

# Why workers engage in quasi-formal employment? Some lessons from Croatia

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## Abstract

*Although quasi-formal employment has become a constituent part of labour markets around Europe, there is still limited understanding of the exact mechanisms underlying this illicit scheme. The lack of knowledge is particularly pronounced when it comes to the rationales for workers to accept such jobs regardless of all pitfalls attached. To fill the gap, this paper elaborates on the most important findings from qualitative interviews with 30 quasi-formal workers in Croatia. Besides low employment prospects, this study conducted in 2015 also highlights distrust in institutions, low intrinsic willingness to pay taxes, lack of deterrence and misperception regarding financial gain as the key factors shaping the decisions of labour suppliers in this respect. Apart from sizeable theoretical contribution, the findings presented in this paper are also expected to assist policymakers in Croatia and beyond in their endeavours to reduce the attractiveness of wage underreporting for workers.*

**Keywords:** quasi-formal employment, under-declared employment, envelope wages, Croatia, qualitative research

## Introduction

According to some estimates, almost 12 million dependent employees in the European Union (EU) have their wages deliberately misreported (Williams, 2013b). Known as quasi-formal or under-declared workers, these individuals came to an informal agreement with their employer to declare only a part of the salary to the authorities (OECD, 2008; Williams and Padmore, 2013a). That is to say, quasi-formal workers essentially receive two different wages for the same job: the amount paid through official channels (usually via bank transaction) is regularly supplemented with a concealed (most often cash-in-hand) payment which circumvents tax legislation (Kedir *et al.*, 2011). To emphasise the illegitimate nature of this practice, the latter part of the remuneration is commonly referred to as an envelope wage (Hazans, 2005; Meriküll and Staehr, 2010).

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Both stakeholders are formally registered and seemingly comply with the legislation, thus making it extremely hard for the surveillance bodies to detect and verify the fraud (Eurofound, 2013; Meriküll and Staehr, 2010). It is, therefore, not surprising that repression, which is by far the most popular approach for tackling regular forms of tax evasion in the EU (Dekker *et al.*, 2010; Eurofound, 2008, 2013), proved to be rather inefficient in this particular case. In line with this, calls have been made to shift towards indirect policy measures seeking to reduce the attractiveness of this illicit employment scheme (Round *et al.*, 2008; Williams *et al.*, 2015; Williams and Franic, 2017; Williams and Horodnic, 2015). However, this would require profound knowledge about the key reasons for stakeholders to engage in wage underreporting. Yet, while incentives of employers are well described (see the next section), it is still not clear what exactly motivates workers to do so, especially having in mind all drawbacks of such jobs<sup>1</sup>.

To start filling the gap, this paper presents findings from 30 interviews with envelope wage receivers in Croatia. The aim of this qualitative inquiry, which was part of a large-scale project evaluating the prevalence and nature of informal practices in South-East Europe, was not to merely describe the state of affairs in the newest and one of the poorest EU member states, but rather to understand how decisions and overall behaviour of workers are interrelated with the wider social and economic environment in which they operate. This article is thus expected to have broader resonance outside of the Croatian case, as it illuminates many aspects of the phenomenon that are likely to hold true in other (especially post-socialist) countries. The issue has become particularly important since the outbreak of Covid-19 pandemic, which not only put substantial pressure on public budgets but also undermined the psychological contract between the citizens and ruling elites. Apart from advancing our knowledge about the key supporting pillars of quasi-formal employment, the findings presented here are, accordingly, also hoped to assist policymakers in finding efficient strategies to tackle this illegitimate practice.

To achieve these objectives, Section 1 first gives a short summary of the existing studies on quasi-formal employment in Europe. After a brief account of the socio-economic situation in Croatia, in Section 3 we give a detailed overview of the fieldwork and the sample obtained. The elaboration of research findings starts in Section 4 with the classification of workers according to their entrance rationales. Section 5 dissects the issues of tax morale, distrust in institutions, size of take-home pay and (the lack of) deterrence, which appeared to be the central drivers of quasi-formal employment from the perspective of workers. Implications of the results and suggestions for a more successful fight against this phenomenon are given in the last part of the paper.

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<sup>1</sup> Some apparent issues include lower pension upon retirement, lower unemployment benefits and limited eligibility to loans and mortgages (Hazans, 2005; Sedlenieks, 2003). A detailed discussion about other risks is given later in this paper.

