

Factsheet on Undeclared Work – CROATIA

1.1 Nature and Estimated Scale of Undeclared Work

1.1.1 Definition of undeclared work

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 authorities¹), and is used by all institutions engaged in the design and implementation of activities working towards combating undeclared work.

1.1.2 Characteristics of undeclared work

Publicly available data on the scope and specificities on undeclared work in Croatia are quite limited and based on different estimates and assumptions. Based on the results of different inspections (please see Section 1.1.3), it can be concluded, however, that most common forms of undeclared work in Croatia include performing business activities without registration, envelope wages and illegal immigrants working. The highest number of violations of the Labour Act in 2014² have been recorded in the areas of catering, trade and construction sectors, but no data is available on the distribution of undeclared work by employer size. According to Bejaković (2015)³, it can be assumed that the non-payment of taxes and contributions is less common in large companies, primarily because the extent of their operations and the need to run complete accounts and non-cash payments.

Empirical researchers in most cases find the tax burden as the most important determinant of the unofficial economy, followed by the motivation of taxpayers to paying taxes (sometimes referred to as 'tax morale') and quality of state institutions⁴. Bejaković (2015)⁵ concluded that the official and underground economy in Croatia are substitutes, working in opposite directions, with the shadow economy increasing as a result of the recession in the period 2009-2010. In that period, the most important factors influencing the shadow economy in Croatia (such as tax moral, tax burden and labour market conditions), according to Bejaković (2015)⁶, worked in the same direction, increasing the share of the shadow economy in the period 2008-2010, opposite to the period 2002-2008, when these were stable. Therefore, it can be concluded that main motivators for undeclared work in Croatia include a low employment rate and lack of work opportunities, as well as relatively high taxes and obligatory contributions on wages.

1.1.3 Estimated scale of undeclared work

There are different estimations on the scale of undeclared work in Croatia, which range from less than 10 % to more than 30 % of GDP. Schneider (2011)⁷ estimated that the shadow economy in Croatia amounted to 30.4 % of GDP; analysis conducted by A.T.

¹ There is no formal national definition.

² Commission for combat against undeclared work (2014). Consolidated report on the measures taken for combating undeclared work.

³ Predrag Bejaković (2015) A revision of the shadow economy in Croatia: causes and effects, Economic Research-Ekonomska Istraživanja, 28:1, 422-440, DOI: 10.1080/1331677X.2015.1059104

⁴ Lovrinčević, Z., Mikulić, D., & Galić Nagyszombaty, A. (2011). Unofficial economy in Croatia and the impact of the economic recession on the unofficial economy. In Z. Reić & V. Šimić (Eds.), Conference proceedings challenges of Europe: Growth and competitiveness reversing the trends (pp. 479–908). Split: University of Split, Faculty of Economics.

⁵ Op. cit.

⁶ Op. cit.

⁷ Schneider, F. (2011), 'Shadow economies all over the world: new estimates for 162 countries from 1999 to 2007', in Schneider, F. (ed.), Handbook on the shadow economy, Cheltenham, Edward Elgar.

Kearney (2013)⁸ evaluated that the shadow economy amounted to 28 % of GDP; while the CBS estimate (unofficial data) indicates that it is more realistic that the shadow economy reached 7.4 % of GDP in 2014.

Despite the evident lack of data on the shadow economy and its size in relation to GDP, reports on conducted labour inspections indicate a gradual decrease of cases of undeclared work in Croatia, which can primarily be attributed to the wide scope of different measures designed and implemented to combat undeclared work and the shadow economy in general (please see Section 1.3).

According to the data of the Croatian Labour Inspectorate for 2014, cases of undeclared work have been identified in almost all industries, especially in the hospitality industry, trade and construction. Most common violations detected by the labour inspectors have included:

- employment of workers without an employment contract or delivery of the written confirmation on the concluded contract, in cases where the contract has not been concluded in written form;
- concealing of working relation through conclusion of different forms of contracts (e.g. service contract) for jobs with characteristics which require conclusion of work contracts;
- failure to register workers for mandatory pension or health insurance;
- employment or work of foreigners contrary to the relevant legislation or without application to the competent authorities of pension or health insurance, where required; and
- hiring seasonal workers for temporary or part-time seasonal jobs in agriculture.

