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Informal Economy and Welfare State Programs in Kosovo

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To my parents!

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INFORMAL ECONOMY AND WELFARE PROGRAMS IN KOSOVO

PËRPARIM KRYEZIU

Abstract

KEYWORDS: Informal Economy, Welfare Programs, Social Capital, Institutional Asymmetry, Post-socialist societies, Kosovo

The purpose of our study is to explore an assumed negative relationship between economic informality and welfare state expenditure in the case of Kosovo. We do that by comparing Kosovo's indicators of informal economy and welfare state policies with those of 28 other European countries. We then zoom in on Kosovo's case by using relevant studies, reports and material gathered in eight semi-structured interviews with representative of institutions whose work is related to the subjects of study.

We discuss informal economy in relation with welfare state policies, institutional asymmetry and social capital in post-socialist societies. We provide statistical evidence that countries with larger informal economy are more likely to have poorer welfare state programs, lower social capital and higher institutional asymmetry. Results show that Kosovo fits the theoretical model.

Nevertheless, although data do suggest that such a relationship exists, we could not provide evidence disentangling causal directions or their relative intensities.

ECONOMIA INFORMAL E PROGRAMAS SOCIAIS EM KOSOVO

PËRPARIM KRYEZIU

Resumo

PALAVRAS-CHAVE: Economia informal, Políticas Sociais, Capital Social, Assimetria Institucional, Sociedades Pós-socialistas, Kosovo

O objetivo deste estudo é explorar a relação presumidamente negativa entre economia informal e gastos com programas política social in Kosovo. Fizemos isto através da comparação dos indicadores de economia informal e políticas sociais em Kosovo e em outros 28 países europeus. Em seguida, analisamos o caso de Kosovo utilizando estudos relevantes, relatórios e os dados recolhidos em oito entrevistas semiestruturadas a representantes de instituições cujo trabalho está relacionado ao tema em estudo.

Discutimos a relação entre economia informal e políticas sociais, assimetria institucional e capital social nas sociedades pós-socialistas. Por fim, apresentamos dados estatísticos indicando que países com maiores índices de informalidade económica tendem a possuir programas sociais mais limitados, menor capital social e maior assimetria institucional. Os resultados obtidos apontam que o caso de Kosovo corresponde a este modelo explicativo.

Contudo, embora os dados sugiram a existência daquela relação, não nos foi possível analisar as direções causais e as suas respetivas intensidades relativas.

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INTRODUCTION

This study entails a discussion of two separate subjects, namely those of the informal economy and welfare state programs, in search of relationships between the two. We express a particular interest towards their interaction within post-socialist societies, particularly the Republic of Kosovo.

The purpose of our study is to explore an assumed negative relationship between economic informality and welfare state expenditure in the case of Kosovo, by comparing Kosovo’s indicators of informal economy and welfare state policies with those of 28 other European countries, an then zooming in on Kosovo’s case by using relevant studies, reports and material gather during out semi-structured interviews with representative of institutions whose work is related to the subjects of study.

The study starts off by discussing the informal economy, its definition, common practices, the reasons and motivations behind the spread of informality with special focus on institutional quality, institutional asymmetry and social capital, its dubious impact in the economy and ways of tackling it. A discussion follows on welfare state policies, regime types, and transformations experienced in that respect in the post-socialist societies. We then look at the impact of the welfare state programs on social-economic development at large, and in relation to economic informality, based on available studies. Conclusively, we provide our statistical evidence that countries with larger informal economy are more likely to have poorer welfare state programs, lower social capital and higher institutional asymmetry. Results show that Kosovo fits the theoretical model.

1. Background of the problem

The notion of informal economy is widely used and it encompasses many different economic activities that could be bound to both legal and illegal nature. However, for the purpose of our study, we will define informal economy or undeclared economy, as it is often referred, as all activities that while not criminal in their substantive outcome, are hidden from the state or ignore state legal regulations; e.g., informal employment, informal payment, under-declaration of salaries, tax evasion etc.

Our definition excludes marginal-non-taxed activities, and assumes money as the medium of exchange.

The size and the character of the informal economy are vulnerable to many factors. Researchers have identified that informality is subject to low-economic development, inappropriate tax system and restrictive labor regulations (de Soto 1989; Lehmann 2012; OECD 2004; Riinvest 2013), fragile administration, poor monitoring and enforcement mechanisms, bureaucratic incompetence, lack of trust towards institutions (Gerxhani 1999), miscarriage of taxpaying services and poor pubic services (Schneider 2007). Suggestively, informal economies are commonly widespread in developing countries, in which they serve as a survival mechanism as the existing regular economy fails to accommodate and provide for everyone.

Although we come across arguments that informal economy has a positive impact in the economy, especially in the developing countries, due to the ability to absorbs a considerable part of population who are left outside the formal sector (Portes and Haller 2005; Riinvest 2013), most schools of thought seem to agree that it must be eradicated because it hinders economic growth, offers poor working terms and conditions, and deprives citizens of state benefits (Gerxhani 1999; Hudosn, Williams, Orviska, and Nadin 2012). Therefore, for as longs as appropriate measures or/and incentives are not introduced to decrease informal economy, its self-preserving mechanisms will ensure maintenance and will feed on inappropriate policies and measures and ineffective public institutions (Krasniqi and Topxhiu 2012).

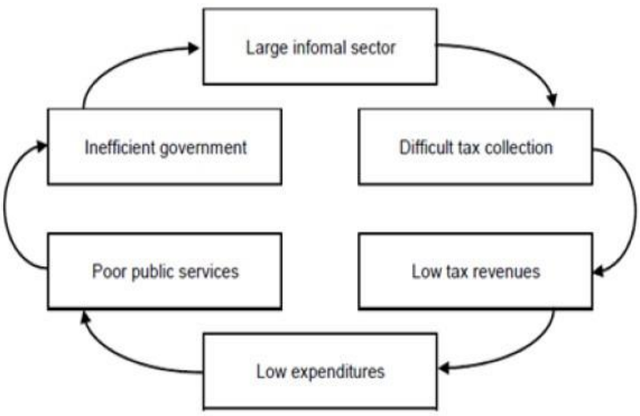

Figure 1. The vicious cycle of informal economy and public expenditure and services (Krasniqi and Topxhiu 2012, 9)

Recently, there has been a rise in relevance of “asymmetry” approach emerging out of institutional theory. According to this approach, the more significant the asymmetry between formal and socially shared rules provided by informal institutions, the higher the propensity for subjects to indulge into informal economic practices (Gerxhani 1999; Williams and Franic 2016; Williams and Horodnic 2015). As such, the “asymmetry” approach does not treat informal norms and rules independently from formal rules and regulations. In fact, their interplay is vital to a successful implementation of formal rules. When the informal norms comply with formal rules and regulations, these will be complementary to the formal institutions and will serve as a reinforcing mechanism (Sartorious 2003), but when the two find themselves incompatible, informal rules will tend to be substitutive and to serve as an obstruction mechanism to the implementation of formal rules and regulations (North 1990; Polese and Morris 2015; Williams and Franic 2016). Under the circumstance of the latter, an asymmetry or non-alignment is created, manifested by dissatisfaction, hindrance, and public distrust of formal institutions (Williams and Horodnic 2015; Williams and Franic 2016), and suggest higher levels of informal economy (Gerxhani 1999).