## 1. What do we know so far about the roots of quasi-formal employment?

Greed is widely recognized as the main driver of quasi-formal employment on the part of employers (Sedlenieks, 2003; Williams and Padmore, 2013b). Indeed, underreporting of gross wages automatically shrinks the tax base, thus decreasing the amounts that business owners are supposed to pay in the name of personal income taxes and social security contributions for their employees. Yet, sometimes underreporting can be a pure survival strategy as it helps employers to reduce the overall expenditure and consequently to preserve the total number of jobs during poor periods (Williams and Padmore, 2013a). As well, quasi-formal employment is found to be an efficient solution for temporary upsurges in production (Meriküll and Staehr, 2010). Instead of recruiting new employees, companies facing short-term growth in labour demand can opt to increase the workload for the existing ones and pay those additional efforts in cash.

Nevertheless, there is also evidence of employers using this practice to oppress and exploit their personnel, as well as to get rid of undesirable workers (Hazans, 2005; Woolfson, 2007). The whole concept is grounded strictly on a verbal agreement between two parties, and hence there is limited (if any) legal protection for the worker should the employer fail to fulfil their part of the deal. By threatening to cease supplementary cash payments or by reducing them for every mistake, business owners can easily create an atmosphere of uncertainty and fear for employees (Woolfson, 2007). What is more, workers whose employers stopped paying envelope wages are more likely to voluntarily quit their job, thus liberating the owners from severance pay and administrative hassle with firing procedures (Williams and Padmore, 2013b).

Given this, it is not surprising that quasi-formal employment was until recently perceived as “the ‘dark side’ of employers’ illicit wage practices” (Williams, 2013a, p. 1). Company owners hiring workers on a quasi-formal basis were usually described as abusers retaining most of the benefits from such arrangements (Round *et al.*, 2008; Williams, 2009). Workers were accordingly treated as the hapless victims who are “forced to accept or even typically collude in the receipt of envelope wages for fear of jeopardizing their employment” (Woolfson, 2007, p. 555).

However, an emerging body of research has started to challenge the generalisability of these depictions. The Special Eurobarometer Survey on undeclared work, for instance, revealed that every third quasi-formal worker in the EU is happy with this scheme (European Commission, 2007). This is in line with Yang and Williams (2017), who found that three out of ten envelope wage receivers in Bulgaria are contented with their employment. Rather high approval among workers was also evidenced by similar surveys conducted in North Macedonia and Croatia, with the accompanying shares accounting for 36 percent and 19 percent respectively (Francic and Williams, 2017; Williams and Bezeredi, 2017).

A few recent quantitative studies have pointed at the crisis of citizens' intrinsic willingness to pay taxes as the most plausible explanation for these unusual findings (see Williams and Horodnic 2016; Williams and Bezeredi 2017; Williams and Franc 2017). On the other hand, the risk of being detected and prosecuted seems to be completely irrelevant in the decision-making process of workers. As Williams and Horodnic (2016) argue, the roots of quasi-formal employment from the perspective of workers most probably have a lot to do with the decreasing satisfaction of Europeans regarding the efficiency of state institutions, fairness of tax systems, and procedural and redistributive justice. If this reasoning is indeed true, it would undoubtedly explain why underreporting of wages is far more frequent in transition economies (European Commission, 2007, 2014).

However, given the limited capability of quantitative methods to provide a detailed account of the mechanisms underlying human behaviour, validating these theories requires in-depth qualitative research. This was exactly the main idea of the study whose results are presented in this paper. The next section explains why Croatia appeared to be a highly suitable location for this task.

## **2. Croatia – from painful transition to EU membership**

With approximately 27 percent of gross domestic product remaining out of the official statistics, Croatia is one of the most problematic EU member states when it comes to the pervasiveness of informal economic activities<sup>2</sup> (Schneider, 2016). According to Bejaković (2009), in order to understand why this is so, one first needs to look back to the turbulent period of socialism. At that time Croatia was one of the six republics within Yugoslavia, a federal state characterized by a vast and expensive state apparatus, inefficient social protection system, low trust in institutions and wide societal acceptance of noncompliant behaviour (Bejaković, 2009). This gave rise to a weak tax payment culture, a heritage that has remained deeply embedded in Croatian society up to modern days.