In 2014, there was total of 6 853 potential violations of labour regulation reported by the Inspectorate, which resulted in 2 957 misdemeanour charges at competent courts against employers, 258 mandatory misdemeanour warrants and 118 misdemeanour warrants issued, and 55 penalties imposed on the scene. In addition, inspectors have issued 495 decisions on penalties related to an identified 774 workers which were not registered for pension insurance upon commencement of work or were registered with incorrect working hours, and 93 foreign workers who were working illegally. About EUR 292 000 has been paid to the State Budget based on these fines. This data indicate a decrease of detected violations in the area of labour regulation in comparison to the period 2011-2013, when an annual average of 1 321 workers were identified as unregistered for compulsory insurance, and 388 as illegal immigrants.

1.2 Institutional Framework

1.2.1 Responsibilities for addressing Undeclared Work:

There is no single public organisation responsible for tackling undeclared work in Croatia. Instead of that, responsibility is shared between different ministries and government departments, including:

- Ministry of Labour and Pension System, especially Labour Inspectorate's department;
- Ministry of Finance, especially Tax Administration and Customs Administration;
- Ministry of Interior;
- Ministry of Tourism;
- Ministry of Agriculture; and
- Croatian Employment Service.

Departments which carry the highest responsibilities in the area of preventing and combating undeclared work in Croatia are predominantly the Labour Inspectorate within

⁸ A.T. Kearney (2013). The Shadow Economy in Europe, 2013. Available at: <https://www.atkearney.com/documents/10192/1743816/The+Shadow+Economy+in+Europe+2013.pdf>

the Ministry of Labour and Pension System, as well as the Tax Administration and Customs Administration within the Ministry of Finance in cooperation with Ministry of Interior. Somewhat lower level responsibilities in combating undeclared work are situated within the Ministry of Tourism, Ministry of Agriculture and Croatian Employment Service

1.2.2 Characteristics of the responsible organisations

The Labour Inspectorate carries out inspections and other professional activities in the field of labour and safety at work, performing inspections of the implementation of laws and regulations governing: labour relations and occupational health and safety, obligatory notification, check-out and changes over insurance of workers on the mandatory pension and compulsory health insurance, relations with the employer, preparation of answers and statements to the requirements of the state attorney in civil and criminal proceedings conducted by the applications or proposals for labour inspectors, preparation of reports on inspections conducted and the measures taken, performance of representation before magistrates' courts in misdemeanour proceedings and before the administrative courts concerning actions in administrative proceedings. It also conducted joint actions with the Ministry of Interior in combating the illegal employment of foreigners, and collaborated with Ministry of Finance in surveillance regarding compliance with the minimum wage act and legislation in the field of taxes and social contributions.

The Tax Administration department is responsible for collecting tax revenues. The Tax Administration inside its' organisational structure has a tax inspectorate which controls payment of taxes and unreported income. The Tax Inspectorate also has responsibility to prepare proposals for initiating criminal proceedings and the submission of applications for criminal acts in cases of economic offences such as attempted tax evasion.

The Customs Administration is in charge of inspections and enforcement activities in the fight against the grey economy, with particular emphasis on the supervision of the implementation of regulations governing the trade and the provision of services, and supervision of all forms of unregistered and illegal trade activities. By taking control of affairs in the field of aforementioned unregistered activities, the Customs Administration is also in charge of detecting possible regulations that violate labour regulations. In addition, the Customs Administration is in charge of surveillance of compliance regarding sojourn tax.

The Ministry of Interior in cooperation with the Labour Inspectorate is mainly in charge of combating the illegal employment of foreigners. The Ministry of Agriculture inspects the observance of special regulations in the field of Agriculture, Forestry and Water Management. However, inspectors cannot take concrete measures in combating illegal employment in the agriculture sector except in specified cases where information is forwarded to the Labour Inspectorate.

The Ministry of Science, Education and Sports controls implementation of regulations on job placement for regular students. This should be realised through actions of student centres, which formally are organisational units of public universities / polytechnics in Croatia but with their own legal personality. The Ministry of Tourism is authorised for the inspection of activities by registered entities and individuals engaged in providing services in tourism, but not for detection and prosecution of undeclared businesses in this field, which is a responsibility of the Customs Administration. The role of the Croatian Employment Service in combating the illegal employment is that if an unemployed person from the Croatian Employment Service unemployment register was detected in undeclared work activity, then penalties in the form of deletion from unemployment register will follow.

