

Efendic, Nirha; Pasovic, Edin; Efendic, Adnan

## Article

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# UNDERSTANDING THE INFORMAL ECONOMY IN PRACTICE – EVIDENCE FROM BOSNIA AND HERZEGOVINA

NIRHA EFENDIC<sup>1</sup>, EDIN PASOVIC<sup>2</sup>, ADNAN S. EFENDIC<sup>3</sup>

## Abstract

This paper provides insights into the informal economy of Bosnia and Herzegovina (BiH), a post-conflict transition economy in the Western Balkan region aspiring to become part of the European Union. After the introductory section and literature review, we introduce the economic outlook of BiH and then provide evidence estimating the size of the informal economy, which is identified to be around 30% over the last couple of years. As the size of the informal economy is high and persistent, this implies that current policy approaches are not efficient in tackling this economic challenge. To understand how the informal economy operates in practice, we use data from two different surveys to assess tax morality, undeclared work and the structure of the participants in the informal economy. In the next section, we supplement the study with ethnographic insights. In particular, we identify how participants in the informal economy use it for different purposes and with different motives. This includes reliance on the informal economy as a survival strategy for households, as a way to supplement insufficient formal income, to compensate for economic insecurity, or to decrease costs of formal business by using “envelope wage” practices, but equally importantly to overcome formal institutional rigidities linked to current contradictory laws. Still, we find indications that the growth of informal business is converging to formalisation, as informality at some stages of business development becomes a burden to higher entrepreneurial growth aspirations.

**JEL classification:** O17

**Keywords:** informal economy, formal institutions, informal institutions, undeclared work, Bosnia and Herzegovina

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- 1 National Museum of BiH, Affiliate fellow at CISAR, email: e.nirha@cisar.ba, ORCID: <https://orcid.org/0000-0003-3414-2376>.
- 2 Researcher at CISAR, email: p.edin@cisar.ba, ORCID: <https://orcid.org/0000-0001-9233-7775>.
- 3 University of Sarajevo; Affiliate Fellow at CERGE-EI, email: adnan.efendic@efsa.unsa.ba; ORCID: <https://orcid.org/0000-0003-0241-0938>.

## INTRODUCTION

The informal economy is a persistent phenomenon registered in all developing economies, having a huge share in economic activities, and, thus affecting directly and indirectly the general economic performance of these societies. There are many reasons for such performance of developing economies, but at a very general level some authors recognize the significant presence of the informal economy as an outcome of the mismatch between formal and informal institutions operating in these societies (Webb et al., 2009; Williams et al., 2017).

Globalization is changing the life of contemporary generations, and also brings innovations that make it easier today to communicate, travel or rent an apartment in any part of the world. This has changed not only the habits of both service providers and users, but also contributed to a situation in which these activities are not declared and formalized. Informality today has many dimensions and various participants engage in the informal sector. In everyday life, people buy groceries produced on private farms and sold at unregistered markets, get their hair cut without getting a bill, pay the instructor for children's home piano lessons or babysitters who look after their children. Moreover, many developing economies also struggle with “envelope wage” practices, where business owners use the opportunity to increase their competitiveness by paying lower social and pension contributions to the workers. There are many other examples which can be identified in the everyday life of developing societies, and which cause an increase in the informal economy, with all its direct and indirect consequences for these societies.

Apparently, making a choice of engaging in informality cannot be reduced to a single determinant, as there is a diverse structure of informal economy participants, which make any research into the informal economy challenging. Moreover, we can differentiate between the actors who use informality as a survival strategy and the ones who are involved in such activities to gain more profit (Fields, 2004).

In this study we contribute to the current literature by improving understanding of the ways the informal economy functions for diverse participants in the post-conflict economy of Bosnia and Herzegovina. While quantitative studies are consistent in reporting a high presence of informal economic activities in this country, there is not enough research that contributes

to understanding how it operates on the ground, which provides the main motive for our investigation. In this study we rely on available quantitative data and perform a qualitative analysis based on in-depth interviews with those engaged in the informal economy.

To develop our arguments, we structure the paper as follows. After the introductory section and literature review, we provide a short overview of the BiH economy. The following section provides data on the level of the informal economy in this country based on available secondary and primary data. The next section reports our findings on functioning of the informal economy among diverse participants and based on in-depth ethnographic interviews. The discussion of results and conclusions are in the final sections of the paper.