In fact, the situation additionally worsened after the fall of the socialist regime. The ruling elites paid little attention to the economic and social transformation during the early 1990s since the main focus was on the devastating war for independence (Čučković, 2002; Franičević, 1997). In these circumstances, many privileged individuals took their chance and rapidly accumulated substantial wealth through bribery and string-pulling practices (Čučković, 2002; Franičević, 1997; Šundalić, 1999). As an outcome, Croatian society witnessed further deterioration of the trust in formal institutions during the 1990s, as well as the formation of a huge gap between various groups of taxpayers (Williams and Franc, 2015).

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<sup>2</sup> More precisely, only Bulgaria (30.2) and Romania (27.6) face higher incidence of dishonest economic practices. On the other hand, the average share of the hidden economy in the EU is estimated at 17.9 percent (Schneider, 2016).

Defiance hence became a sufficient rationale for many citizens to try outsmarting the tax authorities (Bejaković, 2009; Williams and Franic, 2015). At the same time, many low-skilled workers were pushed on the edge of poverty after their companies had gone bankrupt, which additionally enhanced already ubiquitous informalities in this South-East European country (Karajić, 2002; Ott, 2002).

Not much has changed since then, regardless of recent accession to the EU. Due to economic and political instabilities over the last two decades, this newest member state still faces substantial labour market disruptions (Eurostat, 2018a, 2018b). Also, no significant improvement of the psychological contract between the state and citizens has been achieved<sup>3</sup>, which explains why the share of the informal economy in Croatia has remained rather stable during the last few years<sup>4</sup> (Franic, 2019; Schneider, 2016).

Speaking about quasi-formal employment, it is estimated that almost 8 percent of dependent employees in Croatia have their wages underreported, with this illegitimate practice being dispersed among all social and occupational groups (European Commission, 2014). It suffices to say that only Latvia faces higher incidence rate (11 percent), while the EU average accounts for 3 percent. According to Franic and Williams (2014), 9 percent of managers and 11 percent of highly educated professionals are getting one part of their wages under the table (alongside 12 percent of manual workers and 13 percent of individuals holding service jobs), which is one of the main reasons why this South-East European country appeared quite interesting for the fieldwork. Indeed, one of the research aims was to explore how perceptions and attitudes of workers towards quasi-formal employment depend on their income prospects. An additional peculiarity of this post-socialist country is that four out of ten envelope wage receivers work in its capital city (Franic and Williams, 2014), thus highlighting Zagreb as a reasonable location for a qualitative inquiry.

### **3. Research design and fieldwork details**

The study took place during April and May 2015. Workers were recruited following the snowball sampling procedure, which was the only feasible option due

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<sup>3</sup> According to the 2019 Standard Eurobarometer survey on public opinion, Croatia is by far the worst achiever when it comes to the trust in national authorities. Explicitly, only one in eight citizens trusts the central government, while every fourth is satisfied with the work of public administration (European Commission, 2019).

<sup>4</sup> Research studies on the matter underlined construction, agriculture and tourism as the sectors in which informal economic activities most often occur (Franic and Williams, 2014, 2017). In general, men are more susceptible to undeclared work than women, and the same holds true for new entrants to the labour market compared to more experienced individuals. Although undeclared economic activities are more frequent among low income earners in Croatia, no occupation is immune to this phenomenon (see European Commission, 2014; Franic and Williams, 2017).

to the concealed nature of this tax evasion scheme. However, several mutually unrelated informants were identified in the initial stage so as to secure the diversity of the sample<sup>5</sup>. The total number of respondents was not predetermined, as the intention was to keep searching for quasi-formal workers until reaching the saturation point in terms of new information and knowledge gathered.

The main idea was to get an insight into the key reasons for workers to enter this realm, their role in the decision to underreport income and the course of negotiation between the two parties. In addition to this, the aim was to see what workers generally think about their own position and this type of employment in general. Interviews were hence semi-structured, allowing a discussion on these important issues with every single participant while, at the same time, permitting them to develop the topics and potentially unravel new aspects of the phenomenon.

The final sample included a total of 30 individuals (16 women and 14 men), 16 of whom were receiving envelope wages at that moment. Three study participants quit their job during the two-month period preceding the study, while six of them terminated quasi-formal employment less than a year before the interview took place. In the later stage of the fieldwork five individuals who had terminated their job more than two years prior to the interview were also included. Besides illuminating novel features of quasi-formal employment, the stories of those five individuals gave important insights into the evolution of envelope wage practices in Croatia over the last decade.

