5	11.0	13.2	6.6	67.5	62.1	3.8	5.8	42.8	1.3	5.0	15.0	43.0	11	2.48
Latvia	65.0	20.5	35.1	8.9	4.4	6.9	76.1	73.0	4.0	6.3	33.0	4.7	3.8	17.6	53.0	20	3.54
Lithuania	63.7	21.4	30.8	9.1	2.7	7.4	73.7	73.9	3.5	6.1	31.9	6.3	4.6	19.4	57.0	27	2.56
Luxembourg	65.7	15.3	19.0	11.2	7.1	5.9	94.3	96.2	5.8	4.6	32.9	3.2	4.6	6.2	80.0	62	1.92
Malta	60.8	11.5	24.0	5.9	7.5	7.5	86.6	87.2	5.0	4.1	23.3	4.7	4.9	14.9	56.0	59	1.69
Netherlands	73.6	12.9	15.9	4.5	20.5	7.1	96.7	97.2	6.4	3.6	38.5	8.5	3.3	5.5	83.0	44	2.24
Poland	60.0	27.3	25.8	10.7	26.9	7.7	71.3	73.5	4.2	4.9	33.9	6.9	4.4	12.3	60.0	14	2.80
Portugal	60.6	36.1	27.5	10.5	21.4	6.5	85.6	82.9	3.9	6.0	25.4	4.4	4.8	14.6	62.0	10	2.43
Romania	60.1	24.6	40.4	18.0	1.4	7.5	52.2	56.9	2.7	6.6	30.4	2.1	5.1	15.0	43.0	26	2.10
Slovakia	59.9	33.5	19.8	5.7	7.0	6.9	73.2	64.0	2.7	3.6	32.3	1.2	4.9	6.0	47.0	28	2.98
Slovenia	63.3	20.4	20.4	7.1	16.5	5.9	78.9	80.6	3.8	3.6	35.6	3.2	4.8	20.5	57.0	10	1.98
Spain	54.8	53.6	27.3	10.5	23.1	5.4	82.8	81.0	4.0	6.3	33.5	2.2	5.2	12.7	59.0	8	1.79
Sweden	74.4	20.2	16.4	7.1	16.9	6.9	98.6	99.5	6.2	3.7	38.6	9.2	3.0	16.4	89.0	60	1.41
United Kingdom	70.5	19.0	24.8	8.4	6.2	8.2	90.0	92.9	6.2	4.6	25.2	3.9	3.8	16.6	76.0	22	1.82



## APPENDIX 4 QUESTIONNAIRE FOR THE QUALITATIVE INTERVIEWS WITH UNDER-DECLARED WORKERS

### Part one: General information

#### 1. Gender

Male	1
Female	2

2. We are going to start with your experience on the labour market. Could you tell me for how long you have been working?

3. And what is your main occupation?

4. So, this means that your current position is.....

*Offer the most convenient option from the table. Keep chatting until the respondent defines her/his position. Code the answer.*

Employed professional (employed doctor, lawyer, accountant, architect, etc.)	1
General management, director or top management (managing directors, director general, other director)	2
Middle management, other management (department head, junior manager, teacher, technician)	3
Employed position, working mainly at a desk	4
Employed position, not at a desk but travelling (salesmen, driver, etc.)	5
Employed position, not at a desk, but in a service job (hospital, restaurant, police, fireman, etc.)	6
Supervisor	7
Skilled manual worker	8
Other (unskilled) manual worker, servant	9

5. So, you are essentially working in....

*Offer the most convenient option from the table below. Code the answer.*

Construction	1
Industry/Manufacturing	2
Household services (incl. gardening, child and elderly care)	3
Transport	4
Personal services	5
Retail	6
Repair services	7
Hotel, restaurant, cafes	8
Agriculture	9
Other.....(write down)	10

**6. Is this the job for which a part of your income is received in cash?**

*If the answer is 'NO', go back to questions 3-5, modify them and repeat for the job in which a part of money is received in cash. Add answers next to those for the main occupation. Otherwise, go to Q7.*

***Part two: Causes and nature of under-declared employment***

READ OUT: NEXT QUESTIONS REFER SOLELY TO THE JOB FOR WHICH A PART OF MONEY YOU RECEIVE IS IN CASH (I.E. ENVELOPE WAGE).