## LITERATURE REVIEW

Economic theory has evolved in its view of the informal economy in contemporary societies, but still has distinct elaborations. Some scholars consider the informal economy as a separate concept from the formal sector of the economy (Giotto & Baccheschi, 1972), while others assume that informal participants are simply trying to increase competitiveness over their counterparts on the official market (Castells & Portes, 1989). De Soto (1989) identifies institutional motives of informality, such as legal or administrative pressure, while Maloney (2004) emphasizes tax avoidance and regulation as significant factors of informal economy engagement. Still, there are similarities in explanation of the informal economy, including an argument that the informal sector mostly consists of participants who normally prefer formal jobs, but are involved in informality due to bad government or poorly performing institutions, characterized by high tax burdens, unstable institutional environments, or lack of the formal employment supply (Harris & Todaro, 1970; Chen, 2006). An overview of the given theories suggests that the informal economy includes a vast set of activities by different economic agents that fall outside of state regulation. To capture this diversity, Portes and Haller (2010) offer the following typology of informal practices: survival type (e.g., self-construction of shelter), dependent exploitation type (e.g., underground, undeclared work) and growth-oriented type (e.g., capital formation through solidarity-based networks), while they emphasize that these three types are not mutually exclusive.

The most commonly used definition explains the informal economy as all currently unregistered economic activities, which contribute to the official gross domestic product (Feige, 1989; Schneider, 1994; Breusch, 2005). The importance of the informal economy is in understanding that those activities are legal in their nature but informal because participants do not declare them, which means that there are actors who only have informal jobs, but also those who are involved in informality to some extent (De Soto, 2001). The informal economy has various socio-economic impacts, as the informal sector can lead to the inefficient functioning of labour market, while causing improper allocation of resources, and decreasing official GDP.

Engagement in the informal economy exposes participants to the lack of legal support and adequate social protection (Eilat & Zinnes, 2002), which is why the informal economy is often seen as needing to be formalized. However, having in mind that the informal economy may lead to an increase in money in circulation and lowering of the total unemployment rate, it is necessary to approach this phenomenon with caution. The main challenge facing decision makers is to tackle the informal economy while allowing formalization of the informal sector.

The informal economy in BiH is often estimated to be high and sometimes viewed as a means of confronting poverty and unemployment, thus affecting the welfare of those involved in informality. It is also seen as having the potential for improvement of the business environment and general economic activity through enabling the formalization of current informal activities (International Labour Organization, 2002).

Empirical literature which estimates the size of the informal economy in BiH is limited, but we can identify a few studies that analyse this phenomenon from different angles and using different empirical methodologies. Dell' Anno and Piirsild (2004) investigate the informal economy in BiH and provide results on the scope of legal and illegal activities in the informal economy. IMF (2005) analyse the informal economy as part of their country report, concluding that activities in the official national accounts are understated because of the large share of the informal economy. Nastav and Bojnec (2007) attribute the informal economy in BiH to the low level of economic development, high unemployment rate and the war conflict which brought physical destruction of human,

social and institutional infrastructure. Tomas (2010) assesses the informal economy in BiH for 2008, using the indirect method with factors such as labour supply and tax evasion. Schneider, Buehn and Montenegro (2010) and Medina and Schneider (2018) conduct a panel analysis, using the global sample, including BiH. Finally, Pasovic and Efendic (2018) estimate the informal economy using tax burden, unemployment rate and size of the agricultural sector as significant causes of informal economy. Results of these studies are provided in a table reported in Appendix 1.

The estimates from these studies suggest that the informal economy in BiH is large; in most studies it is estimated to be around 30% of GDP in the last years, while in some cases there are structural differences between these estimates. The diverging estimates primarily reflect different measurement and estimation methods and different definitions of the informal economy. However, the majority of studies are consistent in concluding that the informal economy in this country is a persistent economic phenomenon and it indicates ineffective policy approaches used to tackle this challenge. The transition process itself brought systematic transformations in the country, which made increase in informal economic activities inevitable (Efendic & Hadziahmetovic, 2015), and stimulating different manoeuvres between formal institutions and informal practices existing on the ground (Halilovich & Efendic, 2019). This urges meaningful reforms that will target the gap between formal institutions and informal practices in this Western Balkans' environment (Gordy & Efendic, 2019).

## **THE ECONOMIC OUTLOOK OF BOSNIA AND HERZEGOVINA**

Economic development of BiH, as part of Yugoslavia (before the 1990s), was oriented towards the industrial and construction sectors with some of the large and high performing companies contributing to the positive trade balance, having a high share of exports. At the time, BiH had a low unemployment rate, more open market, but also lower per capita output when compared to other Yugoslav republics. Unfortunately, the Bosnian war in 1992-1995 completely disrupted the economic activity existing in the former socialist period, resulting in a lagged transition process. The Dayton Peace Agreement stopped the conflict (1995), transition started together with



reconstruction of the country, with a goal of achieving macroeconomic stabilization (Efendic & Hadziahmetovic, 2015), but leaving the country with a uniquely complex institutional environment (Efendic & Pugh, 2015). This led to high GDP growth rates in the first years after the war, which were primarily a consequence of the low starting base and high donor support. The latest growth prospects are far from satisfactory, being 1-3% annually over the last couple of years. Unemployment is estimated to be above 20% of the labour force, there is a persistent problem with current account deficit and reliance on financial support from a diaspora which sends remittances above 10% of GDP (Efendic at al., 2014). One of the continuous challenges is a quite high emigration rate, generally being present in the whole South East Europe (Zbinden at al., 2016).