All age cohorts were represented, with a slight predominance of new entrants to the labour market. The youngest participant was 23 years old, while the oldest one was 64. This variety in the age structure of participants proved to be highly beneficial as it enabled to understand how the views and attitudes of quasi-formal workers depend on their work experience and how certain life events (such as the change of marital status or having a baby) affect their reasoning.

Finally, the sample covered a large scale of occupations, ranging from low-skilled individuals (waiters, cooks, gardeners, construction workers, mechanics, goldsmiths) to highly educated professionals (lawyers, dentists, architects, construction engineers, mathematicians, teachers, linguists and graphic designers). There was also a group of mid-income earners, such as secretaries, salespeople, commercial travellers and dental technicians. All respondents were essentially working on a full-time basis, although some were officially declared as part-time employees. It should also be stressed that all study participants were or had been employed in the private sector.

Every interviewee was requested to sign the Consent Form before commencing any discussion. Dialogues were voice recorded only if allowed by the

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<sup>5</sup> This was done with the help of friends, colleagues and acquaintances. Given the pervasiveness and high tolerance towards this practice in Croatia, finding and recruiting survey participants proved to be a much easier task than envisaged.

interviewees and notes were taken if permission for recording was not granted. To secure their anonymity, all personal information of the participants was rendered as non-identifiable. Qualitative data analysis tool NVivo was used to systematize transcribed material, while thematic analysis was pursued to unravel complex mechanisms that shape the behaviour of workers.

#### **4. Four groups of quasi-formal workers in Croatia**

In its essence, an interview for a job assuming under-declaration of wages is a psychological game between an employer and their potential employee, wherein a significant difference in negotiating power between these two parties generally exists. Employers are usually (but not always) the first to show their cards, while workers have very limited time for a final decision. Although every interviewed individual had their unique experience in this respect, they can be roughly divided into four groups according to the key reason(s) for entering the quasi-formal realm.

##### **4.1. Quasi-formal employment out of desperation**

It should be stressed from the very beginning that this qualitative inquiry endorsed findings from the previous studies on the matter, which appear to be correctly describing the position of many envelope wage receivers (see Woolfson, 2007; Round *et al.*, 2008; Williams, 2009). Explicitly, for a substantial number of interviewees, their decision to enter this employment relation can be described as confined or reluctant voluntarism, as this was the only way for them to escape unemployment and poverty. The term voluntarism is used here simply to emphasize the fact that such individuals consciously accepted wage underreporting, which is not always the case (as described later).

Given low employment prospects for certain professions, business owners are commonly aware they will eventually find an individual who will agree with all their terms. Many of them thus apply the “take it or leave it” strategy, essentially facing the worker with a straightforward choice:

You can either work on a quasi-formal basis or not work at all. The boss says that you are going to receive one part of your wage in cash and you simply accept it. There is no discussion on the matter. This type of employment is so normal in our country that you do not even think that it could be any different. It has never occurred to me to go to my boss and start complaining about this. (Cook, 23)

Nevertheless, this group of workers is not limited to low-skilled individuals nor is specific for any particular vocation or sector in Croatia. As a matter of fact, a substantial misalignment between university quotas and the demand for the

workforce has forced many young professionals to reluctantly start their careers as quasi-formal workers:

After six months without any success in finding employment, I decided to weaken my criteria far beyond the usual limits in order to get a job. (Dentist, 28)

Even though they freely chose to hide a part of their remuneration from the authorities, workers from this group are by no means happy with their position. This is not surprising given a strained relationship with their employer, which is a direct consequence of the “take it or leave it” approach. However, it would be incorrect to assume that all reluctant voluntarists are eager to leave the quasi-formal realm once and forever. Actually, many individuals from this group admitted they would be ready to accept another quasi-formal job again. While some of them saw underreporting of wages as a perfect means of rebellion against the inefficient and over-intrusive state, others reasoned it is completely rational behaviour given the low culture of tax compliance in Croatia:

I have no moral problems with this. Only if anyone was paying their taxes would I agree to pay my own taxes. (Teacher, 29)

The role of horizontal trust (namely trust amongst citizens) and vertical trust (trust between the authorities and citizens) in the decision-making process of workers will become particularly evident when unfolding the views of individuals who are highly satisfied with their position. Before that, we briefly describe one specific group of quasi-formal workers, whose experiences further reinforce the notion that wage misreporting has become standard practice in Croatia.

