

# How to reduce undeclared work in the Republic of Croatia?

- Iva Music Oreskovic<sup>1</sup>

## EXECUTIVE SUMMARY

Undeclared work is not a foreign phenomenon in the Republic of Croatia. Various reasons lead to its appearance. It has negative consequences for the entire community. On the one hand, employers face cases of unfair competition, workers suffer from insecurity in terms of social dimensions, while the state is deprived of a part of the income, the investment of which would bring numerous welcome benefits to society. Undeclared work leads to the creation of a practice of tax evasion, noncompliance with regulations governing labor relations, especially the protection of workers, which in this case is violated. Over time the question arises as what measures are sufficiently effective for combatting undeclared work.

## ACKNOWLEDGEMENTS

The author would like to thank the Training Team of the ILO Research Department and particularly Dr. Naren PRASAD, for helping her in the review process of this policy brief. She would also like to thank Markus Pilgrim for his comments on an earlier version of this brief. The views and opinions in this paper are solely those of the author and the responsibility for the information set out lies entirely with her.

## KEYWORDS

Undeclared work, Informal economy, Croatia

## INTRODUCTION

Definition of undeclared work in Croatia follows the definition set at the EU level (any paid activities that are lawful as regards their nature but not declared to public authorities), and is used by all institutions engaged in the design and implementation of activities against undeclared work.<sup>2</sup> As the Prohibition and Prevention of Unregistered Activities Act (Official Gazette, 2011) states, 'unregistered activity' is any type of legal work conducted by individuals or firms without complete and valid documentation and required permissions.<sup>3</sup>

The objective for this brief is to propose several policy recommendations to the policymakers to reduce undeclared work in Croatia. Undeclared work is a priority issue in Croatia. The share of undeclared economic activities in Croatia is one of the largest in the European Union, estimated to be around 30% of the official GDP.<sup>4</sup> Almost 6 out of 10 Croatian citizens believe that at least 20% of Croatian citizens do not comply with tax and labour regulations.<sup>5</sup>

This Policy Brief provides a review of undeclared work, including existing and possible measures to combat undeclared work in Croatia. It is based on Strategy and Action Plan for Combating Undeclared Work in the Republic of Croatia. The Strategy and Action Plan provides a brief overview of the scale, nature and factors of the undeclared work, and determinants of fight against undeclared work, as well as approach to the problem and the policies applied. The brief uses the method of compilation of existing papers -

<sup>1</sup>This policy brief was prepared by Iva Music Oreskovic, Senior Advisor at the Ministry of Labour, Pension system, Family and Social policy of Croatia. The opinions expressed herein are those of the author and do not necessarily represent the views of the ILO or its staff.

**\*The policy brief is based on the ILO's training on Evidence-Based Policy Making for Decent Work, which was organized by the Research Department from 26 April to 23 June 2021.\***

<sup>2</sup> Factsheet on Undeclared Work – Croatia, p. 1, <https://ec.europa.eu/social/ajax/BlobServlet?docId=18156&langId=en>.

<sup>3</sup> Undeclared Work in Croatia, Josip Franic and Colin C Williams, p. 7, <https://bib.irb.hr/datoteka/895891.SSRN-id2435142.pdf>

<sup>4</sup> Ibid.

<sup>5</sup> Ibid. p. 3.

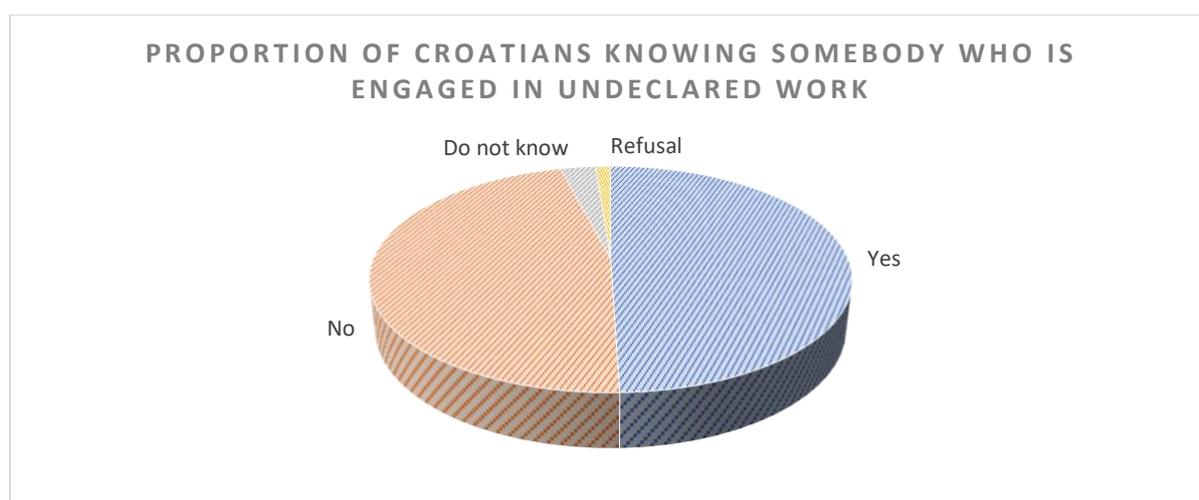
quantitative and qualitative research and analysis of statistical data.<sup>6</sup> It proposes several policy recommendations to reduce undeclared work in Croatia.