Some of the factors identified as problematic for the development of BiH's economy are a high level of bureaucracy, corruption, government and policy instability, high fiscal burdens, lack of alignment of education with the labour market and poor access to finance (Federal Institute for Development Programming, 2008). One of the challenges in this country is a high share of informal economic activities estimated to be around 30% of GDP. In April 2015, the Council of Ministers of BiH presented the conclusions from the Conference on tackling the informal economy, which includes measures to limit the expansion of the informal economy (Council of Ministers of BiH, 2015). This conference emphasized that coping with the challenges of the informal economy is currently in the focus of the decision makers, and one

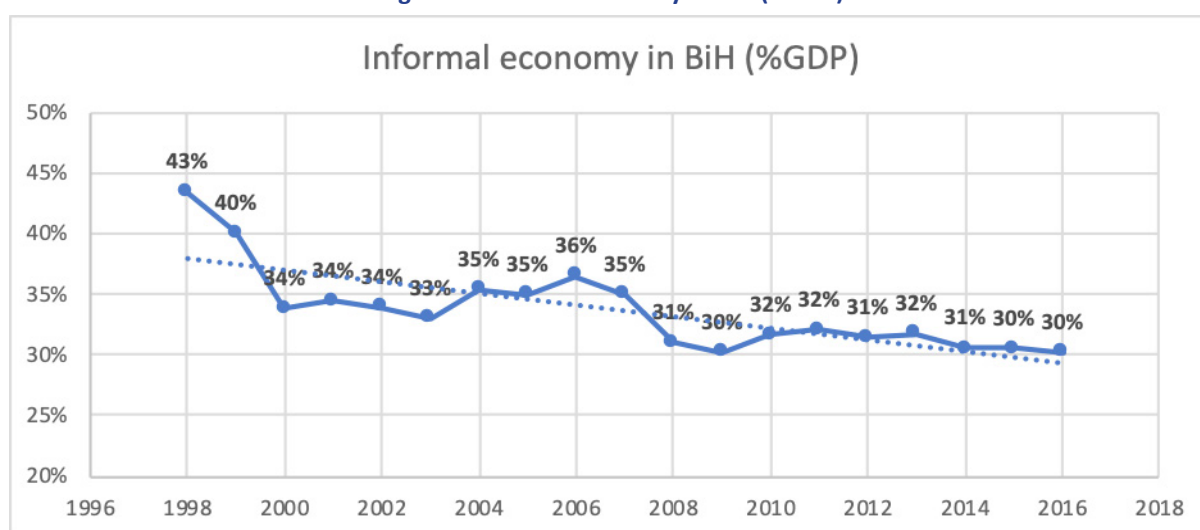
of the requirements for EU integration. Apparently, the informal economy has become one of the priorities on the domestic policy agenda, although very little is known about its structure and how it functions on the ground.

## THE INFORMAL ECONOMY IN BiH

If we look at the dynamics, the most recent estimate of the informal economy in BiH (Figure 1) by Pasovic and Efendic (2018) suggests a downward trend over the last two decades. Some of the key structural points in this trend include a decrease in the informal economy after the value added tax (VAT) reform was introduced in 2006 and increase of the informal economy after the global economic crisis in 2009. The changes in this indicator suggest that the informal economy is affected by tax reforms, but also that citizens rely on informality more during difficult times, such as the latest global crisis. However, as can be seen from Figure 1, over the last couple of years, the level of the informal economy remains unchanged at around 30%.