#### **4.2. Becoming a quasi-formal worker unintentionally**

Although the majority of research participants had given their explicit consent for under-declaration of wages, there were also some who had been pulled into this realm by deceit. This was possible due to a common practice among workers and employers in Croatia to negotiate strictly the amount of monthly net wage. In fact, many interviewed individuals could not even approximate their gross earnings and, accordingly, were not able to say how much they contribute to the public budget.

Being aware that only take-home pay matters for the majority of Croatians, some employers obviously do not find it important to discuss the payment strategy during the job interview. The deception only becomes apparent once the worker is asked to sign the contract, which is usually too late for them to change their mind. As explained by a 53-year-old architect, who became a quasi-formal sales manager in one large construction company by deceit, at that particular moment she was left



out of any choice since she had already quit her previous job. Yet, despite eventually signing the contract, the respondent immediately started seeking for a new job. This cognition completely destroyed her trust in the employer, thus overshadowing the fact that the job actually represented one step forward in her career, both in terms of position and overall income.

The story of another individual finding herself inside the quasi-formal realm unintentionally reveals an additional reason for employers to withhold this crucial information. According to a 62-year-old economist, she was befooled first and foremost because the employer anticipated she would most probably decline the offer. The interviewee had had previous (mostly pleasant) experience with this particular person given that he had been a business partner of her former employer. Being familiar with her competences, as well as with the high moral standards she applied in her work, the new employer thus rather decided to omit this detail just to trap the respondent. The interviewee admitted being completely speechless upon realising the truth. As a highly educated and experienced professional, she had never expected to find herself in this situation:

Of course, I was shocked at that moment, but since I really needed a job at that time, I decided to sign the contract. However, in the very same moment, I said to myself that I was going to leave the company as soon as the first opportunity appeared. (Financial director, 62)

These experiences highlight the dark side of this practice from the part of business owners, thus validating inferences of the previous research studies on the matter (Woolfson, 2007; Round *et al.*, 2008). As one could envisage, all individuals from this particular group expressed absolute discontentment with their position and entirely opposed this type of employment. Again, this had a lot to do with their repairable effect of employers' dishonest conducts on mutual trust. In fact, the relationship between the two parties appears to be one of the central factors behind quasi-formal employment in Croatia, as will become clear after describing the remaining two groups of quasi-formal workers.

### **4.3. Wage underreporting as a quasi-rational decision**

Besides the “take it or leave it” approach, there is yet another widely prevalent (but more fruitful) recruitment strategy. Explicitly, some resourceful employers let a candidate choose freely between full declaration and quasi-formality. However, by offering a somewhat higher take-home pay in the case of wage underreporting, they push the worker into a tricky process of reasoning wherein the emphasis is wittingly narrowed to financial aspects of one's future employment.

This particular tactic seems to be quite beneficial for business owners from different viewpoints. Firstly, it sends a seductive message that the company will do

anything to increase the wellbeing of their personnel, even if it assumes illegitimate actions such as this one. In addition, the ultimate decision is given to the worker, which creates a false impression that the owner fully respects the will and needs of their employees. Finally, and most importantly, the tangible difference in the take-home pay between the two offered options clearly shows the worker how much they are going to lose if a full declaration is chosen. Indeed, judging from the experience of interviewed individuals, this psychological game regularly ends with the worker deciding to receive one part of their wage in cash:

The most important thing for me is the amount of money I get at the end of the month. It is less important how it will be paid. If for instance I was paid HRK 4,000 officially plus additional HRK 3,000 in cash, and if upon requesting to be completely declared my employer offered full declaration on HRK 5,500, I would not accept it. That would be HRK 1,500 less, which is a lot. If I had to choose between HRK 20,000 and HRK 19,000, then it might be reasonable to accept the full declaration. If you earned only HRK 7,000, you would not want to sacrifice money for the full declaration. (Gardener, 28)

Individuals belonging to this particular, so far not described group of quasi-formal workers, are essentially monetary rationalists. Although their decision to accept envelope wages might be seen as a rational choice in the given situation, the problem is that such workers commonly fail to consider all remaining elements of the cost-benefit analysis due to heavy reliance on the financial aspects of their future jobs.