## Research and Statistics

### ***Undeclared work in the Republic of Croatia***

This policy brief uses the Strategy and Action Plan for Combating Undeclared Work in the Republic of Croatia as a road map, as well as other data sources that are important for detecting the key causes of undeclared work and formulating measures for its suppression. Thus, for example, the research of the author of one source shows that since 2000 the rate of undeclared work has been falling in the sector of production and trade, while it has grown sharply in hotels, restaurants, and other business activities.<sup>7</sup>

Report on the Illegitimate Economic Practices in Croatia, based on a representative survey of 2 000 citizens, covers the period of August and October 2015. This survey of 2,000 citizens was focused on the experiences of Croatians with undeclared work, envelope wages and the practice of 'pulling strings and other types of dishonest behaviour. According to the results of the research, every second Croatian citizen knows a person who is engaged in undeclared work. In terms of occupational structure of undeclared workers, citizens stated that it is the unemployed who are most often involved in undeclared work.<sup>8</sup>



9

Views of Croatians on root causes of undeclared work in the country are primarily related to the compensation of low wages in some sectors (56.4% of respondents) and the lack of regular occupations (46.5%). Furthermore, the third reason for the occurrence of undeclared work is the high tax burden. Unfortunately, this is associated with the inertia of the state because every fifth respondent thinks that it is not worth paying taxes because the state does nothing in return. Respondents who felt the risk of detection was high were more likely to admit receiving an envelope salary (7.5%) than those who thought the risk was low (7.2%). Some respondents identified weak enforcement mechanisms, and some participants stressed that insufficient control

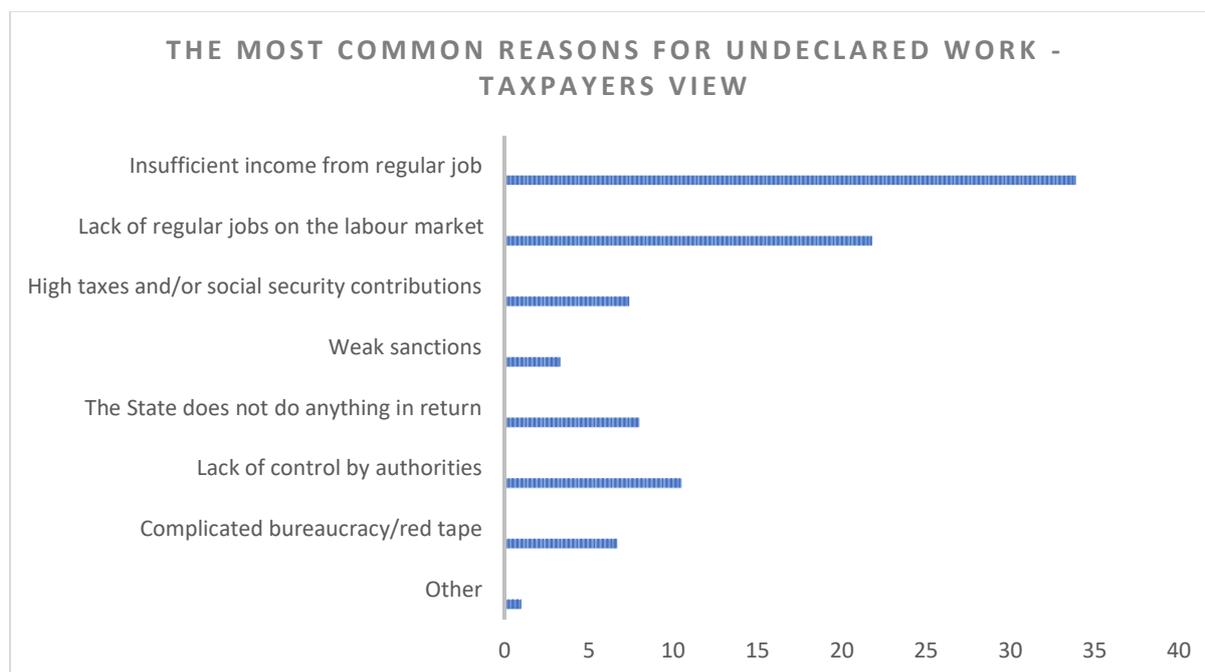
<sup>6</sup> Strategy and Action Plan for Combating Undeclared Work in the Republic of Croatia, Colin C. Williams, Marek Radvanský i Miroslav Štefánik, p. 3., Strategy and Action Plan for Combating Undeclared Work in the Republic of Croatia.docx.

<sup>7</sup> Undeclared Work in Croatia, Josip Franic and Colin C Williams, p. 18.