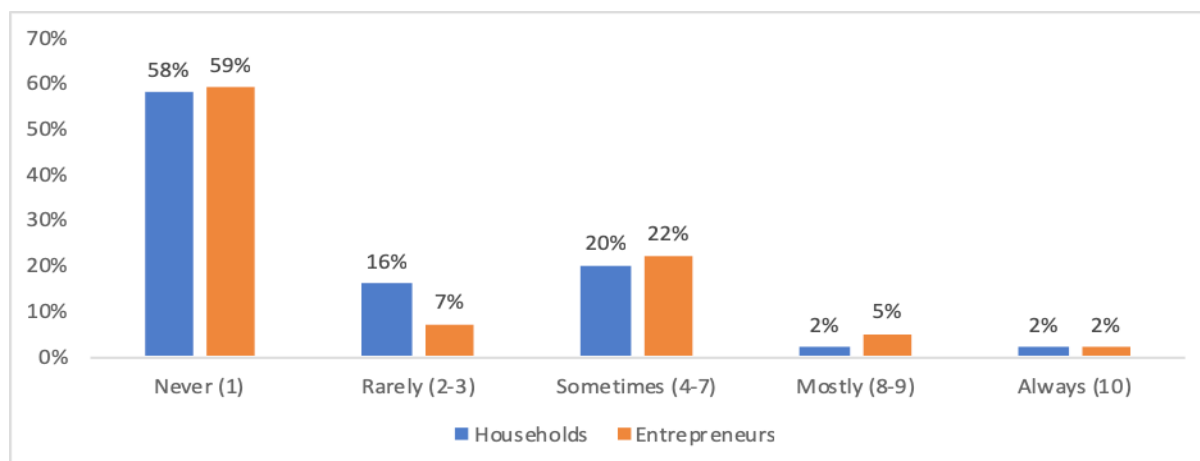
Conventional causes of the informal economy such as taxation, unemployment and institutional environment, which are identified in the literature as potential drivers of the informal economy, lead us to investigate some underlying motives for engagement in the informal sector. However, it is important to mention that these factors can be in direct or indirect relationships, affecting each other through different channels. Tax policy is directly influenced by institutional quality and regulation; therefore, it affects incentives to engage in formal or informal employment.

Figure 1: Informal economy in BiH (%GDP)



Source: Pasovic and Efendic, 2018

**Figure 2: Justifiability of evading taxes in BiH**



Source: INFORM, 2017

Simply, the identification strategy for empirical work is complex.

Many authors have examined the relationship between tax morality and the informal economy, with findings suggesting that lower tax morality might lead to a higher probability of participation in the informal economy. We use data on tax morality from the regional INFORM<sup>1</sup> project collected in 2017 as part of the representative survey which included 1,245 respondents from BiH. Our findings (Figure 2) suggest that 40% of respondents from the household and entrepreneurial sectors justify tax evasion to some extent, which tells us that tax morality is low when compared to EU countries (European Commission, 2013). This serves as confirmation of consistency with the theoretical explanation of tax policy affecting the informal economy through tax morality. Williams et al. (2015) show that, at the individual level, participants in informal work have a significantly lower tax morality when compared to those engaged in formal activities.

Good performance of formal institutions leads to an increased cost of informality, affecting the incentives to work in the informal economy (Schneider, 2010). We capture perception of institutional quality by examining respondents' trust in government, which might serve as citizens' judgment of institutional performance. We

use data from the RRPP<sup>2</sup> survey implemented in 2015, where 6,021 randomly selected respondents from BiH answered questions regarding the informal sector in BiH. Our findings suggest a low trust in institutions, with more than 60% of respondents stating that they have no trust in different levels of government. Such perception of institutions provides fertile ground for the development of the informal economy (Williams & Horodnic, 2016).

The high unemployment rate in BiH, which was 20.5% in 2017 (ILO, 2018) suggests labour market distortions. Thus, it is important to examine the heterogeneous structure of participants in the informal economy. Unemployment has a significant effect on the decision to engage in the informal economy, as difficulties in paying household costs turn people to informality (Williams et al., 2015). This source of the informal economy is ambiguous, as a decrease in employment might indicate a general slowdown of the economic activity, thus lowering the activities in both the official and informal economies (Klaric, 2010).

To further examine the structure of the informal economy in BiH we assess the scope and structure of paid activities, legal in their nature, but not declared to public authorities, i.e. undeclared work (Eurofound, 2013). Here, we also use representative data from the RRPP survey introduced above.

<sup>1</sup> INFORM project "Closing the gap between formal and informal institutions in the Balkans" is a EU Horizon 2020 multidisciplinary research focused on formal and informal institutions in the Balkans. The survey was conducted in all Western Balkan countries in 2017 by a professional research agency. The database contains 1,246 respondents for the BiH sample, including respondents from household and entrepreneurial sectors. More on the sample and the data can be obtained from the report: [http://www.formal-informal.eu/files/news/2017/Deliverables%20and%20Milestones%202017/Study%20on%20formal%20and%20informal%20economy\\_upd\\_27122017.pdf](http://www.formal-informal.eu/files/news/2017/Deliverables%20and%20Milestones%202017/Study%20on%20formal%20and%20informal%20economy_upd_27122017.pdf)

<sup>2</sup> The data were collected as part of the RRPP supported project: 'Social capital, migration and economic performance – evidence from a post-conflict environment', implemented by CISAR and supported by the Swiss Development Agency, Sarajevo, 2014-2016. The primary survey data has been collected by a professional research agency for social, media and marketing research in BiH in 2015. 6,021 randomly selected respondents between 16 and 65 years of age participated in the survey. The survey was conducted via computer-assisted telephone interviewing (CATI) and every municipality in BiH had at least 40 participants. More information on these data is available at <https://seedsdata.unil.ch/project/study-public-overview/153/0/>.