1.2.3 Cooperation and collaboration between authorities and cross-border authorities

Despite the fact that there are examples of cooperation in data sharing and joint actions, generally there is a lack of coordination among these ministries and departments. That was the main reason why the Croatian Government in August of 2014 has formed one committee in charge of coordinating actions for tackling undeclared work in Croatia. The composition of this committee represented different Ministries which were involved with their responsibilities and measures in tackling undeclared work in Croatia. The following ministries delegated their representatives in this committee: Ministry of Economy, Ministry of Labour and Pension System, Ministry of Finance, Ministry for Crafts and Entrepreneurships, Ministry of Tourism, Ministry of Agriculture, Ministry of Interior, Ministry for Social Policy and Youth, Ministry for Health, Ministry for Science, Education and Sports, Croatian Employment Service and Croatian Pension Insurance Fund. On the other hand it seems that results in terms of creating effective mechanisms for tackling undeclared work in Croatia was not achieved through the work of this 'committee'.

There is no publicly available information regarding any cross-border co-operation of Croatian public bodies in combating undeclared work, so it is quite difficult to deliver any judgment in that direction.

1.3 Policy Focus and Measures

1.3.1 Policy approach

Country Specific Recommendations 2014 identified a high proportion of undeclared paid activity in Croatia and emphasised the need to address undeclared work, recommending to outline plans to tackle the issues of undeclared work by the end of 2014. The Ministry of Labour and Pension System has pronounced 2014 as the year of combating informal employment, which was emphasised through different planned activities, including preventive, curative and repressive ones.

The Commission for Prevention of Undeclared Work was established in 2014 by the Croatian Government. The Commission consists of representatives of thirteen ministries, the Croatian Employment Service and the Croatian Institute for Pension Insurance. A report on the measures taken for combating undeclared work was drafted in 2014, which identified different areas of activity which regulate the measures against undeclared work, including employment in the fisheries sector, student work, combating undeclared work in the field of unregistered business activities etc.

Initiation of more active involvement of the Tax Administration in development and implementation of instruments for combating undeclared work has been planned in 2015, primarily through the adoption of the Action Plan which should have defined the areas of implementation and guidelines for combating all types of earning income by 'moonlighting', without payment of taxes. Implementation of the measures has been envisaged through efficient and close cooperation of the Tax Administration and other institutions in collecting and analysing data essential for identification of correct tax liabilities, which also includes the identification of areas exposed to risk of undeclared employment, measures for combating this form of employment, as well as awareness-raising measures.

Most of the measures tackling undeclared work and the shadow economy in general are based on a deterrence approach, as described in more detail in the following sections. Awareness raising campaigns have been initiated relatively recently, while other measures based on an enabling approach mostly include active labour market policy measures incentivising self-employment and employment in Croatia.

1.3.2 Measures to tackle undeclared work

The Ministry of Finance and Tax Administration implement most of the measures tackling undeclared work, which are based on the deterrence approach. Fiscalisation of cash payments has been introduced in 2013, to ensure efficient oversight over transactions

done in cash. These transactions are immediately (via internet) reported to the Tax Administration. Results have been achieved almost immediately, since the reported revenues have increased significantly with the introduction of fiscalisation, especially in catering and other tourism-related business activities. The Act on nannies regulates the mostly informal personal child-care service provision by setting up basic standards allowing persons and firms to register such an activity, and permitting local government to subsidise such services. Since 2014, employers have the obligation to submit a unified form with wage calculations (JOPPD form) to the Tax Administration. The JOPPD form substituted six different forms used before 2014 and enabled the Tax Administration to monitor the payments of contributions, taxes and income of individual workers.

The Ministry of Labour and Pension System is in charge of design and implementation of measures which are primarily based on the enabling approach. These primarily include awareness-raising campaigns on the harmful effects of undeclared work on the economy, as well as design and implementation of the active labour market policies and measures, whose budget and scope increased significantly in 2015, with the support of funding from ESIF. The Act on Employment Encouragement, adopted in 2012, has introduced several new measures aiming to decrease undeclared work. Vouchers have been introduced for temporary and seasonal employment in agriculture, employment procedures have been facilitated for employers, incentives for self-employment have been introduced, as well as different incentives for employment being introduced to facilitate employment and decrease the share of undeclared work in Croatia. The Act on Mediation in Employment and Rights during unemployment stipulates that persons who perform work without a contract or other receipt enabling work activities will be deleted from the registry of unemployed administered by the Croatian Employment Service, and will be able to apply again after six months.