Given that welfare state programs are funded either by the general revenues of the central government budget and/or by mandatory individual contributions, both strongly depend on the state’s ability to enforce taxes on registered economic activities, as well as to provide incentives to comply with the formal economy and contributory responsibilities. Both, inadequate welfare provisions and the inability to provide compliance with formal rules, break social trust in formal institutions. This marks the crossing point between economic informality, low compliance rate, and the size and effectiveness of welfare programs, and sets the ground base of our overall research assumption that the informal economy and welfare state programs interact in a negative feedback relationship.

In our study, welfare state programs will imply exclusively the government’s responsibility to ensure the security and adequacy of decent standard of living for all its citizens, through social security and labor market policies that work as mechanisms that provide protection for citizens at times of vulnerability. The type and the size of welfare state, in addition to the states’ budgetary constraints, are influenced by many factors and pressures, both domestic and external, as discussed below in the literature review in Chapter I. Namely, as any arrangement between the state and markets, they involve the government's willingness and political support to take on one different combinations of roles (Rainwater and Rein 1983). Accordingly, welfare state regime clusters are formed. Esping-Andersen (1990) distinguishes three types of welfare state regimes based on the level of decommodification and the kind of social stratification they produce: liberal, conservative-corporatist and social democratic welfare states. Others have urged the need to introduce a "southern" type of welfare state as fourth type, not just as an underdeveloped subcategory of any another type (namely, Esping-Andersen's conservative type) (Ferrera 1996; Bonoli 1997), as well as an adequate type for post-socialist countries because often they do not fit into the conventional cluster of regimes (Aidukaite 2011; Fenger 2007).

Although studies about the socio-economic implications of welfare states have been present for quite some time, lately a growing interest with regard to labour market policies and their effects has emerged. Labor market policies include government intervention targeted at groups of the population with difficulties in the labour market, by facilitating training services, providing employment incentives, startup incentives, unemployment benefits, early retirement, and as such they are a common feature of welfare states. Disagreements among researchers are abundant in the literature when it comes to evaluating these policies. On the one side, we encounter scholars who suggest that welfare programs of the labour market policies kind are prone to moral hazard and cheating. As such they are ineffective, often hindering economic development (Pejovich 1999; de Mooij 1999; Marie and Castello 2011), and creating long-term dependency, laziness and employment resistant personality (Ahmend and Miller 2000, cited in McDonald and Miller 2010; Lichter and Jayakory 2002; Perkins 2016), making way to the argument that welfare policies fail to challenge informal economy because they do not provide enough incentives to exit informality. On the other side, supporters of welfare state programs argue that an increase in expenditure in these policies may directly provide jobs, and also affects employment levels via job training and educational opportunities, which facilitate for their beneficiaries to develop higher levels of education and professional skills, and have an overall positive effect on the economy (McDonald and Miller 2010; Wolfe 2002), making way to our argument that welfare state benefits may also be effective in fighting informality.

Heinze and Olk (1982) believe that the relationship between the formal and informal sectors depends "entirely on what sort of economic, social, and unemployment policies are pursued" (197). Policies that could lead to an improvement in employment and welfare may minimize the operation space of informal economy and stigmatize informal economic behaviors. To that extent, Bosch and Esteban-Pretel's (2015) and Fugazza and Jasques (2003) provide support by claiming that welfare provision can be effective policies to attract individuals from the informal to the formal sector. Moreover, Williams and Renooy (2013) found significant negative correlations between the levels of undeclared economy and social protection expenditures, social protection effectiveness, and labour market policy expenditure in a number of European countries. Studies have shown that countries with lower GDP and higher socio-economic inequalities generally suffer more from informal economy (Aidukaite 2011, Williams and Renooy 2013). In the European context, with but a few exceptions, these countries are usually situated in Central and South Eastern Europe, and share a former socialist past (Williams and Renooy 2013). As such, we find it likely that many citizens in these countries shirk paying taxes as a response to the governments' failure to provide adequate support in cases of social risk (Aidukatite 2009, 35; Aidukaite 2010).

2. Statement and purpose of the study

The interplay between informal economy and welfare state programs has already been explored and discussed to a fair extent; however, to the best of our knowledge no other studies have looked at this in the specific case of Kosovo, or included Kosovo in their research. Although local and international researchers and institutions have conducted studies with regard to informal economy and welfare state programs in Kosovo, generally they are discussed separately and no cases are found where the two subjects are intentionally discussed as possibly correlated matters.

We understand that Kosovo is a young country, having declared independence only in 2008, and therefore it has received little attention in this regard. However, the fact that Kosovo is a former autonomous entity of Socialist Federal Republic of Yugoslavia, with a recent history of conflict, and a state in the making closely administered by the United Nations and European Union over the past 18 years, represents a unique case of study for our subjects of interest, not to be found in other post-socialist societies in the Central and South-Eastern Europe. Thereby, our study is an attempt to contribute to filling up this "knowledge gap". As a citizen of Kosovo, it is only fair to see it as my responsibility to cover gaps in the knowledge related to Kosovo and address its major issues. As social scientists, it is our responsibility to take advantage of first-hand knowledge and access to data and information that will be used to represent Kosovo in the scientific discussion of the relationship between informal economy and welfare state programs.

We shall achieve that by taking a closer look at the problem of high informality that Kosovo faces, which may amount to as much as 37% of its GDP (Riinvest 2013), and discuss it in its context of low economic development, fragile institutions, low levels of public trust, high political instability, and high levels of unemployment. Then, we shall look at the welfare state programs currently active in Kosovo, namely social assistance and pensions, alongside its historical transition from a universal to a neoliberal welfare state system. In order to contextualize the level of informal economy and welfare state programs in Kosovo, we replicated Williams and Renooy's (2013) study and include Kosovo in the multi-country database, which allows us to identify Kosovo's position in relation to the negative relationship between the informal economy and the welfare state, in addition to which we looked at relationships between informal economy, institutional asymmetry and social capital.

CHAPTER I: LITERATURE REVIEW

1. Informal economy

Definition

The concept of informal economy, also known as 'undeclared economy' or 'shadow economy', originated in a series of urban labor market studies in Africa (Portes and Haller 2005). Economic anthropologist Keith Hart (1990), the first to adopt the term, used it as a way to depict the difference between his experience in Africa and what his English education had previously taught him, namely the widespread economic activity which, while not illegal in itself, he saw consistently carried on outside the scope and purview of administrative authority in African countries.

However, in spite of developing countries being shown to be more vulnerable to economic informal practices due to fragile administration, low economic development, and socio-political background, the literature suggests that an informal sector is an inevitable part of every economy. Granted, the informal economy will encompass different things and practices in more developed nations from those in developing ones. Often, informal economic practices in developing countries are presented as a survival mechanism in the face of a disadvantaged and impotent regular economy, whereas in developed countries they are presented as a mere medium for improving quality of life (Gerxhani 1999; Wallace and Latcheva 2006; Williams and Nadin 2012). In either case, regardless of its manifestations, the informal economy is not seen as altogether performing a substitution role to the formal economy. Rather, it is argued that it is complementary to the formal one, and reported that individuals often participate simultaneously in both formal and informal economic activities (Williams and Nadin 2012).