However, most research participants actually admitted that only take-home pay matters to them. The remaining part of the gross wage is generally perceived as an intangible asset thrown into a black hole. It is thus not surprising that the majority of Croatians rather choose to receive more money today, while not bothering to consider how their decision will affect the uncertain future:

Well, it is how it is. As long as you can earn some additional money - everyone is welcome to fight for themselves the best they can. (Mechanic, 26)

Further remarks on this issue will be given in the next section. Before that, we describe the viewpoints of the last and most extreme group of quasi-formal workers.

#### **4.4. Quasi-formal employment as a willing choice**

Among the army of envelope wage earners in Croatia, there are a great many who can be labelled as pure voluntarists, owing to their outright readiness to join this realm. Besides individuals holding top-paid jobs in their companies, this particular group also comprises a non-negligible cohort of low-income workers who developed considerable reciprocal respect with their superiors.

Alongside being quite frequent to encounter during the fieldwork, such persons also demonstrated an outstanding eagerness to participate in the study. Not only did they perceive quasi-formal employment as widely prevalent and standard in Croatia, but also as something fully reasonable and desirable. In line with this, the pure voluntarists interviewed felt completely comfortable to talk about their experiences and were keen to provide a deeper overview of the phenomenon. Many of them were even confused by the fact that someone would spend their time and resources on studying such a trivial and logical business strategy.

Study participants from this group either personally initiated wage underreporting or reached the idea together with their employer. It is not hard to conclude that all of them expressed a high level of contentment with their own position. In addition to increasing their take-home pay, hiding one part of the wage was also a sort of protest against the sizeable tax burden imposed on high-income earners. A few individuals went even further by describing quasi-formal employment as a social glue strengthening human relations in the company:

Everything was so logical and there was no reason for someone to say: “Wait people, in this way we are cheating the state”. Who would even start thinking about that? I mean, that would be silly. For us, it would have been a more serious offence if someone inside the firm had stolen an eraser or pencil. Yes, that would have been more problematic behaviour from our standpoint. How should one say this - cheating the state is one completely abstract wrongdoing. (Linguist, 67)

Indeed, pure voluntarists scrutinized their employment first and foremost through the lens of the mutual trust between them and the employer, as well as between all individuals working in the company. A 50-year-old manager in a mid-sized company, for instance, provided a rather interesting depiction of the alliance between the owners and employees in this respect. Faced with financial problems during the global economic crisis, the owners of this particular company offered and actively discussed the option of wage underreporting with all employees. It was eventually decided that only workers in the production section were to receive cash payments, while those on higher positions remained fully declared.

Yet, this new situation ignited strong prosocial behaviour which resulted in workers’ in other sections (that is to say, not directly involved in production) decision to show their solidarity with the owners and the rest of the personnel. Employees whose job description assumed business travelling thus developed a habit to bring gasoline and toll receipts from their private journeys to the financial department. The accountant fictitiously reimbursed them, but the cash extracted this way was actually transferred to the workers in the production section.

This was just one of the numerous strategies to create cash for envelope wages encountered during the fieldwork. In any case, after enumerating the most important

reasons for entering this realm, in the rest of this paper we discuss key factors influencing behaviour and decisions of workers after commencing quasi-formal employment.

## **5. Unceasing envelope wage earners vs. one-time quasi-formal workers**

As one could anticipate from the previous discussion, the enthusiasm of workers to retain a quasi-formal job is highly dependent on the perceived abundance of their take-home pay. Indeed, when asked about present-day position and future prospects within that particular employment, the majority of interviewed individuals immediately went on to evaluate their job through the lens of current net income. This was commonly done by comparing their total wage with those of other fellow workers holding similar fully declared jobs, as well as by assessing where they stood with respect to the average earnings in Croatia. In general, higher satisfaction with own take-home pay entailed greater eagerness to keep obeying the verbal agreement with the employer.

However, one's intrinsic willingness to pay taxes seems to be an even more important factor in this regard. As a matter of fact, envelope wage receivers fully opposing evasion of taxes were actually quite rare to encounter during the fieldwork. Those who did have such characteristics made it clear that all positive aspects of their employment were utterly overshadowed by the very cognition of being engaged in something so illegitimate. It was grief that dominated in the reasoning of such individuals, which explains why they commonly sought the first opportunity to run away from this practice. It is therefore not hard to conclude that all interviewees opposing tax frauds were either reluctant voluntarists or had been pulled into this type of employment by deceit.