**Table 1: Distribution of undeclared work in BiH (2015)**

%	BiH	LABOUR FORCE		AGE		GENDER		URBAN			ENTITY		
		Yes	No	Young (16-35)	Old (35+)	Male	Female	Urban	Sub-urb	Rural	FBiH	RS	BD
NO	74	79	70	72	74	71	76	80	76	69	75	72	74
YES	26	21	30	28	26	29	24	20	24	31	25	28	26

\*Those who have informal employment and activities but not any formal employment

Source: RRPP, 2015

Diverse groups involved in undeclared work suggest that there is no universal rule explaining involvement in the informal sector, but some patterns do emerge. We find that 8% of respondents from our survey are involved in undeclared work in addition to their formal job, while 26% of respondents are exclusively performing undeclared activities. More undeclared workers come outside of the official labour force, with males and younger individuals participating more in undeclared work, and with greater participation of those from rural areas.

Participation in the informal economy may be affected by low income of participants and the difference between their actual and desired income (Kim, 2005). When the percentage of population which is at risk of poverty is greater, the informal economy tends to have a greater scope (Williams, 2014).

To assess the structure of those engaged in informality, we grouped respondents based on the level of their personal monthly income. Then, we used data on percentage of their household income that comes from informal economy. From Table 2, we can see that respondents who have lower monthly incomes from the declared activities come from households which earn more of their total income from the informal economy. This serves as an indication of the structure of participants in the informal economy in BiH, concluding that a higher share of those involved in informality use the informal economy as a survival strategy. In addition to this, we

notice that most of the respondents (74%) come from the lower income group, that reflects lower development of the economy, something that should be taken into consideration when creating policy recommendations. It should be noted that around 38% of respondents didn't know or refused to state their personal monthly income, while around 14% didn't know or refused to state what percentage of their income comes from the informal economy.

The relationship between poverty and the informal economy is presented through two different views. The marginalisation view explains the informal economy as a sector with a large share of marginalized groups, such as the unemployed and those with lower income levels, involved in informality due to unemployment (Gutmann, 1978). On the other hand, the reinforcement view states that those marginalized groups benefit less from the informal economy when compared to higher income participants, causing reinforcement of inequalities (Williams, 2004). The former thesis is based on perceived lack of resources, opportunities and skills of the informal participants, together with caution regarding the potential penalties they would face if caught. With the two theses being complementary to some extent, it is possible that marginalised groups participate in informality to a greater extent, but they benefit less from this involvement, reinforcing their marginalized status (Williams, 2014).

**Table 2: Structure of participants in the informal economy**

Personal monthly income (average)	Percentage of household income from the informal economy			Total share of respondents
	0%	10-50%	60-100%	
Low (Under 300€)	68%	26%	6%	74%
Medium (300-500€)	72%	24%	4%	18%
High (More than 500€)	76%	19%	5%	8%

Source: INFORM, 2017



## UNDERSTANDING THE FUNCTIONING OF THE INFORMAL ECONOMY

To further investigate and understand the structure of the informal economy in BiH and the performance and behaviour of its participants, we conducted ethnographic visits to different parts of the country. Starting in November 2016 up to December 2017 we conducted interviews from the Eastern to Western part of BiH, including a few interviews in 2019. The ethnography includes 12 participants, of which six are female and six male, aged from 26 to 65 years (Appendix 2). Their affiliations are also different, and they include jobs such as mechanical technician, who lost his job during the war and is still unemployed, to the owner of a big and prominent transnational corporation. Some of them stayed formally unemployed even though they run informal businesses (e.g. mechanical technician and a hairdresser), while the others support their home budget with some informal income, even though they have formal jobs (e.g. the professor of German, the lawyer and electrical technician). Finally, we also have an example of a young economist and businessman who has a formal job but is also very well informed about informal economic practices in his business.

In many post-socialist societies like those in the Western Balkans, the period of socio-political transition – when the old system collapsed and the new one was in the process of being established – the centre of governance and control moved from the state to the individual level (Brkovic, 2016). In the absence of a regulated infrastructure and efficient formal institutions, the economically most successful individuals proved to be those with larger social and mainly informal networks. As many people stayed unemployed, and the period of the war and humanitarian support ended, making their lives difficult, many of the citizens used their “own ways” to achieve a stabilisation of their home budgets. As most of the big companies from the socialist period collapsed, the citizens were seeking any means of survival. One of the strategies for survival at the individual level was to engage in informal businesses.

Very shortly after the war in the 1990s, a significant number of people who were seeking economic survival in the new environment got involved in “network marketing”. These firms and offices emerged in the region before the new forms of social networking appeared

on the Internet. Others recognized an opportunity to initiate certain business activities through micro-credit organizations, and many simply joined different initiatives, without formally establishing non-governmental or other organizations, but they wanted to preserve the practice of socializing that had decreased with the departure of traditional practices. All of this was happening mainly as informal initiatives.