<sup>8</sup> Illegitimate Economic Practices in Croatia: findings from a representative survey of 2,000 citizens, Collin C. Williams, J. Franic, GREY Working Paper No. 9, Sheffield University Management School, University of Sheffield and Institute of Public Finance, Zagreb, p. 6

<sup>9</sup> Ibid., p. 12.

encourages people to engage in undeclared work (17.1%), while some were unsure that undeclared work in Croatia could be explained by weak sanctions).<sup>10</sup>



11

As one of the problems, the respondents state a specific form of tax evasion which is marked as "undeclared employment" or "quasi-formal employment" (the formal employer pays the formal employee the officially declared salary, but also the additional undeclared salary). 6.6% of employees admitted to received more than stated in their written contract, while 2% refused to answer this question and 0.4% said they did not know. This practice is more common among men and younger people, occurring most in the agricultural sector and the construction industry. The financial situation and tax morale are most conducive to this. This discovery is in line with the situation in other European countries.<sup>12</sup>

According to the technical report presenting findings from a study focused on three South-East European economies facing a high level of noncompliant behaviour, research has been conducted relating to individuals and their activities, while the second explored undeclared economic practices from the perspective of 521 companies. The research was conducted in the period between August and October 2015. Although is a member state of the European Union, Croatia has one of the lowest GDP rates, comparing to other EU countries. This is precisely one of the reasons influencing the creation of practices of undeclared economic activities and a problematic work environment for employers, employees, and industrial relations.<sup>13</sup>

When assessing the quality of business environment in Croatia, one third of the interviewed representatives stated that rules and procedures do not influence on their business activity, while the majority isolated taxes as a major obstacle<sup>14</sup>, as well as corruption and illegal competition (highlighted by 30.83% and 30.35% of the respondents). On the other side, treatment of local and central administration, and access to finance, represents an obstacle for 37.87% and 34.06% of respondents. Also, too strict controls and inspections as well as inefficient courts do not impact

<sup>10</sup> Ibid., p. 21

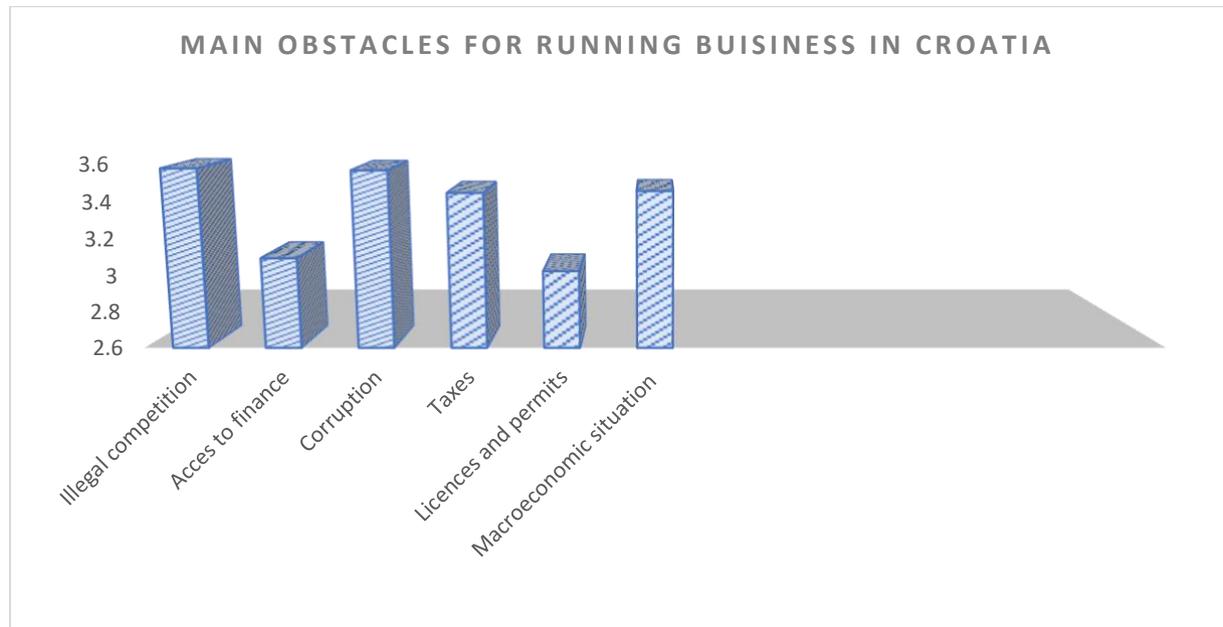
<sup>11</sup> Ibid., p. 22

<sup>12</sup> Ibid., p. 48

<sup>13</sup> Undeclared economic activities of Croatian companies Findings from a representative survey of 521 companies, September 2017, Predrag Bejakovic and Colin C Williams, GREY Working Paper No. 13, Sheffield University Management School, University of Sheffield, Institute of Public Finance, Zagreb, p. 6

<sup>14</sup> Ibid p. 6

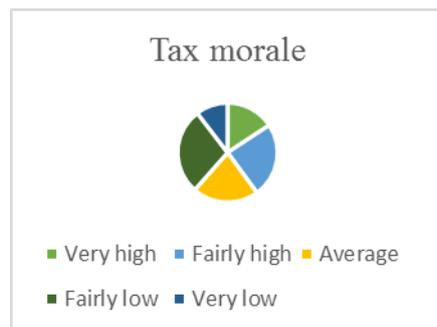
negatively on their business activity. 2.38% of respondents pointed out government's support for entrepreneurs, as unsatisfactory. There is a common view that the state does not give businesses enough in return for the taxes they pay, which ultimately creates the willingness to be involved in undeclared economic activities.<sup>15</sup>



16

Among other things, in 2015 and 2016, a qualitative research was conducted in Zagreb.<sup>17</sup> The conclusion of the research was that over-reporting can follow independently of undeclared work due to the many alternative options for making money for envelope salaries. One of the main motivators for such payment on the part of the employer is the reduction of the obligation to the public budget and the more difficult detection of evasion by the public authorities.<sup>18</sup>

Grey research shows that the higher the tax morale is, the lower the chance of participating in undeclared work is.