The informal economy comprises a wide range of economic activities and has been variously defined in the academia. For our study purposes, hereafter we will refer to 'informal economy' or 'undeclared economy' as meaning all activities that while not criminal in their substantive outcomes, occur hidden from the state or ignore state legal regulations by taking resource to, e.g., informal employment, informal payment, under-declaration of salaries, tax evasion, etc. Our definition is adapted from those offered by the International Labor Organizations (ILO, 1993) and Friedrich Schneider (2012). The

ILO defines informal economy as “an ensemble of unregistered economic activities that are driven by tax and social security evasion or by attempts to avoid compliance with certain legal standards and procedures” (cited in Krasniqi and Topxhiu 2012, 2). Schneider’s (2012) definition, on the other hand, includes all market-based production of goods and services that, though legal in their substance, are purposefully hidden from the administrative authorities’ sight. Both definitions exclude criminal and marginal non-taxed activities, and assume money as the medium of exchange, as well as some kind of state regulations and fiscal monopoly.

Many authors list varying sets of reasons and motivations for subjects to engage in the informal sector of economy, namely the level of taxes and barriers imposed by administrative and labor regulations (De Soto 1989; Lehmann 2012; OECD 2004; Riinvest 2013), the lack of quality in public goods and services, corruption of government officials, maltreatment of taxpaying services (Schneider 2007), insufficient economic development, weak and complex legal framework, inefficient enforcement mechanisms, bureaucratic incompetence, and lack of trust towards state institutions (Gerxhani 1999). Similarly, we find arguments in the literature about the possible negative and positive effects of an informal economy.

While, according to some authors, a high level of economic informality mainly entails tax-revenue losses, inhibition of economic growth as a result of lack of capital investment, poor working terms and conditions, and abridgment of state benefits for those engaged in informal sector (Gerxhani 1999; Hudson, Williams, Orviska, and Nadin 2012), others tend to underscore some positive effects of the informal economy for both the state and the market, especially in developing countries. According to these authors, informal activities perform a complementary role in the economy, by providing income to a large part of the population, who would otherwise be deprived of livelihood as a result of the incapacity of the formal sector to provide employment operating within the state’s rules. It can also have a significant function in providing tranquility and preventing political upheaval, by granting services and goods that “lower the cost of consumption for formal workers and cost of production and distribution for formal firms” (Portes and Haller 2005, 420; see also Henry 1982; Rinvest 2013). This is known as the “shadow puzzle”, a situation where governments are rather tolerant to informal practices, despite the ever improving technological mechanisms to detect these activities, under the fear that an intensification of enforcement of labour regulations will lead to higher unemployment (Ulyssea 2010). Accordingly, we encounter clashing arguments in the literature as to whether economic informality needs eradicating because it impedes economic growth, or it buffers fragile economies from total collapse by providing income to those who are excluded from the formal economy.

Five schools of thought

In order to typify the vast body of literature on the underlying motivations and positioning on tackling the informal sector, we can categorize it into five schools of thought (Dzhekova, Franio, Mishkov, and Williams 2014; Hudson, Williams, and Nadin 2012).

The *dualist school* explains undeclared economy as a "direct consequence of the disparity between labor market demand and labor supply" (Dzhekova, Franio, Mishkov, and Williams 2014, 19; see also Hart 1973). This school of thought basically argues that individuals engage in informal economy as a survival strategy. This formed the earliest platform for discussing informal economy, which perceived it as an unwanted and unwelcomed phenomenon. Put simply, dualists assume that besides being completely separate and independent, the formal and informal versions of economy challenge each other. Measures should be taken such as the creation of new formal jobs, in order to bring about the demise of the informal economy. The main drawback of this pioneering theory is the very assumption that the formal and informal dimensions of the economy are separated and completely independent of each other (Dzhekova, Franio, Mishkov & Williams 2014), which often clashes with evidence of the two sectors being interdependent and reliant on each other.

The *legalist school* focuses on the perspective of business in deciding whether or not to perform informal activities, pointing to the state as the sole responsible for the development of the informal economy by imposing harmful regulations (De Soto 1989; Dzhekova, Franio, Mishkov, and Williams 2014). As a consequence, business owners may find it more convenient to conduct their businesses in an undeclared way, dodging financial and administrative burdens which pose rather significant expenses in money as well as time. If the cost of formality is too high for them to bear, firms engage in informality as a rational and voluntary choice (Danielsson 2016). The legalists therefore advocate less state interference and lower taxes as the viable solution in tackling informal economy. Studies have shown that state interference and repressive enforcement often breed more informal economy, the so-called 'paradox of state control' (Portes and Haller 2005, 409-410). For instance, the case of Cuba, known for its state control practices, echoes the impotence of obsessive control measures and heavy penalties for the wrongdoers, as the Cuban informal economy amounted to about 40% of the national domestic product in 2000 (Henken 2002; Roque 2002). Evidence on the impact of taxation, on the other hand, is rather mixed, as are views on whether the tax rate is a lead determinant in explaining undeclared economy (Abdixhiku 2012). While the legalist school lists high taxes as a push factor causing subjects to partake in informal sector, studies indicate that the informal economy is generally higher in less developed countries where tax rates are lower, and lower in developed countries where tax rates are higher (Hudson, Williams, Orviska and Nadin 2012; Friedman, Johnson, Kaufmann, and Zoido-Lobaton 2000). This rather turns the spotlight from the taxation level to other factors that the legalist school fails to credit.

The *structuralist school* is mainly focused on the role of capitalism. It commonly depicts labor informal sector as "waged employment conducted under degrading, low-paid and exploitative 'sweatshop-like' conditions by marginalized populations who do this work out of necessity" (Hundson, Williams, Orviska, and Nadin 2012, 101;). Emerging from late capitalism, as an end product of economic globalization and increasing global competition, informal economic practices are seen as "a new facet of contemporary capitalism", and jobs conducted under this sector occupy the bottom tier in employment ranks, due to downgraded labor terms and conditions. As such, the informal sector should be eradicated from the economic realm by all means (Hudson, Williams, Orvisnska, and Nadin 2012). Contrary to legalist theories, which call for a neoliberal approach to the economy, structuralists call for more regulations and state intervention in order to tackle informal practices, amidst both small and large businesses (Dzhekova, Franio, Mishkov, and Williams 2014). However, the assumption scripted in the structuralist school of thought that all the informal economy amounts to is low-paid waged work has been continually under scrutiny, as studies have shown that informal wage rates appear to be as fluctuating and polarized as those in the formal labor market. Moreover, as some formally employed individuals receive two wages, a declared official and an undeclared unofficial salary in the form of envelope wage, several scholars have even started to question whether there can be jobs that are neither formal nor informal (Hudson, Williams, Orvinska, and Nadin 2012).

The *voluntarist school* provides a rather individual-centric explanation to informal economy. In this view, the tendency to engage or conduct undeclared economic activities boils down to a rational choice reached by individuals and firms, after evaluating cost-benefits ratios for compliance and non-compliance (Dzhekova, Franio, Mishkov, and Williams 2014). This approach hinges on taxpayers' morals and their perception of the competence of state authorities. If they "assess that the expected cost (financial and/or administrative) of being caught and punished is lower than the extra profit made by evasion, they will opt to conceal their activities from the authorities" (Dzhekova, Franio, Mishkov, and Williams 2014, 21; Allingham and Sandmo 1972). There seems to be a strong consensus within the scientific community with regard to the relationship between undeclared economy and rational choice decision, expressed in compliance costs and audit rates as two of the explaining determinants.