Traditionally, women in the informal economy relied on “gender defined jobs” to support the family budget, including examples such as caring for elderly people and children, renting spare rooms, cleaning, etc. (Efendic et al., 2018). The situation with “male” jobs was quite similar. One of our informants is a man who had a stable job in a solvent company before the 1992-1995 war, after which it went bankrupt. He was responsible for specific machines and their proper functioning, as he was a mechanical technician. Apart from that, he was a farmer and he could do some extra jobs that included physical effort (e.g. chopping wood, planting). While he was searching for a new job adequate to his specialisation (after the war), he offered his services to the many returnees in his neighbourhood who needed a hand in physically demanding tasks, especially the women who had lost their male family members in the war.

*I know how to do everything on the land - to cut the grass, to cut the wood and to make a wooden fence. Every day I have to do something for somebody, and I can barely come to my household to do what I need during the summer time. (M 8, mechanical technician)*

That was the first step of a survival strategy in the countryside, to do anything no matter whether it is linked to your particular skills and specialisation. As this job generates non-regular and unpredictable income, this informant did not consider formalisation of his work, and remained informal, with the aim to survive in these harsh times under informality.

Another example is from an urban area; it is a woman involved in a kind of “network marketing” for which women use social and family networks to develop a business and make some profit. Another informant from an urban area is a woman who wanted to increase her income by selling cosmetics via her informal network of people developed over time (Efendic et al., 2017). She did not sign any kind of contract for selling cosmetics, as she was satisfied with her primary job as a schoolteacher which she wanted to keep. But still she was encouraged



to carry out some extra economic activities to financially support herself and her mother who was looking after her children. The income from her official job (she is a teacher of German language in an elementary school) could not cover all her needs which is why she engaged in informality. Her story is the following:

*This is the only way that I can earn additional money, not a lot, but still enough to support my mother, to buy something for her. She looks after my children, and doesn't want anything in return, but I buy something for her from time to time; usually it is medicines from the recent past. I am lucky because I know a lot of people; otherwise I could not sell anything in this way (through the network). (F 1, teacher of German language)*

The other challenge for people on the ground was to set up small businesses which were mostly supported by microcredit organizations and small funding which they could not get easily through the banking system. People largely used this possibility for getting initial funding without the need for additional guarantors. It was crucial to have a “feasible” idea. In particular, the war returnees (those who left their homes during the war and returned) in the region have been using this means to build greenhouses, to expand stables, and to set up farms, where they would produce milk or other products made from milk. These kinds of activities traditionally were done by women – from milking cows to producing cheese. Still, men also were interested in exploitation of resources that the countryside offers. Our next informant is from the countryside; it is a man who got a job in a stable private company, but still wanted to increase his income with an idea to raise cattle on his farm. He also did not consider registering his additional business activities.

*I do my job in the factory, but afternoons I still can do a lot of work on my farm. So, every day when I finish the shift, I take the tractor and work on the field. Sometimes, I give a hand to the others with tractor, but firstly I have to finish all on my farm and to produce enough food for the cows. (M 7, electro-technician)*

One of our interviews in Sarajevo, the capital city, was with a hairdresser. She used to work in a beauty salon but after delivering her first baby she could not work formally as she could not cope with eight hours working time (Efendic et al., 2017). Apparently, the lack of flexibility that BiH has in the contracting laws together with a heavy tax burden is one of the reasons for the greater appearance of the informal economy. (F 2, hairdresser).

*I worked for a woman before delivering my baby, and that salon is closed now: not just because of my absence, but due to a lack of customers. My husband is policeman, and for now, he has a stable and solid salary, but we have two kids, the costs of living increased and I offer style hair in my house, at the moment without interest to formalise it, because I cannot cope with the tax of the State, and precise working hours. (F 2, hairdresser)*

In cities, where we identify many newly established companies, there is some kind of race for survival under competitive pressure from existing companies. To keep all workers, and avoid some taxes, they choose to register employees only on a minimum wage, and to give them the rest in an envelope, an informal practice known as “envelope wages”. That kind of phenomenon we can define as “partly informal”. Here is an experience:

*I have worked in the environment where every employee was officially declared at the minimum wage and got the rest of the salary in an envelope, which is a clear case of under declaring income. What is interesting is that this informal practice is not mentioned during the interview for the job and the company's employee selection process. During our time we spent in this company, around ten new workers came and all of them had a similar experience but having the opinion that it is better to have a partially informal job, than not work at all. (M 10, economist)*

One more interviewee from the informal sector is claiming to struggle to fulfil all of the obligations towards the state. He identifies administrative procedures as burdensome to his business. This young and educated entrepreneur and a co-owner of a newly established business finds himself often in a situation where making a business deal depends on his willingness to conduct activities in the informal economy, although he prefers a job to be done completely formally:

*All the troubles that I have to face when doing the paperwork, preparing documents and similar activities leave me with much less time for doing the real work. I am a co-owner of the business and I practically have no working time, since I work almost all the time. ... Sometimes, I'm in a situation when the client requests a lower price and invoice issued for a lower value, while the rest of the money is given in cash. When we do business in that way, I have to calculate the cost of materials used, to be in line with my inbound invoices.*

*To be honest, most of the time these activities are slowing me down. (M 11, business co-owner).*

When asked about informality, our respondent identifies some cases when they provide service for people who are involved in the informal economy. A woman who is the owner of rent-a-car business says that sometimes you depend on other peoples' actions that you cannot control.