For the majority of monetary rationalists and pure voluntarists, on the other hand, reluctance to pay taxes was actually the prime reason to join and stay inside this realm. They regularly expressed huge disappointment with public institutions and overall capability of the state to satisfy the needs of citizens:

The state is taking too much from me without a clear reason. Really too much. Therefore, there is no solidarity towards the state. [...] This cannot be just one-way solidarity - I mean, that we are giving to the state, while at the same time not being supported by the state when we need something. [...] I do not see any solidarity here. I can just see that our contribution to the state budget goes on salaries of numerous public officials that were employed by their relatives. (Head of finance, 41)

As already mentioned, many interviewees also found justification for their misconducts in the low culture of compliance within society. Evasion of other

citizens provided enough rationale for such individuals to do the same, which again emphasizes the significance of social norms for the existence of this practice:

If someone is allowed to steal billions just like that, then my evasion of HRK 500 annually is a completely negligible moral problem. This is how things are going on in our country. (Gardener, 28)

However, the most striking group of quasi-formal workers in this respect are those who have never truly reconsidered the ethical aspects of their behaviour. That is to say, many interviewed individuals argued that only their employer bears the moral burden for cheating the state, thus neglecting the fact that they typically gave their consent for this fraud:

I am aware of the moral issue, but I do not care. This is because I feel that I am not doing it personally. It is a psychological thing. [...] If I had my own company, I would not do that. Yet, I do not have it and thus I do not care what my employer is doing - and some 75 percent of Croatians think the same. (Graphic designer, 25)

This widely prevalent reasoning can also help in explaining why the fear of being caught and penalized is quite low among quasi-formal workers in Croatia. The issue of deterrence was actually the one in which the respondents reached the greatest level of agreement, as all of them were confident they would eventually go without any penalty even if detected. While many argued that inspectors would treat them as victims, others were certain that even their employers did not have any reason to be afraid.

There is a prevailing conviction that the authorities have no means of proving the fraud as there is no written evidence of the cash payment. In fact, no respondent had any experience with the authorities discovering the hidden wage arrangement:

I think it cannot be detected. I have personally never heard that someone was caught in quasi-formal employment. The only way this would be possible is if I had the audio or video record of meeting with my boss, which I then could bring to the Labour Inspectorate and report everything. (Waiter, 31)

A substantial number of interviewees went even further arguing that the authorities actually play a vital role in the whole process. As many admitted, their employer had influential contacts in the Inspectorate and/or the Tax Administration who regularly informed them about possible threats:

She [the employer] always knew when they might come. Somebody always informed her. [...] Let us say she had some sort of power to know things in

advance. And honestly, I was never, but really never scared of such things because I knew she would always sort things out. Besides, she had been constantly reiterating that she is capable of doing that. (A notary public office worker, 26)

What is more, the authorities in Croatia are widely believed to tacitly tolerate this practice. Respondents who had experience with audits explained that inspectors actually never dig deeply into one's employment documentation and other inconsistencies that could signalize the existence of envelope wages. They only checked whether there was a valid work contract and if all the liabilities of the company towards the state and the worker were fulfilled:

They [the inspectors] know what is going on. They just check whether people have a contract and that is it. I had one experience in my previous workplace where a girl told her full income by mistake. Nothing happened in the end: the inspector started writing things in his notebook and then she interrupted him: "Well, no, no, you know - I made a mistake". He replied: "Yes, I know, you confused the amounts". And then he wrote down: "She changed her mind. The first amount was incorrect. Probably this was her wage from the previous workplace". (Waiter, 40)

These findings thus reinforce recent studies on the matter, which also revealed that deterrence is a quite irrelevant factor from the perspective of workers (see Williams and Bezeredi, 2017; Williams and Franic, 2017; Williams and Horodnic, 2016).

Rather unexpected statements were also regularly encountered during the part of the interview dedicated to potential consequences of such arrangements for one's wellbeing. For instance, while the interviewed quasi-formal workers were mostly aware that this practice would ultimately result in somewhat lower income from the pension system, not many seemed to be concerned about this. This was the first and foremost owing to a perceived mismatch between current obligations towards the pension funds and the amount one could expect after ending their career. The lack of care for this particular issue was particularly pronounced in the case of new entrants to the labour market, as most of them expressed low confidence in the long-term sustainability of retirement schemes:

To be honest, given that the retirement age will probably be increased to some 80 years by the time I am to be retired [ironically], I simply do not care about the pension. (Gardener, 28)

Indeed, Croatian authorities are strongly determined to change the age limit for a full statutory pension so as to improve a rather low ratio of workers to pensioners (Government of the Republic of Croatia, 2018; Werding and Primorac,

2016). Yet, such an intention seems to have a deleterious effect on workers' enthusiasm to contribute to the scheme. This is not surprising since an increase in the age limit essentially prolongs the period during which a worker pays to the system, while simultaneously decreasing the time span during which they will receive retirement benefits.