This result is confirmed by a statistical analysis, showing a strong correlation between tax morale and the purchase of undeclared goods. This indicates that a lack of horizontal trust among citizens is associated with a higher possibility for participation in undeclared work. This leads to the conclusion that a greater opportunity to participate in undeclared work is associated with a lack of horizontal trust among citizens in Croatia.<sup>19</sup>

<sup>15</sup> Ibid., p. 7

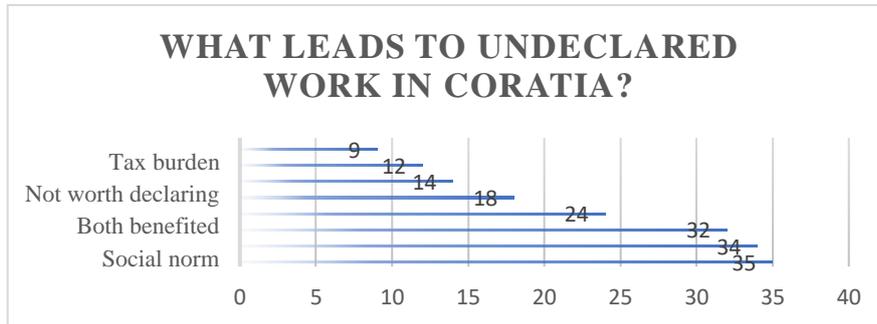
<sup>16</sup> Ibid., p. 25

<sup>17</sup> During the semi-structured interview, workers are asked questions aimed at motivating and initiating the acceptance of undeclared wages, as well as negotiating with employers that led to undeclared work. The interview also included representatives of labor unions, employers' associations and enforcement bodies. - Dissecting the illicit practice of wage underreporting: some evidence from Croatia, Josip Franic.

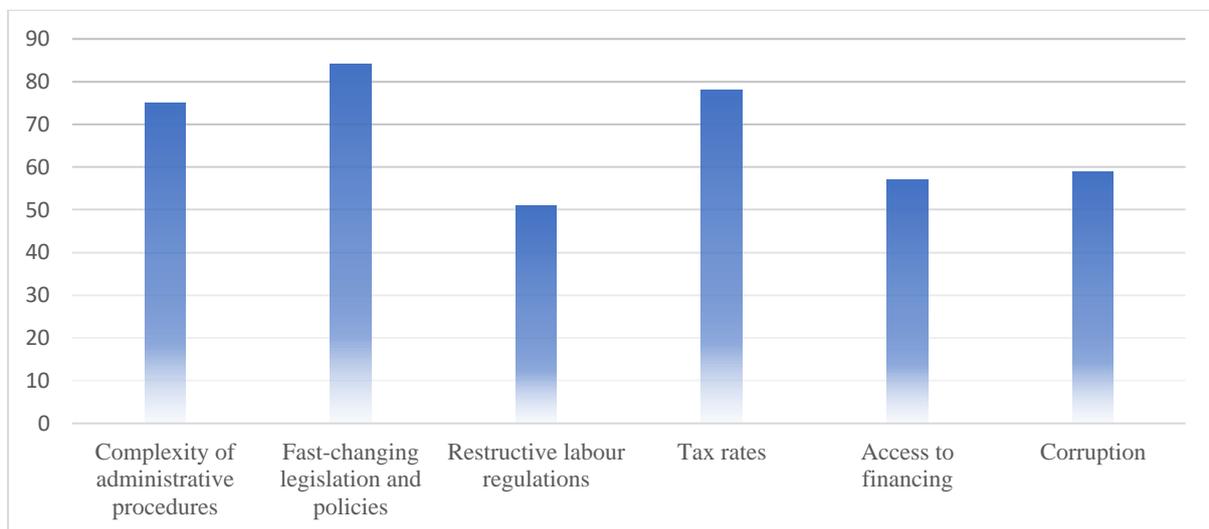
<sup>18</sup> Ibid.

<sup>19</sup> Tackling Undeclared Work in Croatia: Knowledge-Informed Policy Responses, Grey policy brief no. 3, 2017, Ruslan Stefanov, Colin C. Williams and Peter Rodgers, p. 5