**7. Could you tell me for how long have you been working on this particular job?**

**8. So, do you work full-time, part-time or is it flexible?**

*Code the answer.*

Full-time employee	1
Part-time employee	2
Other.....(write down)	3

**9. And who first suggested under-declaration of your income? Was it your wish or was it suggested by your employer? Or was it a joint idea?**

**10. So, what happened? You/she/he came up with this idea and.....**

*Now let them explain in their own words. If necessary, ask supplementary questions. Make sure that all topics from the list below are covered.*

POTENTIAL SUPPLEMENTARY QUESTIONS: Was the agreement made before you commenced the job or was it agreed on later? Was it imposed or you chose it voluntary? How did you and your employer agree on the amount you are declared on?

**11. What were main reasons for you to get engaged in under-declaration of income?**

*Do not prompt the answer, let them think and give their own explanation.*

**12. Did you feel that refusal of the arrangement would mean you lost the job?**

**13. So, how exactly does it work in practice?**

*Let them explain in their own words. If necessary, ask supplementary questions. Make sure that all topics from the list below are covered.*

POTENTIAL SUPPLEMENTARY QUESTIONS: Does your employer respect the agreement? Does your employer pay you what you expect? Do you know how the accounting system of the company is adjusted to enable these cash payments?

14. Do you feel that this practice gives your employer some power over you and in what way?

15. Can I just check whether this cash payment is for your regular work, overtime hours, or both?

16. So, thinking now about your officially declared salary, is it significantly above the minimum level?

*Code the answer.*

Paid at the level of the minimum wage	1
Above the minimum wage	2
Below the minimum wage	3
Refusal	4
DK	5

17. Now, thinking about all money you get for this job (declared salary + envelope wage), is your net income from this job....

*Show card and later code the answer.*

< 3,000	1
HRK 3,000-3,499	2
HRK 3,500-3,999	3
HRK 4,000-4,999	4
HRK 5,000-6,999	5
HRK 7,000-9,999	6
> 10,000	7

**Part three: Attitudes and perception about their own under-declared work**

18. Would you say that in this way you earn more than if all your income was declared?

19. Would you say that your job security differs in comparison with those of people who are completely declared?

20. In general, are you happy with such an arrangement or would you rather prefer full declaration? Could you explain your answer?

21. In your opinion, what advantages does this practice have for you?

**22. On the other hand, do you think there could be some negative consequences of this practice for you in future?**

*Let them talk. If they are struggling, offer some options from the list below. However, ensure that you stay neutral.*

POSSIBLE NEGATIVE CONSEQUENCES: constrained access to loans and credits, lower pension, lower benefits in the case of unemployment, etc.

**23. How would you describe the risk of being detected by the authorities?**

*Show card and later code the answer.*

Very high	1
Fairly high	2
Fairly small	3
Very small	4

**24. Do you think there will be any sanction if the authorities find out that a part of your income remains untaxed?**

*Read out possible answers and then code the chosen one (or add if they think it is something else).*

None, only my employer would be sanctioned	1
Normal tax or social security contributions due	2
Normal tax or social security contributions due, plus a small fine (up to HRK 2,000)	3
Normal tax or social security contributions due, plus a severe fine	4
Community work	5
Other..... (write down)	6
Refusal (SPONTANEOUS)	7
DK	8

**25. What would you say, what percentage of formal employees in Croatia receive envelope wages?**

*Let them think and express their own view. Write down the exact answer and then code it in the table below.*

< 1 %	1
1-5 %	2
5-10 %	3
10-20 %	4
20-30 %	5
30-50 %	6
> 50 %	7
DK	8
Refusal (SPONTANEOUS)	9

**26. And what about the situation in your type of employment?**

*Again, let them think and express their own view. Write down the answer and then code it in the table below.*

< 1 %	1
1-5 %	2
5-10 %	3
10-20 %	4
20-30 %	5
30-50 %	6
> 50 %	7
DK	8
Refusal (SPONTANEOUS)	9

**Part four: Additional employment**

**27. Besides this jobs(s) we were talking about, do you have any other job?**

No	1
Yes	2

**28. Could you provide more details about that additional job?**

POTENTIAL SUPPLEMENTARY QUESTIONS: Is it a temporary position or regular job?  
Are you registered? How much does it contribute to your overall personal income?