## **Discussion and conclusion**

The conducted qualitative inquiry has revealed that the Croatian quasi-formal workforce is not as homogeneous as one would assume based on the existing studies from other transition economies (for instance, Woolfson, 2007; Hazans, 2005; Round *et al.*, 2008). While the lack of formal employment opportunities indeed plays an important role for certain part of envelope wage receivers in Croatia, there are a great many who join this realm out of defiance and/or owing to the belief that they earn more this way. Given the importance of vertical and horizontal trust in this respect, quasi-formal employment appears to be not only an economic but also a psychological and sociological phenomenon (see also Littlewood *et al.*, 2018).

On the other hand, our findings endorse recent studies which challenged the effectiveness of repression in tackling this illegitimate wage practice (see Williams and Bezeredi, 2017; Williams and Franic, 2017; Williams and Horodnic, 2016). The interviewed quasi-formal workers were certain that the authorities can hardly prove the existence of a hidden wage arrangement without the help of involved parties. What is more, many of them identified prevalent corruption as an additional reason not to be scared when engaged in such activities.

In line with the presented aspects, an indirect approach seeking to reduce the gap between the authorities and taxpayers, as well as between different groups of taxpayers seems to be a more viable policy solution in Croatia. Above all, there is a need to remove obstacles blurring the link between citizens' contribution to the public purse and the quality of goods and services they receive in return (Barone and Mocetti, 2011; Horodnic, 2018; Williams and Martínez, 2014). Among other important structural changes, this would also require substantial efforts to improve public budget transparency, increase the efficiency of public administration, boost the fight against corruption and strengthen the rule of law (Barone and Mocetti, 2011; Frey and Torgler, 2007; Torgler, 2004). Also, it is essential to align future retirement income with current payments to the pension system in order to increase the rates of voluntary compliance on the part of workers. Addressing the mistrust in fellow citizens, on the other hand, requires improvements in the horizontal fairness of the tax system so that every taxpayer bears a fair burden (Frey and Torgler, 2007; Levi, 1988; Song and Yarbrough, 1978).

A lot can also be done by targeting both current quasi-formal workers and young entrants to the labour market. There are, for instance, some praiseworthy examples of awareness-raising campaigns emphasising the shortcomings of this type

of employment, as well as the benefits of full declaration (Eurofound, 2008, 2013; Williams *et al.*, 2013). However, changes in the attitude of a wider population towards this and other forms of tax evasion will be hardly achievable as long as there is limited understanding of the role and importance of taxes in society. While certain enhancements in this respect could be done by printing catchy slogans on public property (for instance, vehicles, buildings and roads) and by sending information letters to taxpayers (Eurofound, 2008, 2013), a long-term improvement would require putting more emphasis on the issue of taxation in the school curriculums.

It should, however, be mentioned that certain things have changed in Croatia since the time the fieldwork was conducted. This first and foremost relates to a significant drop of the unemployment rate, which resulted not only from the tangible recovery of the Croatian economy since 2015 but also owing to considerable emigration. The latter process was ignited after the remaining EU member states removed their employment restrictions for Croatian citizens (Draženović *et al.*, 2018). This plausibly shifted the balance of power between employers and workers, which could have affected the dynamics of the quasi-formal realm in the newest EU country. In line with this, it is hoped that our study will encourage other researchers in Croatia to further explore this detrimental economic and social phenomenon.

Finally, although many aspects of the practice presented here probably also hold true in other countries (especially those in transition), it ought to be stressed that this paper is by no means an attempt to give a representative overview of quasi-formal employment in Europe and beyond. Its sole aim was to actually demonstrate how decisions and behaviour of workers are interrelated with the wider social and economic environment in which they operate. Accordingly, if this study inspires similar research in other countries, it will nevertheless have fulfilled one of its broader aims.

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