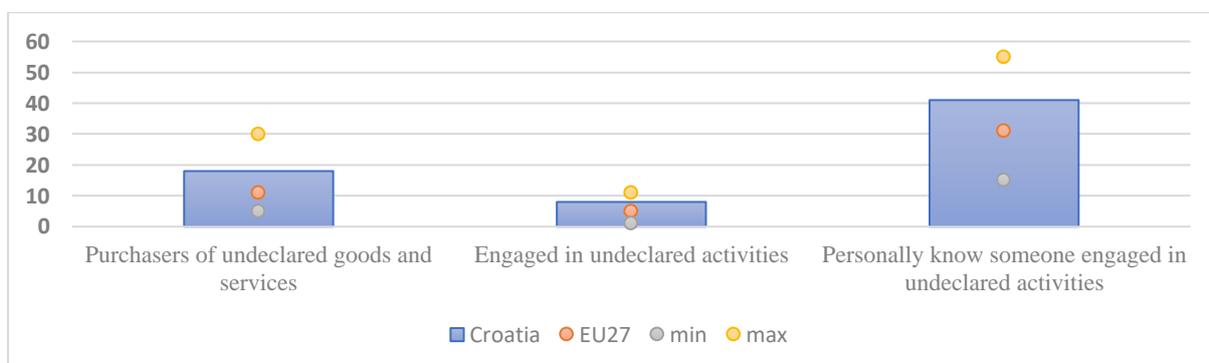
Undeclared work allows a chance to earn more cash unrestricted of formal regulations. But there is a question why do people engage into undeclared work? The two main motives are usually to help friends or relatives. The graph below shows the research results.<sup>20</sup>



Among other things, respondents were asked questions about the main obstacles for declaring a work. Unfortunately, the results show that there is a wide negative perception of the business environment among Croatian companies. The results of the research are shown in the graph below.<sup>21</sup>



The graph below shows a comparison of Croatia and other EU member states regarding prevalence of undeclared work. Croatia has a more developed practice of undeclared work.<sup>22</sup>



<sup>20</sup> Ibid. p. 6

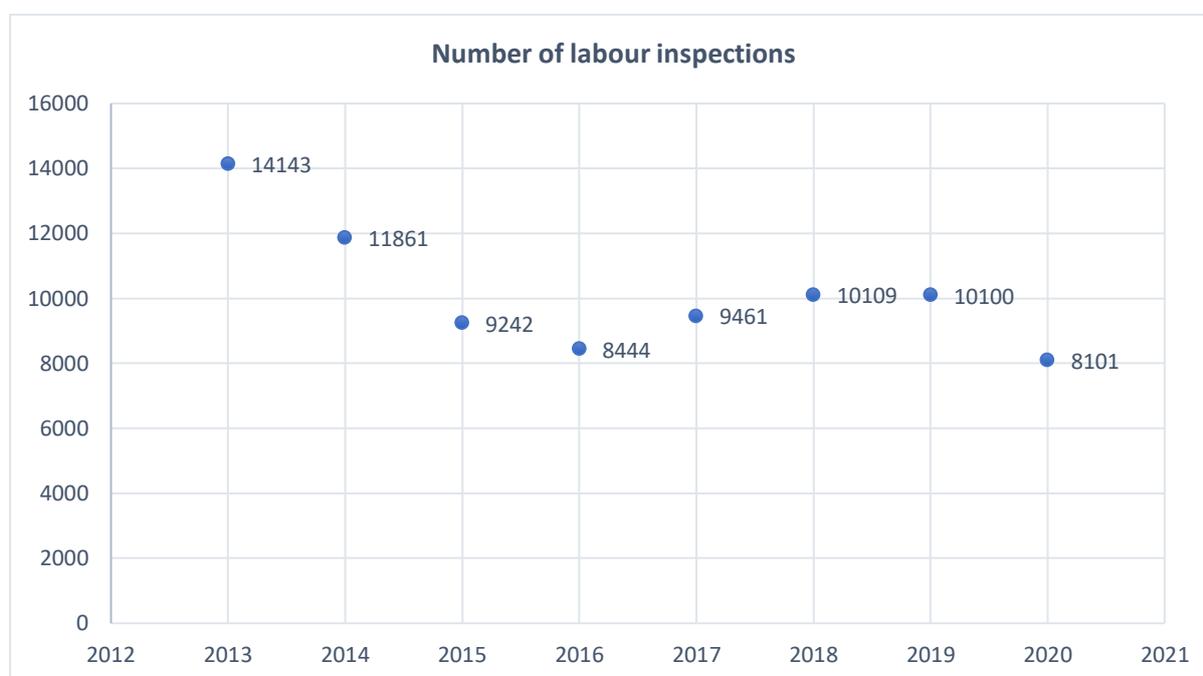
<sup>21</sup> Undeclared Work in Croatia, Josip Franic and Colin C Williams, p. 34

<sup>22</sup> Ibid. p 11.

Regarding the use of measures, according to a survey of stakeholders from 31 European countries, respondents felt that repressive measures have the greatest effect.<sup>23</sup>