Lastly, the *complementary school* occupies a rather different corpus of explanations, which offers a primarily societal perspective. It argues that there are incentives other than financial ones encouraging people to engage in undeclared activities, namely for the purpose of "reinforcing of social ties, improvement of the position in community, or simply a desire to help neighbors, acquaintances and kin" (Dzhekova, Franio, Mishkov, and Williams 2014, 21). However, these activities are labeled as positive rather than harmful, and as such they should be nurtured rather than tackled. In fact, Gaughan and Ferman (1987) strongly opposed the argument made by the first three schools of thought that the informal economy has developed as a result of glitch or failure of the economic system of distribution, claiming that a significant part of the undeclared economy, "with an emphasis on its mutual obligation and reciprocity", is part of a "nexus of social glue that makes the formation and maintenance of social life possible", and that failing to understand this social character of the informal economy "leads us to an inadequate picture of economic life in traditional and postindustrial societies" (Gaughan and Ferman 1987, 25).

Out of the above-listed schools of thought, the legalist, structuralist and voluntarist approaches captivated the center of our attention in the later discussion of the hypothetical explanatory relationship between the informal economy and welfare regimes, dictated by applied state policies and governance quality. That is because all three schools share a common feature in their approach to informal economy, which is the effect of governance quality. While in the legalist perspective those are expressed as inadequate state interventions and regulation seen as intrusive and burdensome by firms and entrepreneurs, in the structuralist and voluntarist perspectives, the effects of governance quality are expressed as, respectively, poor state policies providing insufficient protection to firms/individuals, who then seek support in the informal sector as a survival strategy; and as ineffective enforcing mechanisms and deficient policies that lower the expected cost of getting caught performing informal economic activities, causing it to be outweighed by the expected gains. However, each of the three schools entails its unique components, which will be discussed in the following sections. The legalist approach entails regulations and models of tax systems applied in a given country; the voluntarist approach entails social capital as an indicator of individuals' behaviors in relation to the undeclared economy; and the structuralist approach entails welfare regime and protection programs as a reflection of state actors' commitment to creating public goods and solidarity as an encouraging mechanism for citizens to comply and cooperate with state institutions.

Emerging explanations

For much of the past century, informal economic practices, such as informal employment for avoiding tax dues, was dominated by the aforementioned dualist school, otherwise known as the 'dual economies' approach. Informal economic activities were seen as remnants of underdeveloped and traditional societies, surviving within the traditional sectors of dual economies, unlike the modern, progressive and advanced societies which have subscribed to a formal form of economy (Williams, Kedir, and Nadin 2013). Such theories propose increasing government control and detection mechanisms, in order to curb the informal economic sector. Even though recent studies find the effects of offensive mechanisms against the informal economy to be less than conclusive (Williams and Horodnic 2016), the dualists' understanding of informal economy as part of a characteristic to which underdeveloped or developing societies are prone, that of poor governance, remains a valid blueprint to this day. Most of the drivers the literature points out for businesses and/or individuals to engage in informal economy, derive from various aspects of quality of governance (Lacko 2000; Dreher et al 2005; Johnson et al. 2000, in Williams and Nadin 2012; Torgler and Schneider 2009), levels of corruption, and trust towards state institutions (Gerxhani 1999; Hudson, Williams, and Nadin 2012; Williams and Franic 2016; Williams and

Horodnic 2016), the negative features of which are all to be found mainly in developing countries (Friedman et al 2000).

Lately, a new "asymmetry" approach has been emerging out of institutional theory. According to this approach, informal economy arises when there is an evident "lack of alignment of the codified laws and regulations of society's formal institutions with its informal institutions, namely the norms and values of its citizens that produce socially shared unwritten rules and understandings" (Williams and Franic 2016, 2). The more significant the asymmetry between formal and socially shared rules provided by informal institutions, the higher the propensity for subjects to indulge into informal economic practices (Gerxhani 1999; Williams and Franic 2016; Williams and Horodnic 2015). For instance, the practice of envelope wage or of fully undeclared employment occurs when employee and employer adhere to shared rules based on informal agreements, rather than to the formal institutional regulations.

In addition to providing a different take on informal economy, this approach hence introduces new implications on how informal economy should be tackled, shifting the focus to the significance of unforced cooperation and compatibility of formal rules. The theory does not see informal norms and values as independent of formal rules and regulations. Often they are a direct response to the nature and compatibility of the latter. When the informal norms comply with formal rules and regulations, these will be complementary to the formal institutions and will serve as a reinforcing mechanism (Sartorious 2003). However, when the two configurations find themselves incompatible, informal institutions will tend to be substitutive and to serve as an obstruction mechanism to the implementation of formal rules and regulations (North 1990; Polese and Morris 2015; Williams and Franic 2016). Potential incompatibility, non-alignment or asymmetry is broadly affected by the incompetence and ineffectiveness of formal institutions and their upholders, and it is expressed in dissatisfaction, hindrance, and public distrust towards formal institutions (Williams and Horodnic 2015; Williams and Franic 2016).

On that basis, we find a related avenue in the discussion of undeclared economy in relation to social capital as a composition of informal values and rules. Putnam (1993), along with Knack and Keefer (1997), are among the pioneers advocating the significance of social capital in governance quality and economic welfare (La Porta et al. 1999; Slemrod 1998). Putnam (1993, 167) originally defined social capital as "features of social organizations (…) that can improve the efficiency of society by facilitating coordinated actions". He therefore claims that cooperation is easier in societies with a larger inherent stock of social capital. He disagreed with game theorists' views, according to which cooperation is higher when involved subjects possess abundant information about each other's past behaviors, or when they engage in indefinitely repeated transactions, so that non-compliance will face punishment in future transactions. If these were valid explanatory factors, Putnam argued, impersonal cooperation would be rare and in decline, contrary to what seems to be common in much of the modern world. Alternatively, Putnam advanced social capital as the main enabler of widespread voluntary and spontaneous cooperation. Social capital by itself provides the circumstances needed for subjects to engage in cooperation, according to game theorists – namely, those of easily spotting defectors and the availability of abundant and reliable information –, and it does so at a much wider and impersonal scale.

To Putnam's understanding, social capital is a complex setting of three elements that causally partake in each other's structure, namely: social trust, civic norms and a dense network of civic engagement. Trust, according to him, "lubricates cooperation, and cooperation itself breeds trust" (Putnam 1993, 171). However, social trust is by no means blind. It involves predictions about the actions of the other independent subjects, and is ingrained in the civic norms shared by the individuals within a community. The most important of such norms is that of reciprocity. Putnam defines generalized reciprocity as a "continuing relationship of exchange that is at any given time unrequired or imbalanced, but that involves mutual expectation that a benefit granted now should be repaid in the future" and as such the norm of reciprocity "serves to reconcile self-interest and solidarity" through a combination of "short-term altruism and long term self-interest" (Putnam 1993, 172).