**Part five: General attitudes and opinion**

**29. Now I am going to read out some statements. Could you say for each of them to what extent you agree with it?**

*Show card and code answers.*

		Strongly agree	Somewhat agree	Neither agree nor disagree	Somewhat disagree	Strongly disagree	Refusal	DK
1	Tax evasion by citizens in Croatia is a major problem.	5 <input type="checkbox"/>	4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>	998 <input type="checkbox"/>	999 <input type="checkbox"/>
2	Tax evasion by companies in Croatia is a major problem.	5 <input type="checkbox"/>	4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>	998 <input type="checkbox"/>	999 <input type="checkbox"/>
3	Tax burden in Croatia is too high.	5 <input type="checkbox"/>	4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>	998 <input type="checkbox"/>	999 <input type="checkbox"/>
4	The high amount of unemployment benefits in Croatia means people do not bother to seek a formal job.	5 <input type="checkbox"/>	4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>	998 <input type="checkbox"/>	999 <input type="checkbox"/>

5	If people were better informed on how the government is spending public money, they would be more willing to pay taxes.	5 <input type="checkbox"/>	4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>	998 <input type="checkbox"/>	999 <input type="checkbox"/>
6	Croatian society is characterised by high differences between social classes.	5 <input type="checkbox"/>	4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>	998 <input type="checkbox"/>	999 <input type="checkbox"/>
7	People evading taxes has a destructive effect on various aspects of society, such as social cohesion, mutual trust, respect for the rule of law, etc.	5 <input type="checkbox"/>	4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>	998 <input type="checkbox"/>	999 <input type="checkbox"/>
8	Every undeclared 'kuna' entails less money for health, education, public order and safety, etc.	5 <input type="checkbox"/>	4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>	998 <input type="checkbox"/>	999 <input type="checkbox"/>
9	There is a clear link between what people have to pay now towards their pension and the amount they will get when they retire.	5 <input type="checkbox"/>	4 <input type="checkbox"/>	3 <input type="checkbox"/>	2 <input type="checkbox"/>	1 <input type="checkbox"/>	998 <input type="checkbox"/>	999 <input type="checkbox"/>

**30. Now I am going to offer you a list of national institutions. Please indicate to what extent you personally trust each of them. Please use this prompt card for your answers.**

*Show card and code answers.*

		No trust										Complete trust											
1	Government	0	1	2	3	4	5	6	7	8	9	10	0	1	2	3	4	5	6	7	8	9	10
2	Parliament	0	1	2	3	4	5	6	7	8	9	10	0	1	2	3	4	5	6	7	8	9	10
3	The legal system	0	1	2	3	4	5	6	7	8	9	10	0	1	2	3	4	5	6	7	8	9	10
4	Tax authorities	0	1	2	3	4	5	6	7	8	9	10	0	1	2	3	4	5	6	7	8	9	10
5	Political parties	0	1	2	3	4	5	6	7	8	9	10	0	1	2	3	4	5	6	7	8	9	10
6	Politicians	0	1	2	3	4	5	6	7	8	9	10	0	1	2	3	4	5	6	7	8	9	10
7	Local authorities (mayors, municipal governing bodies)	0	1	2	3	4	5	6	7	8	9	10	0	1	2	3	4	5	6	7	8	9	10

**31. Finally, I would like to know how you would rate various actions or behaviours. For each of them, please tell me to what extent you find it acceptable or not. Please use the following scale: '0' means that you find it "absolutely unacceptable" and '10' means that you find it "absolutely acceptable".**



Show card and code answers.