New measures have also been introduced in the area of pension insurance. The Pension Insurance Act, adopted in 2013, has significantly widened the scope of persons with obligatory insurance and introduced shorter deadlines for registration of the commencement, changes, and end of pension insurance, which is now due within 24 hours from the occurrence of the change in pension insurance status. Deadline for registration of the commencement with obligatory insurance is before starting work. Registration procedures have also been simplified with the introduction of obligatory electronic forms and decreasing the number of documents which need to be attached to the insurance registration.

It should also be mentioned that the social care centres and local and regional administration have the obligation to regularly exchange data on the social welfare receivers who are capable to work and who have participated in community services without payment, which is their obligation in line with the Social Welfare Act. Furthermore, the Act on Crafts from 2013 introduced the status of 'secondary profession', which enabled persons who have worked without registration to legalise their business activities.

In the area of tourism-related activities, the Ministry of Tourism has amended the Hospitality and Catering Industry Act and the Act on the Provision of Tourism Services, with the aim of facilitation and simplification of starting a business and combating undeclared business activities and employment in the industry.

The Labour Act reform, completed in 2014, resulted with the adoption of the new Labour Act and several accompanying implementing regulations, which entered into force in August and December 2014, respectively. The main objectives of the new Labour Act include facilitating employment and internal mobility of workers, enabling more flexible business operations and reduction of labour costs, encouragement of more effective and faster restructuring of employers, as well as facilitating measures against undeclared work.

When it comes to effectiveness of different measures, available data is quite limited. The effects and efficiency of active labour market policies is currently under comprehensive

analysis, results of which should indicate the actual effects of all ALMPs implemented in Croatia, as well as the need for their re-design. It seems that largest effects have been achieved with the fiscalisation of cash payments, which significantly increased the reported revenues of the catering industry, as well as the introduction of the JOPPD forms for reporting of paid personal income, taxes and contributions, which enabled a more efficient and comprehensive monitoring and control by the Tax Administration.

1.3.3 Good practice

Probably the best practice in tackling undeclared work in Croatia has been the introduction of cooperation of all relevant ministries in the area, under the Commission for Prevention of Undeclared work. It has proven to be especially important since different ministries and government bodies are responsible for different aspects of combating undeclared work and the shadow economy in general. Since 2014, the Commission has published annual reports on conducted measures combating undeclared work, which provides an overview of activities conducted by all relevant bodies and institutions, and facilitates monitoring of their effect on decreasing undeclared work in Croatia. When it comes to individual measures, two measures should be highlighted in terms of their efficiency – fiscalisation of cash payments and introduction of a single electronic form for reporting of paid personal income, taxes and contributions. Both of the measures have enabled the Tax Administration to more efficiently monitor and control obligations and payment of taxes. In the first year of fiscalisation implementation, a significant increase of reported turnovers and income was recorded in activities that fall under obligation of fiscalisation, with an emphasis on trade and catering activities.

1.3.4 Challenges and barriers

The main challenges in tackling undeclared work in Croatia include a low level of utilisation of labour, which further deteriorated under the financial crisis and long-term recession. Tax and administrative burdens in Croatia are still high, which significantly contributes to the development of the shadow economy, including undeclared work. Over the last several years, significant developments in the area of combating undeclared work have been achieved, primarily through the adoption of relevant legislation, simplification of procedures and centralisation of all activities under the supervision of the Commission for Combating Undeclared work. Significant improvements have also been achieved within the comprehensive labour law reform, which was oriented towards flexibilisation of the labour market, decreasing labour costs and simplification of different employment procedures. However, total labour costs have still remained high for employers, as well as general tax and administrative burdens related to doing business in Croatia. In addition, some of the recently introduced regulations (e.g. working time recording) and their application in practice have been unclear to both employers and relevant institutions, which also contributes to the number of labour regulation violations. Additional simplification of relevant regulations, as well as decrease of labour contributions and taxes could positively influence the decrease of undeclared work. Putting a larger focus on prevention of causes, rather than negative effects of the undeclared work could save on costs of inspections and court procedures.