Such norms are established and applied in communities pervaded by dense civic networks. Engagement in horizontal networks, such as neighborhood and religious associations, sport clubs, cultural associations, trade unions among others, creates networks of civic engagement. Networks of civic membership ease "communication and improve the flow of information about the trustworthiness of individuals". Therefore, other things being equal, "the greater the communication (both direct and indirect) among participants, the greater their mutual trust and the easier they will find it to cooperate" (Putnam 1993, 174). Citizens who interact in many horizontal networks are likely to develop "strong norms of acceptable behavior and to convey their mutual expectations to one another in many reinforcing encounters", norms which are then reinforced "by the network of relationships that depend on the establishment of reputation for keeping promises and accepting the norms of local community regarding behavior" (Putnam 1993, 173). The higher the density of such networks within a community, the higher the propensity of its citizens to participate in mutually beneficial cooperation to the advantage of social capital. In this regard, such social capital composition, or lack thereof, will be the defining reason why one society may prevail over the over, as in the case of the economic success of northern part of Italy over the south depicted in Putman's work. Basing our argument on Putnam's work, the lack of social capital in a society is conducive to its incapacity to perform in prime socio-economic development, which is the soil for informal economy in the first place, as supported throughout the literature review.

Moreover, drawing on Granovetter's (1973), Putnam's views that a high level of social capital in a community cannot rest on strong network ties, the likes of kinship and intimate friendship, which are considered as less effective in sustaining social cohesion and widespread collective action than weak ties, such as those of acquaintanceship and shared membership in voluntary associations. He explains that weak ties are more likely to connect people of different affiliations, unlike strong ones which tend to be more focused within particular groups. On another aspect, Putnam regarded the prevalence of vertical networks, which are based on asymmetric obligations and exchanges of the patron-client type, as harmful to social capital, because clientelism is bound to undermine group organization and solidarity. Citizens enrolled in vertical networks are more exposed to opportunism, by both parties, which does not provide the right circumstances to develop cooperative norms, trust, nor to engaging in mutual collaboration (Putnam 1993).

Knack and Keefer (1997), building up on Putnam's work, introduced new empirical evidence, making three major contributions. First, they showed that social capital contributes significantly to economic growth and prosperity by looking at the impact of social capital on both growth and investments rates across section of 29 countries, using measures of trust, civic norms – namely, civic cooperation – and horizontal networking – namely, associational activity, finding that such social capital variables display a significant positive relationship to economic growth and investment, as shown in Figures 2 and 3, respectively.

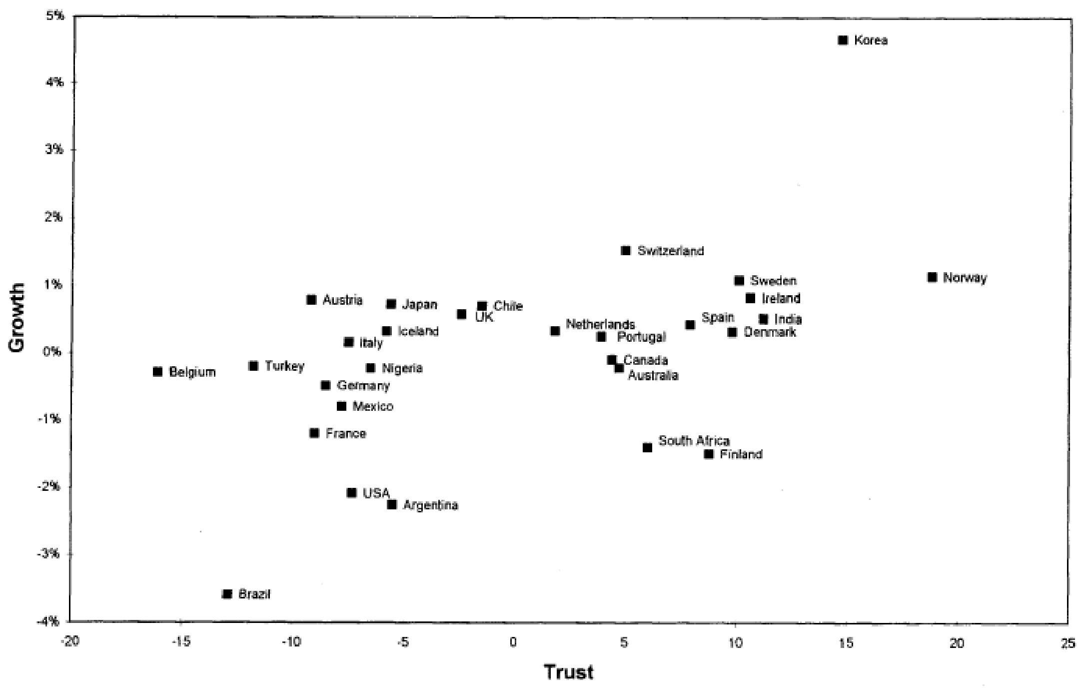

Figure 2. The positive relationship between growth and trust (Knack and Keefer 1997, 1265)

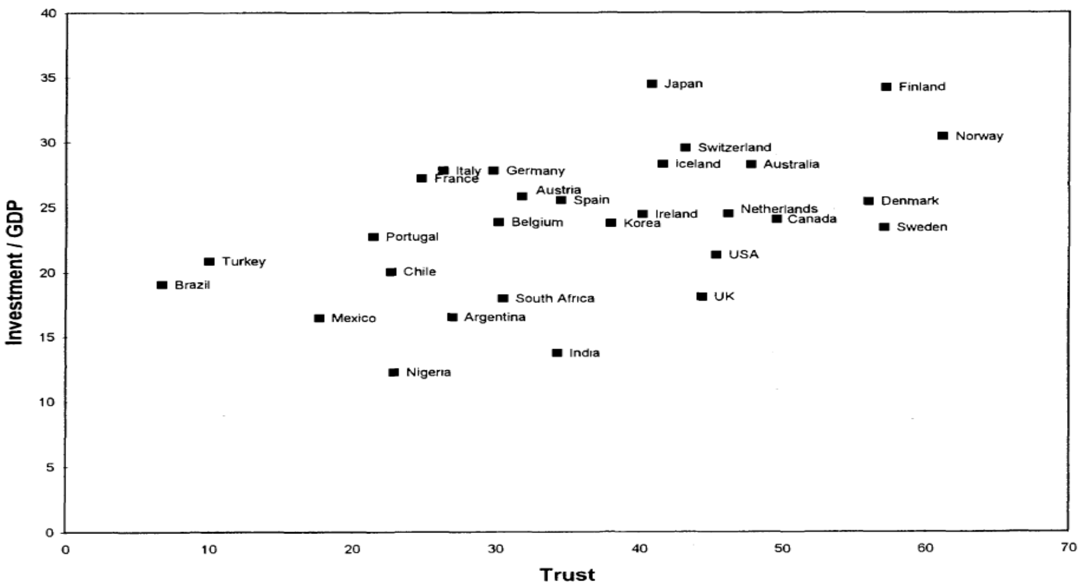

Figure 3. The positive relationship between investment and trust (Knack and Keefer 1997, 1268)

Nevertheless, they also noted that causality of these relationships could go in both directions, as while trust could facilitate growth and prosperity, it could just as well be a byproduct of growth and prosperity.