		Absolutely unacceptable					Absolutely acceptable					
1	Someone receives welfare payments without entitlement	0	1	2	3	4	5	6	7	8	9	10
2	An individual is hired by a household for work and he/ she does not declare the payment received to the tax or social security authorities even though it should be declared.	0	1	2	3	4	5	6	7	8	9	10
3	A firm is hired by a household for work and it does not declare the payment received to the tax or social security authorities	0	1	2	3	4	5	6	7	8	9	10
4	A firm is hired by another firm for work and it does not declare the payment received to the tax or social security authorities	0	1	2	3	4	5	6	7	8	9	10
5	A firm hires an individual and all or a part of the wages paid to him/ her are not officially declared	0	1	2	3	4	5	6	7	8	9	10
6	Someone evades taxes by not declaring or only partially declaring their income	0	1	2	3	4	5	6	7	8	9	10

***Part six: Additional information about the respondent***

READ OUT: SINCE PREVIOUS RESEARCH ON THE PHENOMENON INDICATED THAT UNDER-DECLARED EMPLOYMENT SIGNIFICANTLY VARIES ACROSS DIFFERENT DEMOGRAPHIC AND SOCIO-ECONOMIC GROUPS, I WOULD BE GRATEFUL IF YOU COULD GIVE ME SOME BASIC INFORMATION.

**32. To start with, could you tell me which of these best describes your current marital situation?**

*Read out possible answers and then write down the chosen one (or add if they think it is something else).*

Married or remarried	1
Single living with a partner	2
Single	3
Divorced or separated	4
Widow	5
Other (SPONTANEOUS)	6
Refusal (SPONTANEOUS)	7

**33. And do you have any dependants in your households (children, disabled persons, etc.)?**

**34. In terms of social classes, do you see yourself and your household belonging to...?**

*Read out possible answers and then write down the chosen one (or add if they think it is something else).*

The working class of society	1
The middle class of society	2
The higher class of society	3
Other.....(write down)	4
Refusal	5
DK	6

**35. During the last twelve months, how often have you had difficulties in paying your bills at the end of the month?**

*Read out possible answers and then write down the chosen one (or add if they think it is something else).*

Most of the time	1
Occasionally	2
Almost never/ never	3
Refusal (SPONTANEOUS)	4

**36. The highest level of education obtained...**

*Adjust the question in accordance to previous information; keep chatting until the answer is provided. Code the answer in the table below. Ask for instance:*

“According to your occupation, I assume that you went to college?”

No formal education	1
Still studying	2
Primary school	3
High school	4
Undergraduate	5
Master's degree	6
Ph.D.	7

**37. And finally, I would be grateful if you could tell me your age?**

# APPENDIX 5 AREAS COVERED IN INTERVIEWS WITH REPRESENTATIVES OF SOCIAL PARTNERS AND REGULATORY APPARATUS IN CROATIA

## Ministry of Labour and Pension System

- 1) Their insight into this problem area:
  - a) Available data on the proportion of workers in Croatia working on an under-declared basis
  - b) Types of companies most prone to under-declaration of their workers (according to size, ownership, income, etc.)
  - c) Socio-economic and demographic categories of workers that are most prone to under-declared employment
  - d) Main rationales of employers for under-declaration of their workers
  - e) The role of workers in the process
  - f) Who they think benefits from this arrangement. Do they think that under-declared employees can also accomplish financial gain or employers are the only ones that benefit?
- 2) The most efficient approach to tackle under-declared employment from their perspective
- 3) Steps the government has taken so far to tackle under-declared employment – introduced policy measures and their evaluations
- 4) Plans of the government to tackle the phenomenon in future

## Trade unions

- 1) Their insight into this problem area:
  - a) Available data on the proportion of workers in Croatia working on an under-declared basis
  - b) Socio-economic and demographic categories of workers that are most prone to under-declared employment according to their sources
  - c) The role of workers in the process
  - d) Can the perception of under-declared workers as victims be generalised, i.e. what is the proportion of under-declared workers having financial gain from this type of employment?