*We offer different types of vehicles for rental and have various customers. Sometimes, people who rent a van are working as guides and drivers for tourists. They are not registered as guides and they do not declare their activities to the state. They rent a vehicle from us for private needs that we cannot check but they are actually doing some informal business activities and earn money through informal channels. This exposes us to risk, but we do not have a mechanism to control or forbid such behaviour. (F 6, business owner)*

It is common that people with lower education are turning to the labour market and seeking more often jobs based on physical work. The next example comes from the completely informal sector. A young woman, who is a widow and single mother of two children, has a low income coming from the state, and performs several jobs in the service sector, from looking after others' children to cleaning houses for richer people. Here is what she says:

*I cannot just stay in the house waiting for something. I have to work because my costs are bigger from day to day, as the kids are getting older. One day I will need to send them to university, to give them a better life than I had (F 5, housewife).*

The next interlocutor is a middle-aged woman who has average education (high school), but after the war, she could not find a job in her field. She is married, has two children, but her husband cannot cover all of their costs. They live in a small flat with her husband's mother, and she thought of herself as useless, until she decided to go outside and find an occupation. She says:

*From my early age I knew how to knit. I went to my colleague and ask her if she would like to order some weaved product, since she runs a small business for making unique kids wear. She accepted my offer, and I now have more and more requests for unique knitted blouses or hats. I did not sign any contract, as I don't have regular offers, but who knows in the future... (F 4, housewife).*

One of our interviewees had a one-year contract in the public sector, which was several years after she graduated law at the University of Sarajevo. Being exposed to a risk that she could stay without monthly income after the contract expired, she decided to set up a domestic farm for producing and selling beef, as she lives in a rural area. She took initial funding from a micro credit organization and registered her business. She wanted to ensure a stable demand on the market, and stable customers. She spoke about some possible projects in the future with a lot of ambitions. In order to develop her business in the future, she was aware that she had to formalise it:

*Now we sell our products on the market. That means that we sell meat to the customer who offers a higher price to us. But, at the end of this year, we are planning to get in touch with merchants who will export bigger amounts of beef abroad. For that step, we had to approach the procedure of formalizing the job. (F 3, lawyer and farmer)*

At the other side, we also have an informant among returnees to Western BiH. He owns a big company in Sweden – a call centre for taxi drivers. Through several years he spent in exile, he used this opportunity to improve his education and develop his business. After years spent abroad, he decided to return to his home town in BiH, and to move part of his business there. Here is part of his thoughts and experience:

*In general, I think our people are burdened with the recidivism of socialism and bureaucracy. They expect someone to care for them or to support them. There is no self-initiative or it's bad. I cope with a multi-million-dollar job via an e-mail with a Swede, even if I never saw him. In Sweden, our company employs around 500 people. (Here, I would rather hesitate to do the same) ... In Banja Luka I employ about 30 people currently in this office. Our business is completely formalized, and we want to do each step in the legal way. (M 9, businessman)*

While informality in BiH is present, this is only one of the bright examples of very successful businesses that operate formally, by the book, and at the international level. While informality is widely used, it is not a guarantee for success over a longer period of time.

## Discussion of the results

After conducting in-depth interviews with diverse participants in the informal economy in BiH, who come from different parts of the country and sectors of the economy, we are able to uncover some underlying reasons for engagement in informality. Although we have a limited and non-representative sample, through our ethnographic research we find that the motives of participants in the informal economy change based on their income level, education, gender or environment. Those with a low standard of living and belonging to vulnerable groups (e.g. unemployed, less educated, post-war returnees and those from rural areas), are using informality primarily as the way to cope with socio-economic challenges they face in everyday life. Simply put, the informal economy is used to overcome economic backwardness, to increase standard of living and economic status in the society.

Informality is also seen as a necessity for overcoming difficult periods or covering the basic needs of households or individuals. After investigating the structure of participants in the informal economy (primary and secondary data) and analysing responses from the qualitative interviews, we conclude that the informal economy is often used as a survival strategy, in both crisis and normal periods. This finding is consistent with marginalisation and reinforcement views of the informal economy and indicate that policies which target the informal economy should be aimed to benefit marginalized groups.