Secondly, although they were able to empirically support a positive relation between trust and civic cooperation, as exhibited in the figure below, Knack and Keefer's empirical test failed to find evidence that dense horizontal networking reinforces trust and civic norms, as suggested by Putnam. They concluded that "horizontal networks are unrelated to trust and civic norms and to economic performances" (Knack and Keefer 1997, 1284).

And, thirdly, they surfaced the importance of two sources of trust and civic norms; low social polarization and formal institutional rules. These two prohibit "government from acting arbitrarily" and "are associated with the development of cooperative norms and trust" (Knack and Keefer 1997, 1284).

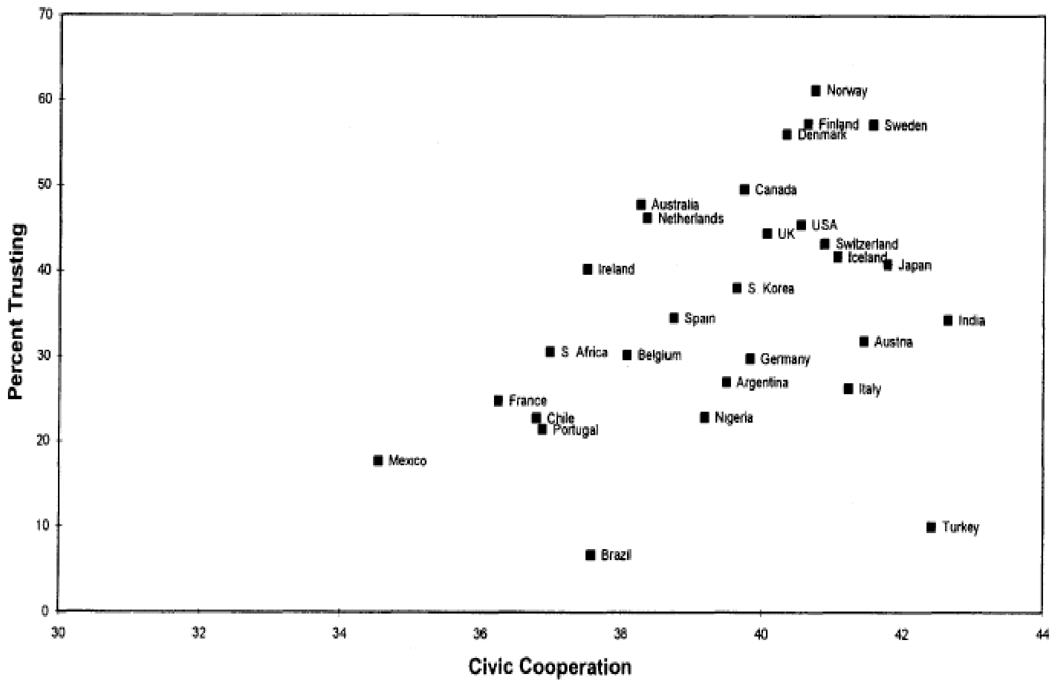

Figure 4. The relationship between civic cooperation and trust (Knack and Keefer 1997, 1259)

The contributions by Putnam (1993) and Knack and Keefer (1997) resonate to institutional asymmetry theory. Even though, admittedly, neither of them refers to undeclared economy as such, their elaborations on social capital, government performance and economic development reflect on institutional asymmetry theory's core concepts, those of formal and informal institutions and their alignment. As previously discussed, in cases of misalignment between formal and informal institutions, the former find themselves challenged by the latter, in which case mutual cooperation, trust and social capital as a whole will deteriorate. Both government and economic performance are jeopardized as a consequence, informal economic structure may thrive as an alternative medium of survival mechanism, and participation in it will become a form of protest against the formal guidelines.

It follows from the above that social capital and generalized trust should play a major role in the size of undeclared economy, and Abdixhiku (2012, 83) found ample support in the literature for the relevance of the negative relationship between trust, tax morale, and the undeclared economy. According to this view, trust and tax morale surpass the relevance and effectiveness of formal deterrence and supervising methods that were strongly encouraged by the dualist approach.

Tax morale, or civic norm as referred in our study, on the other hand, defined as the "intrinsic motivation" to tax compliance, measures not individuals' behavior but rather their attitude (Torgler and Schneider 2006). As an indicator used in the literature for evaluating the proposition on institutional asymmetry, tax morale represents an element of civic norms in the structure of social capital. Preliminary tax morale research dates all the way back to Schmolders (1970) and Strumpel (1969), who tried to connect economics and social psychology by reiterating that economic behaviors should be analyzed from a motivational perspective that goes beyond the standard assumptions of neoclassical economics (Torgler and Schneider 2006). Emphasis on tax morale came as a response to the poor empirical fitting of deterrence models, which assumed the extent of the undeclared economy to be negatively correlated with the probability of detection and the degree of punishment (as in Allingham and Sandmo 1972), and which predicted far too little compliance and far too much informal practices. In many states, the level of deterrence was shown to be too low to explain the actual high level of tax compliance (Torgler and Schneider 2006). Frey and Weck-Hannemann (1983), Frey (1997), Alm (1999) and later on Torgler (2003), in their empirical analyses, found that tax morale had the strongest significant impact on the size of the undeclared economy, as compared to other variables. More than a mere indicator, tax morale became a revolutionary approach in tackling the informal economy. Instead of the state pursuing compliances through "close supervising and monitoring, tight rules, prescribed procedures and centralized structures within the contexts of a low commitment, low trust, and adversarial culture", the tax morale approach encourages "a high trust, high commitment culture (…) that aligns with the values of citizens with the formal rules so as to generate internal control" (Williams and Horodnic 2016, 324).

Informal economy in South Eastern Europe and transition societies

The informal economy was not inexistent in socialist countries by any stretch, despite the lack of public acknowledgment of it. The "orthodox, ideological hostility against the 'petty bourgeoisie', 'refrigerator-socialism', and all forms of individuals in the general", forced official statistics to reveal very little about the size of informality (Portes and Borocz 1998, 17). Nevertheless, estimates provided by Grossman (1989) claim that household incomes coming from informal sources in the Soviet Union during the 1970s could have had gone up to 66%, depending of the regions. Moreover, data obtained in Hungary during state socialism show that around 40% of all population income came from participation in the informal sector (Kolonsi 1984, cited in Portes and Borocz 1998). Informal practices were also identified in the Former Socialist Republics of Yugoslavia, particularly during times of crisis (Woodward 1995).

However, the undeclared economy became a major subject of studies in the South Eastern European societies, given that these societies faced substantive institutional, social, political, and cultural changes during their transition process. Decades after beginning the transition to a market-based economy and a democratic governing system, high rates of informal economy remain a persistent feature across most of South-Eastern European transitional societies. Although progress has been made, recent estimations continue to show a high prevalence of the informal economy amidst these countries. Bulgaria registers an estimate of 31% of GDP, Macedonia 35%, Croatia 28%, Romania 28%, while others have shown more progress such as Slovenia 23%, and Hungary 22%, and so forth (Williams and Renooy 2013; Schneider 2015; Williams and Franic 2016, Williams and Boric 2013). Governments are thereby regularly losing revenues that could be allocated in funding capital investments, public goods and services, and social protection programs.