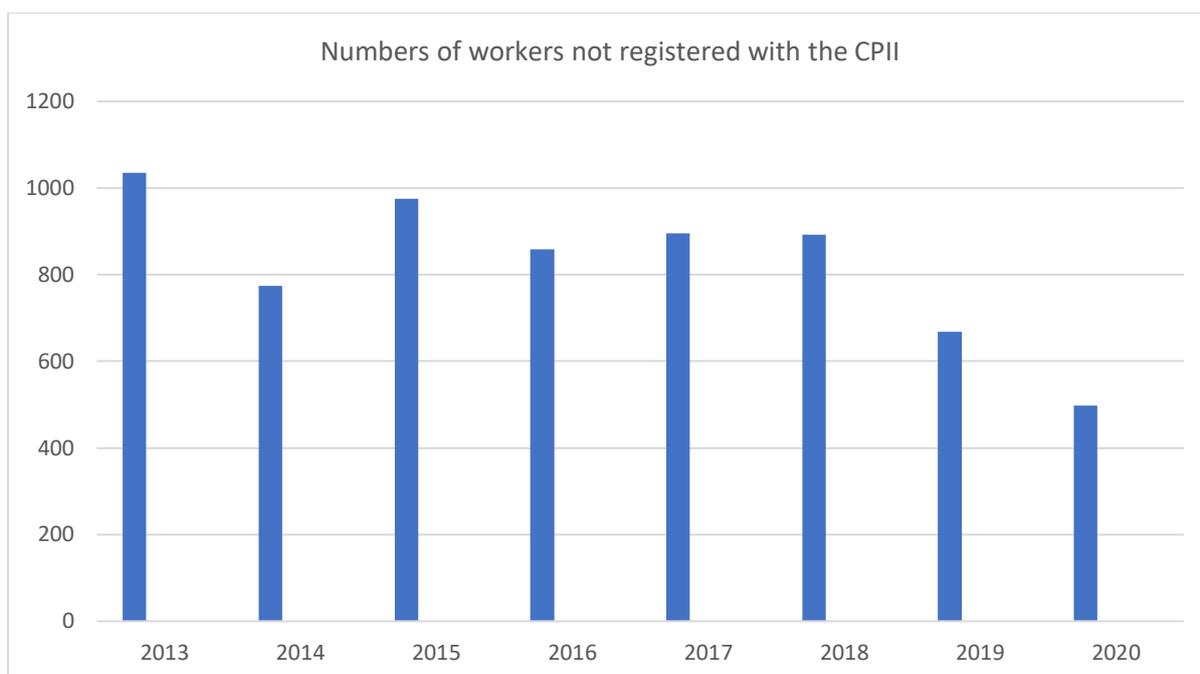
	<b>Most effective</b>	<b>Second most effective</b>	<b>Last effective</b>
<b>Repressive measures</b>	55	13	12
<b>Preventative measures</b>	20	41	13
<b>Curative measures</b>	15	27	31
<b>Measures fostering commitment</b>	10	19	44

On the other hand, according to the provided data of the State Inspectorate, the labor inspection performed the largest number of inspections in 2013. 2020 was the year with the lowest rate of inspections conducted.



Regarding the number of workers who are not registered within the Croatian Pension Insurance Institute, the graph below shows what was determined by the inspection. Data relating to the period 2015-2019 refer to cases of non-registration of workers before they started to work.

<sup>23</sup> Respondents' responses on the most effective measures in tackling against undeclared work., Undeclared work, Josip Franic, and Colin C. Williams p. 39.



According to the data, the labor inspection issued the largest number of decisions on temporary prohibition of performing activities in 2013 (in total: 309) and 2019 (in total: 308), while the lowest number was in 2020 (in total: 168) and 2014 (in total: 182). In 2013, 119 decisions were made to repeal the decision on the temporary prohibition on performing activities, while in 2020 there is only 42 decisions.

Fines were paid for the committed violations. The graph below shows the amount of fines paid on an annual basis. The table below shows the amount of fines paid on an annual basis.

2013	2014	2015	2016	2017	2018	2019	2020
4.530.000,00	2.220.000,00	3.510.000,00	2.730.000,00	3.270.000,00	2.610.000,00	3.080.000,00	1.260.000,00

## Conclusion and Results

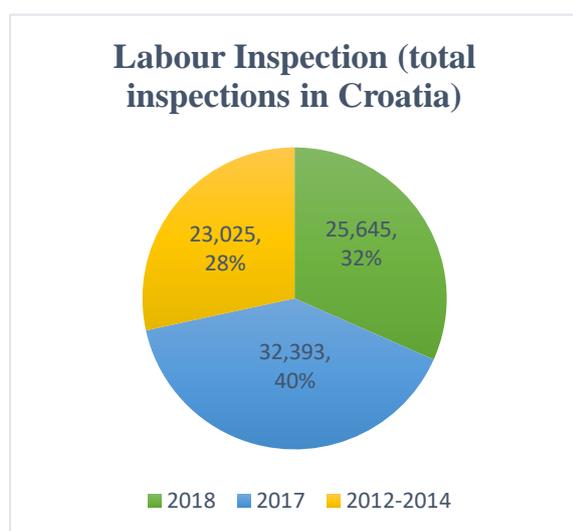
For this reason, to tackle undeclared work, the Government of the Republic of Croatia has established a Commission for Prevention of Undeclared Work in 2014, with the main task to produce a report that would analyse the areas where activities are undertaken for the purpose of establishing measures against undeclared work (for ex. fisheries, student work, etc.).

In 2015, better efficiency of cooperation with the Tax Administration was one of the goals envisaged by the Action Plan as a fundamental tool for tackling undeclared work, especially in terms of gathering information on tax compliance. The action plan focused on sectors in which undeclared work is particularly present as well as on awareness-raising measures, in 2013, fiscalization was introduced to facilitate the control of money transactions by Tax Administration. Since 2014, employers have the obligation to submit a unified form with wage calculations (JOPPD form) to the Tax Administration, which yielded the greatest effect.<sup>24</sup> In that sense, the findings reveal that tax morality and personal attitudes about the extent to which others participate are key

<sup>24</sup> Factsheet on Undeclared Work – CROATIA, p. 4, <https://ec.europa.eu/social/ajax/BlobServlet?docId=18156&langId=en>

determinants. The lower the tax morale is, the greater the propensity to participate in the undeclared economy is (and this applies to both demand and supply). Likewise, the higher the observed number engaged in such activity is, the stronger the personal propensity for such behaviour is.