It is not only that the informal economy is used because of harsh living conditions, but also we have analysed examples that show informality is used to avoid formal institutional rigidities (e.g. related to tax burdens and contractual rights). This confirms that the mismatch between the formal institutional setting and informal practices existing on the ground may be one of the reasons for a higher share of informal economy. This is consistent with our finding on low tax morality in this society, especially among entrepreneurs.

Finally, there are a lot of indications that respondents supplement their income through informality, boosting their standard of living, including at the company level where the owners of businesses engage in different informal practices (e.g. envelope wages) to increase their profit. Thus, informality is used as an opportunity to increase economic wealth.

All these examples provide evidence on the complexity of the informal economic environment in this post-conflict society, with a diverse mix of participants, motives and practices. Such findings suggest that it is hard to identify one policy that can be used to target the informal economy, but rather a diverse mix of policies is needed to properly address different participants in the informal economy. However, we recognize that a holistic approach (Williams, 2017) seems to be a good strategy to target the informal economy in this country, with the aim of improving formalisation of informal economic activities through partly repressive, but more importantly, through progressive measures for formalisation. This means that relevant progressive changes of the institutional environments are also needed.

## CONCLUSION

Our study provides evidence that the informal economy is a widespread phenomenon in BiH, being at the level of around 30% of GDP and rather persistent over the last years. This does call into question the efficiency of the currently used policies to tackle this economic challenge.

To unpack how the informal economy is functioning on the ground we conducted in-depth interviews in BiH, which also confirm that citizens and entrepreneurs, including both those established and nascent, use informal practices widely. However, not all of them should be viewed from a negative perspective as most informants who report some informal economic practices use them as a survival strategy or a strategy to increase their low standard of living in an unfavourable institutional environment. The inflexibility of working hours and contractual possibilities resulting from the current laws provide one of the specific reasons for high informality identified in our research. There are also examples indicating that formal businesses use some informality, supplementing their business, which we find in smaller companies that operate under high competitive pressure on the market. This is one of the negative sides of the informal economy; it affects market competition in favour of informal businesses. While still some entrepreneurs operate fully informally, hence, everything they do is some sort of informal practice; most entrepreneurs who run formal businesses inevitably use also different informal practices to ensure a better position in their



business environment.

At the end, we find an implication that if (informal) entrepreneurs want to have a sustainable business in the future and think about the long run, there is a need to cross from informality to formality. What we found on the

ground is that informality goes before formality, and that informality converges to formality after a certain level of (informal) business development is achieved. It is the goal of government policies to help them in formalizing their businesses, better sooner than later, and better with formalizing than with eliminating the informal economy.

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## APPENDIX

**Table A1: Estimates of the informal economy in BiH (% of GDP)**

Year/Study	Dell' Anno and Piirsild (2004)	IMF (2005)	Nastav and Bojnc (2008)	Tomas (2010)	Schneider. Buehn. Montenegro (2010)	Medina and Schneider (2018)	Pasovic and Efendic (2018)
1998						33	43
1999		42	34		34	33	40
2000	32	41	35		34	34	34
2001	34	41	37		34	34	34
2002	35	39			34	37	34
2003	33				34	36	33
2004					34	34	35
2005					33	33	35
2006					33	33	36
2007					33	33	35
2008				27		31	31
2009						33	30
2010						33	32
2011						33	32
2012						33	31
2013						31	32
2014						31	31
2015						30	30
2016							30
Average	34	41	35	27	34	33	34

**Table A2: List of respondents who participated in ethnographic visits**

Informant	Gender and position	Age	Place of the interview	Date of interview
1	Female, professor of German language	40	Sarajevo, Central Bosnia and Herzegovina	May 2017
2	Female, hairdresser	36	Sarajevo, Central Bosnia and Herzegovina	May 2017
3	Female, lawyer and farmer	39	Eastern Bosnia and Herzegovina, country side	June 2017
4	Female, housewife	38	Sarajevo, Central Bosnia and Herzegovina	November 2018
5	Female, housewife	46	Sarajevo, Central Bosnia and Herzegovina	May 2017
6	Female, business owner	34	Sarajevo, Central Bosnia and Herzegovina	November 2018
7	Male, electro-technician and farmer	47	Eastern Bosnia and Herzegovina, country side	April 2017
8	Male, mechanical technician and farmer	65	Eastern Bosnia and Herzegovina, country side	March 2017
9	Male, businessman	40	Banja Luka, Western Bosnia and Herzegovina	November 2016
10	Male, economist	26	Sarajevo, Central Bosnia and Herzegovina	December 2017
11	Male, business co-owner	27	Sarajevo, Central Bosnia and Herzegovina	November 2018
12	Male, business owner	69	Zavidovici, North Bosnia and Herzegovina	May 2017