Moving from a centrally planned to a market based economy requires a critical set of adjustments and accomplishments in all areas (Abdixhiku 2013). Most centrally planned economies in former socialist South Eastern Europe employed a tax system similar to that in the Soviet Union. Most of the tax revenues came from "profit, turnover, and payroll taxes levied on state-owned enterprises" (Martinez-Vazquez and

McNab 1997, 3). The profit tax, the main source of revenues in centrally planned economies, was used to collect and concentrate resources and to regulate the enterprises' income. The tax rates on profits were typically set at 50 or 60 percent, with registered cases of countries that had progressive tax structures with marginal rates at up to 100 percent (Martinez-Vasquez and McNab 1997). Turnover taxes were applied mainly to consumer goods and some services, while wage and payroll taxes were withheld at the state-owned enterprises for the purpose of funding social expenditures. Deductions from individual income were either trivial or completely absent. Basically, the state made all the decision over production and consumption of goods and services and took on the responsibility to be the sole provider of social services and social protection benefits, by using the revenues generated by profit and taxes of state owned enterprises, and often used its authority to retroactively adapt the tax rates and administrative procedures to perceived tax revenue needs. The rather small number of taxpaying subjects implied that the state could have a reportedly 100% audit rate, while payment methods that ran through the monopolistic operation of state banks ensured administration and enforcement (Martinez-Vasquez and McNab 1997).

The proven resilience of informal economy in the post-socialist societies, according to Abdixhiku (2013) comes down to four main arguments pointed out in the related literature.

The first argument, developed by Kornai (1990), argues that a major reason behind non-compliance may be found in the citizens' lack of experience in paying taxes (Abdixhiku 2013). Critical changes in this respect in the newly established market-based economy, therefore, met with bewildered citizens in the face of unfamiliar tax demands. The fact that the average citizen was being explicitly taxed for the first time created a propitiatory culture for tax evasion (Martinez-Vazquez and McNab 1997)

The second argument, in a more related vein to that of the dualist approach above, relates incompliance to the collapse of the formal prevention structures against tax evasion, during the transition process and the implementation of the new tax systems. According to this view, transitional post-socialist economies experienced an utter lack of rule of law (Abidixhiku 2013). As a result of the nature of the previous centralized economy, tax collection mechanisms were often left underdeveloped and unsophisticated. Deterrence mechanisms against tax evasion were inadequate, if not non-existent, providing no infrastructure to monitor the practices of the newly institutionalized and ever growing private sector and market economy (Martinez-Vazquez and McNab 1997). Under these circumstances, the process of building up a new and compatible tax system was long, difficult (Abdixhiku 2013), and in some cases is still ongoing.

Faced by such necessity, fundamental questions were raised as to what type of tax structure and how should it be adopted. Adopting a modern system much like to those in Western Europe or in North America raised numerous red flags from international experts, who warned against the risks of adopting such a strategy in the face of the significant differences in transitional societies, regarding their actual economies, wider institutional frameworks, and administrative capabilities. However, such warnings were largely unheeded (Martinez-Vazquez and McNab 1997). Allegedly, the most serious mistake was that of focusing primarily on modernizing tax policies, while relegating the tax administration infrastructure and taxpayers' issues to a remote secondary importance: "the focus shifted to tax policy reforms, albeit in many cases without considering the limited capacity of the tax administration" (Martinez-Vazquez and McNab 1997, 29). As a consequence, these societies ultimately built a complex tax system and regulations, requiring a high level of bureaucracy, together with poor administrative infrastructure and incompetent personnel unable to process them in face of the exponential growth of the private sector.

The third and fourth arguments focus on the direct relationship between individuals and formal institutions. The third argument belongs to the above defined structuralist school, and it includes two social capital components; trust and tax morality. Low level of trust towards public and formal institutions was registered across most post-socialist countries, in hand with a high perception of corruption (Martinez-Vazquez and McNab 1997), a possible legacy of the former socialist state (Wallace and Letcheva 2006). Trust becomes even lower the further one moves towards the Eastern and South-Eastern areas of Europe (Wallace and Letcheva 2006). This induces high asymmetry between formal institutions and socially shared rules, as provided by informal institutions. Ultimately, this will result in a likelihood of the emergence and/or maintenance of informal economic practices in their economies (Gerxhani 1999; Williams and Horodnic 2015). Accordingly, low levels of tax morality were registered across most post-socialist societies (Torgler 2004). As state institutions are little trusted by the population, who see them as not representing their interests, participation in the informal economy becomes increasingly reasonable, justifiable and even popular. The moral cost decreases as the stigmatization of such practices diminishes, only to flare up further informal practices.

Lastly, the fourth argument, close to the voluntarist school, argues for an apparent disparity between taxation and the supply of public goods having triggered a sense of detachment from the state in South and East European transition societies, thus undermining the willingness to comply with the new tax system (Alm, Martinez-Vazquez, and Schneider 2004; Torgler 2004). This line of argument is pivotal to our purpose, since it includes the relationship, or lack thereof, between the undeclared economy and the states' welfare provision. Recent studies have emerged in support of this argument. According to Williams (2012), there is a strong correlation between market-based economies with higher levels of market interventions, social protection, redistribution via social transfers and equality, and lower levels of informality. He fairly makes the disclaimer that these correlations should be treated with caution, for lack of evidence supporting a cause-effect relationship. Nevertheless, he tentatively suggests that undeclared economies might be reduced not only by pursuing conventional tax policy and administration measures, but also by modernizing and modifying welfare regime programs through higher levels of expenditure on state intervention in the labor market and social protections, coupled with redistribution via social transfers (Williams 2012).

Informal economy in Kosovo

Kosovo, located in the Southeast of Europe, conforms to the informal economy pattern found in other post-socialist societies, accounting for as high as 30% to 40% of GDP (Riinvest 2013). Yet, we believe that the case of Kosovo has a unique nature and particular features. One of its main peculiarities is that the transition of former socialist states into democratic societies and market-based economies during the 1990s found Kosovo as a formerly autonomous province of the Socialist Federal Republic of Yugoslavia, having had its autonomous status revoked in 1989. Kosovo had no independent executive legitimacy, and was highly dependent on directive policies delivered from the central authority in Belgrade, the former capital city of Yugoslavia. This situation produced a low level of economic development and a high level of unemployment, making Kosovo one the poorest and least developed provinces in Yugoslavia (Stambolieva 2012).

Upon 1999's military international intervention in Kosovo, which put an end to the war between the Serbian authorities and the ethnic Albanians' resistance, international organizations were responsible for designing economic policies and restoring economic development. The European Commission's and World Bank's reconstruction and recovery program had three specific goals. The first was to develop an open and transparent market economy, which could "quickly provide jobs to a large part of the Kosovar population" by "restarting the rural economy, encouraging the development of the private sectors, and addressing the issues of public enterprises". The second goal aimed at supporting a restart of the public administration and establishing transparent, sustainable and effective institutions by "strengthening and reforming existing formal and parallel structures, and by developing new institutions where needed", particular focus being directed to "setting up the central institutions that are key for economic recovery, developing municipal governance, and restoring law and order through an effective police and judiciary". The last goal was to mitigate the impact of the conflict and the legacy of the 1990s by "restoring living conditions (…) rehabilitating the infrastructure networks needed for economic development (…) and upgrading social service delivery (education and health)" (European Commission and World Bank 1999, 3).