On the other side, certain problems stand out. First, there is a limitation of the available data, as well as a lack of studies evaluating the effectiveness of the introduced strategies and deficiency of public debate and pilot projects which would confirm the effectiveness of the measures taken. Further, frequent changes in legislation with insufficient time for adjustment for all involved amplify the shortcomings of the approach.<sup>25</sup> Lastly, Croatia is trying to reduce a narrow approach to dissuasive policy measures, concentrating on penalties and emphasizing the risk of disclosure. The Ministry of Labour and Pension System oversees the design and implementation of measures which are primarily based on the enabling approach. As an example of good practice is the campaign "Stop Undeclared Work!" as part of the EU-funded project "Strengthening Policies and Capacities to Reduce Undeclared Work", encouraging citizens to report such work.<sup>26</sup>



There is a lack of more campaigns to raise awareness and define mechanisms to address shortcomings in the actions of relevant institutions. Some research shows deficiency in the Republic of Croatia of preventive measures for effectively tackling the problem of undeclared work. Finally, studies show that the rate of undeclared work falls in proportion to the increased likelihood that the latter will be detected. In this sense, a move from deterrence measures to preventive measures is needed, especially for the reduction of informal economy, to encourage formal business and declared work.<sup>27</sup>

What is important to link is that 26.5% of respondents supported such a measure, suggesting that it would be very useful if, for

example, the Tax Administration follows cooperation rather than coercion.<sup>28</sup> 19% of individuals thought that increasing prison sentences would be the right way to deal with undeclared work, while almost 30% disagreed with this statement, indicating the importance of preventive and curative measures.<sup>29</sup>

Reliance on personal connections, mainly in terms of medical services, as well as when looking for work, skipping queues, reducing the final price of services and lack of essential information are the most common reasons in Croatia for such behaviour.<sup>30</sup> To sum up, there is a link between undeclared work and reliance on personal connections.<sup>31</sup> In this sense, citizens believe that more inspections are needed at the premises of employers in order to eradicate this negative practice. More than 60% of the individuals surveyed claim that this measure would produce a positive effect.<sup>32</sup>

Creating a culture of voluntary tax compliance is complicated without structural changes aimed at increasing the efficiency of public administration and trust in the government. Control mechanisms

<sup>25</sup> Undeclared Work in Croatia, Josip Franic and Colin C Williams, <https://bib.irb.hr/datoteka/895891.SSRN-id2435142.pdf>, p. 41

<sup>26</sup> The employment and social situation in Croatia, Iva Tomić, Ivica Rubil, Danijel Nestić, Paul Stubbs, p. 24

<sup>27</sup> Ibid.

<sup>28</sup> Undeclared economic activities of Croatian companies Findings from a representative survey of 521 companies, September 2017, Predrag Bejakovic and Colin C Williams, GREY Working Paper No. 13, Sheffield University Management School, University of Sheffield, Institute of Public Finance, Zagreb, p. 92

<sup>29</sup> Ibid., p. 91

<sup>30</sup> Ibid., p. 89

<sup>31</sup> Ibid., p. 84

<sup>32</sup> Ibid., p. 91

need to be put in place to reduce the chances of misapplication.<sup>33</sup> In that sense, the Republic of Croatia has started to eradicate the causes of the problem.

## Recommendations proposed

To address the problems of undeclared work, it is necessary to focus on the following recommendations for improving the situation, in accordance with the Strategy and Action Plan.

- First, it is crucial to continuously promote economy growth, as well as facilitate production and growth of GDP, as a key effort in the work of the Government.
- Second, it is necessary to increase the number of labour inspections to improve the effectiveness of control mechanisms and ensure compliance with relevant regulations. Based on the control performed, companies performing undeclared work activities could be excluded from participating in public tenders and receiving subsidies. The fight against undeclared work should be aimed at filling the gaps between citizens and the state.
- The system for collecting data on the characteristics of undeclared work in Croatia needs to be more consistent. Available resources currently are limited and are not up to date. Body whose jurisdiction includes undeclared work might gather such data and do additional analyses. This should consist in better coordination of all competent authorities at the level of strategy, operational action and mining, data exchange and analysis.
- More expenditure on active labour policies is required. Such policies will restore the trust in formal institutions and demotivate citizens from exiting the formal market as the costs of doing so become higher. Briefly, there is a need for increasing trust in formal institutions to motivate people to be included in formal economy.
- The necessary measures need to be taken to eradicate corruption cases to increase citizens' trust in the administration. In this regard, inspections need to be strengthened as well.
- Creating an effective tax system - the Tax administration should be guided by the principle of cooperation instead of coercion. Improving information on how the public money is being spend is crucial for taxpayers to be actively involved in settling tax obligations. Tax evasion and social contributions should be reduced in a way that improves the efficiency and fairness of the Tax Administration's treatment of citizens. Strengthening citizens' faith in government action needs to increase the level of tax payments and introduction of tax relief for various household services are measures that would contribute to addressing the informal economy. There is also need for ensuring a fairness in how companies and individuals are treated by the tax authorities to reduce evasion of taxes and social contributions.
- As there is an association between undeclared work and reliance on personal connections in Croatia, pulling of strings should be limited, to ensure fair treatment of citizens and reduce tax evasion. As noted, vertical trust will increase if citizens become more actively involved in counselling before implementing measures. Surveys and evaluations of relevant policy proposals should be conducted more regularly.
- In terms of horizontal trust, it is necessary to invest in education and informing citizens in Croatia about the value of taxation and government services, through introducing a specific subject into the school curriculum. Given that the practice of envelope wages is common in Croatia, it is necessary to warn of the harmful consequences they have for solidarity (for example the subsequent impact on retirement workers, causing lower revenues in the Croatian budget, etc.) to change the established culture.
- Involvement of the media is crucial for informing citizens about the negative consequences of engaging in informal economy and the benefits of reported work, considering the