- 2) The most efficient approach to tackle under-declared employment from their perspective
- 3) Steps they have taken so far to reduce the number of employees working under such arrangements
- 4) Their plans for future fight against the phenomenon
- 5) Their assessment of the endeavours of the authorities to eradicate this type of employment

## **Employers**

- 1) Their insight into this problem area:
  - a) Estimate of the proportion of firms in Croatia that hire workers on an under-declared basis
  - b) Sectors in which this type of employment is most commonly found according to their sources
  - c) Types of companies that are most prone to under-declaration of workers (according to size, ownership, income, etc.)
  - d) The main rationales of employers for under-declaration of workers
  - e) The role of workers in the process
  - f) Who they think benefits from this arrangement. Do they think that employees can also accomplish financial gain or employers are the only ones that benefit from such arrangements?
- 2) The most efficient approach to tackle under-declared employment from their perspective
- 3) Steps they have taken so far to reduce the number of companies employing workers on an under-declared basis
- 4) Their plans for future fight against the phenomenon
- 5) Their assessment of the endeavours of the authorities to eradicate this practice

## **Labour Inspectorate and Tax Administration**

- 1) Prevalence of this practice in Croatia according to their experience
- 2) Official data about the number of prosecuted employers and workers due to under-declaration
- 3) Types of companies most commonly detected as violators (according to size, ownership, income, etc.)
- 4) Socio-economic and demographic categories of workers most commonly found to work on an under-declared basis
- 5) Strategies used by companies to extract cash from the financial system of the company according to their knowledge
- 6) The role of workers in the process
- 7) Treatment of workers upon detection
- 8) How common are instances where workers report their own employers for under-declaration?
- 9) Most efficient approach to tackle the phenomenon according to their view (i.e. sticks, carrots, combination of both, or something else)



## APPENDIX 6 INFORMATION SHEET

Dear Participant,

You are being invited to take part in the research project entitled 'Causes and Nature of Under-declared Employment in Transition Countries', carried out by Josip Franic, a Ph.D. student at the University of Sheffield Management School, UK, for his thesis.

This sheet provides information about the research and your potential role in it. Please take time to read this information sheet carefully and decide upon your involvement. If you need additional info or have any questions, please find contact details below.

The aims of the project are:

- 1) To explore the factors influencing the decisions of workers to enter employment relations which include under-declaration of income (i.e. declaring only a part of the income while the rest remains hidden from the authorities)
- 2) To determine how any financial gain from this is distributed between employers and workers
- 3) To explore any links between the minimum wage regulations and the size of the formal part of remuneration within under-declared employment
- 4) To compare how different groups (employees, trade unions, employers and authorities) see the issue of under-declared employment from their own perspectives
- 5) To evaluate current policy responses in tackling the phenomenon of under-declared employment

I wish to conduct some 30 face-to-face interviews with under-declared workers and approximately 10 interviews with representatives of the Labour Inspectorate, Tax Administration, Ministry of Labour and Pension System, trade unions and the Employers' Association in Croatia. All interviews will be conducted in the Croatian language with individuals above 18 years of age.

All the information collected during the course of the research will be kept strictly confidential. Your name and any other personal information which could reveal your identity will be rendered non-identifiable (note that pseudonyms will be used instead of real names). Given this, it will not be possible for other participants or readers of the final report to identify you. Data will be used for academic purposes only.

The interview will take approximately 40 minutes. Audio tapes taken with your permission will be transcribed after the end of each interview and immediately destroyed. If you refuse to be recorded, then notes taken during the conversation will be properly transcribed (to secure anonymity) and also destroyed. All data will be held by the Ph.D. applicant.

Your participation in this research is completely voluntary and it is up to you to decide whether or not to take part. If you decide to take part, you are welcome to keep this information sheet and you will be asked to sign a consent form. However, you can withdraw at any time without any consequences.

If for any reason you have a complaint regarding your participation in the research, you can contact the supervisor of the project: Professor Colin C Williams, Management School, University of Sheffield, Conduit Road, Sheffield S10 1FL, UK. (e-mail: [c.c.williams@sheffield.ac.uk](mailto:c.c.williams@sheffield.ac.uk))

The results of the research are likely to be published in 2016, and you are welcome to request a copy of the summary of the research results.

This project has been ethically approved via the University of Sheffield Management School ethics review procedure.

Contact for further information: Josip Franic, Management School, University of Sheffield, Conduit Road, Sheffield S10 1FL, UK. (e-mail: [jfranic1@sheffield.ac.uk](mailto:jfranic1@sheffield.ac.uk))

Thank you for reading this information sheet!