---

<sup>33</sup> Dissecting the illicit practice of wage underreporting: some evidence from Croatia, Josip Franic

interests of society. Encouraging the presentation of cases of undeclared work to the public could positively affect companies and their decision not to engage in such activities.

- It is necessary to continuously raise citizens' awareness – introducing to citizens the negative consequences of undeclared work (e.g., no insurance cover, no guarantees that health and safety regulations have been followed, no legal recourse) would reduce where they use it. For those citizens and entrepreneurs involved in undeclared work, who are considering moving to formal economy, there is a need to ensure adequate support and advice. Also raising awareness campaigns is important for introducing the negative consequences of operating undeclared (e.g., constrained access to finance, restricted access to market, limited growth prospect etc.) to reduce the latter among companies. Positive practice should be established in form of "whitelist" of employers operating in accordance with the law (not the "blacklist" for public work contracts).
- It is necessary to ensure efficiency in all actions of public bodies and authorities, simplify bureaucratic procedures, especially for small and occasional jobs to ensure legitimately employment of such workers, and improve the provision of information to reduce the use of "pulling the strings".<sup>34</sup>

---

<sup>34</sup> Recommendations based on guidelines of:

- Strategy and Action Plan for Combating Undeclared Work in the Republic of Croatia
- Research conducted in reports: Undeclared economic activities of Croatian companies Findings from a representative survey of 521 companies and Illegitimate Economic Practices in Croatia: findings from a representative survey of 2,000 citizens
- Tackling Undeclared Work in Croatia: Knowledge-Informed Policy Responses.

## References

- Factsheet on Undeclared Work - CROATIA, <https://ec.europa.eu/social/ajax/BlobServlet?docId=18156&langId=en>
- Undeclared Work in Croatia, Josip Franic and Colin C Williams, <https://bib.irb.hr/datoteka/895891.SSRN-id2435142.pdf>
- The employment and social situation in Croatia, Iva Tomić, Ivica Rubil, Danijel Nestić, Paul Stubbs, [https://www.europarl.europa.eu/RegData/etudes/STUD/2019/642345/IPOL\\_STU\(2019\)6\\_42345\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2019/642345/IPOL_STU(2019)6_42345_EN.pdf)
- Strategy and Action Plan for Combating Undeclared Work in the Republic of Croatia, Colin C. Williams, Marek Radvanský i Miroslav Štefánik, Strategy and Action Plan for Combating Undeclared Work in the Republic of Croatia.docx
- Tackling Undeclared Work in Croatia: Knowledge-Informed Policy Responses. [https://www.researchgate.net/publication/324246719\\_Tackling\\_Undeclared\\_Work\\_in\\_Croatia\\_Knowledge-Informed\\_Policy\\_Responses](https://www.researchgate.net/publication/324246719_Tackling_Undeclared_Work_in_Croatia_Knowledge-Informed_Policy_Responses).
- Dissecting the illicit practice of wage underreporting: some evidence from Croatia. <https://www.tandfonline.com/doi/full/10.1080/1331677X.2020.1745083>.
- Undeclared economic activities of Croatian companies Findings from a representative survey of 521 companies, September 2017, Predrag Bejakovic and Colin C Williams, GREY Working Paper No. 13, [https://www.researchgate.net/publication/333994952\\_Undeclared\\_economic\\_activities\\_of\\_Croatian\\_companies\\_findings\\_from\\_a\\_representative\\_survey\\_of\\_521\\_companies](https://www.researchgate.net/publication/333994952_Undeclared_economic_activities_of_Croatian_companies_findings_from_a_representative_survey_of_521_companies)
- Illegitimate Economic Practices in Croatia: findings from a representative survey of 2,000 citizens, Collin C. Williams, J. Franic, GREY Working Paper No. 9, [https://www.researchgate.net/publication/314871559\\_Illegitimate\\_Economic\\_Practices\\_in\\_Croatia\\_findings\\_from\\_a\\_representative\\_survey\\_of\\_2000\\_citizens](https://www.researchgate.net/publication/314871559_Illegitimate_Economic_Practices_in_Croatia_findings_from_a_representative_survey_of_2000_citizens)

## Contact

**International Labour Organization**  
Route des Morillons 4  
CH-1211 Geneva 22  
Switzerland

**Research Department**  
E : [researchcourse@ilo.org](mailto:researchcourse@ilo.org)