The same report showed high enthusiasm as to the speed of development in private sector activities, particularly in the services sector and retail, admiring the "exceptional sense of entrepreneurship by the Kosovars", and it emphasized the importance of newly formed small and medium-sized enterprises as the "main source of growth and employment in most transition economies". Locals were also praised for their commitment to restoring and improving social services, as schools started with unpaid teachers, testifying a high level of social solidarity.

Over 15 years later, however, all macroeconomic and social indicators ranked Kosovo among the poorest countries in Europe. There is a high level of unemployment, fluctuating annually around 35% and 40%, a poverty level as high as 30% (INDEP 2015), slow economic growth, low level of public trust and high political instability (KCSS 2013; 2014; 2015; 2016), along with the aforementioned high level of economic informality.

The European Commission and the World Bank were requested to assist and direct Kosovo in her post-conflict economic reconstruction. Their mission revolved around the privatization of socially and state-owned enterprises and the formalization of the economy. The general idea was “to co-opt rather than confront informality” (Danielsson 2016, 6). They framed the problem of informality under a legalist approach, as the outcome of a lack of formal institutions and regulations yet to be consolidated after the war. The solution was plainly to establish a “formal institutional regulatory framework and provide businesses with formalizing incentives” (Danielsson 2016, 6). In a later report, the World Bank (2003) acknowledged that the size informal economy remained high despite the introduction of regulations, but they interpreted this as a coping strategy due to the lack of the formal sector’s capacity, and insisted that the ongoing implementation of social policies would eventually drag the actors operating in the informal sector into the formal one.

Regardless of an improved regulatory environment in which registration procedures were simplified and entrepreneurs had to face fewer administrative barriers, informality remained high. The World Bank kept much the same position on the matter after Kosovo’s declaration of independence in 2008. In partnership with the local government, “the World Bank continued to act upon informality as a spinoff to problems in the formal institutional framework” and claimed that “informal economy remained sizeable due to the faulty regulations” (Danielsson 2016, 8). Namely, lengthy and costly registration and licensing procedures were emphasized as the main push factors for businesses to operate into informal economy, therefore it should be no surprise that informal sector is this large (Danielsson 2016). However, no support for this claim was found in the various surveys of the business community carried out from 2008 until 2013. For instance, in 2008, according to the World Bank and International Finance Cooperation (2009), only 4.6% of businesses named licensing and permits as a major constraint. By 2013, 95% of businesses were formally registered, and practices of the informal sector were listed to be the major constraint in everyday economic activities by the surveyed firms (World Bank and International Finance Corporation 2013). The World Bank nevertheless repeatedly decided to encourage top-down regulatory arrangements for institutional framework improvement, as the means to formalize the informal sector.

The World Bank’s call for further formal regulatory improvement has been met by strong criticism by Ana Danielsson (2015; 2016). She argues that the ineffectiveness of the World Bank and other international institutions, such as the International

Monetary Fund, in tackling informal economy in Kosovo derived from consistently ignoring social capital and the configuration of power relations in the post-conflict and today's Kosovo, and that the policies they imposed have only made informal practices become an innate resource of the newborn formal economy.[1]

The World Bank did not take the fact into consideration, that since the end of the war, all the informal structure of the parallel state and illicit activities of war entrepreneurs were transformed into "socio-economic differentiations and an unequal resource of distribution" (Danielsson 2016, 11), testifying to the continuing claims about unfair business environment by the private businesses (Riinvest 2013). For instance, the vertical networking possessed by the Kosovo Liberation Army leaders' close circle and the power configuration, which were established during the conflict, strengthened shortly after the war in Kosovo, as from 2004 onwards Kosovo has been governed by the former war front leaders, and the members of this elite circle continued to appropriate political and economic authority (IKS 2010).

As a consequence, the World Bank's regulatory arrangements did not have the same effect to all the business actors; rather they unfairly placed some businesses in better positions than others, by allowing them to "win contracts in openly announced procurement processes, win public bids despite their operating license having been withdrawn, gain licit and illicit profits from processes of privatization, and benefit from the protection and involvement of criminal groups" (Danielsson 2016, 12). The less privileged businesses engage in practices of bending formal regulations, much as the dominant businesses do, construing informality as the taken for granted way of doing business. Consequently, informal economic practices have gradually but surely become a social norm.

According to Danielsson's main argument, informal economic practices became modeled after formal regulations to mimic the requirements ordinarily associated with the formal economy, such as contracts, receipts and bookkeeping. Underneath ritualistic compliance with formal rules, informal economic practices have become an integral

[1] We acknowledge that Danielsson's use of the concept of social capital aligns with Bourdieu's and other sociologists' definition of social capital as a resource of the agents, which differs from that used by Putnam as a collective resource (Portes 1998). To our interest this form of use of highly hierarchized social ties to powerful individuals' or cliques' advantage will be treated as Putnam's "vertical" patronage networks, and therefore noxious to social capital in the latter's sense.

component of the formal economy (...) by enabling a further institutionalization of informality through the use and bending (rather than abandonment) of rules and regulations, informal economic practices support the façade of a formal economy while tacitly undermining it from within (Danielsson 2016, 12).

Obviously, Danielsson's contribution urges us to shift the focus more in line with the structuralist and institutional asymmetry approach, which in the case of Kosovo has been largely overshadowed by the legalist perspective inherent to the international institutions' assistance programs. She has been a pioneer in that regard, and her work represents a major cornerstone for our study.

2. Welfare state policies

Definitional debates

Since the end of World War II, welfare states have formed a cornerstone of capitalist democracies in most Western European Countries. Consensually, by welfare state we understand a "state's involvement in the distribution and redistribution of welfare in a given country" (Aidukaite 2009, 24). Admittedly, this definition was used in the social policy research mainly to study rich capitalist democracies, while the rest of the countries were termed as "countries having some form of social policy" which affect "the social status and life opportunities for families, individuals, or various social groups" (Aidukaite 2009, 24). Although the notion of social policy has been perceived at times as a synonym for that of welfare state, its usage in the literature is often inclined to a broader sense of state activities that have redistribution impact (Aidukaite 2009) and often predate the institutionalized polity commitment in the capitalist democracies to ensure welfare support for their citizens which was largely established in most of the European countries only by the end of World War II (Rainwater and Rein 1984). As such, the modern welfare state mainly consists of two main kinds of government-sponsored programs, transfers and services. The former includes providing income to individuals in particular need in order to ensure income adequacy, either via cash or in-kind transfers. The latter includes providing services to individuals ranging from "social protection to improvement in human capital, to provision of cultural advantages (Rainwater and Rein 1983, 111)

Titmuss (1974) believed that policies designed to allow and facilitate societies to move towards equality should be the pillars of how a good society ought to be organized. Likewise, Wilensky (1975) believed that the minimum standard of living should be guaranteed as a social right in the welfare state. He suggested that this could be attained through eight core policy areas, namely (1) pensions, death benefits, and disability insurance; (2) health insurance; (3) family policies; (4) education; (5) jobs injury insurance; (6) unemployment subsidies and related labor-market policies; (7) war victims' benefits; (8) and miscellaneous aid to the poor (Wilensky 2002); the essence of welfare state is "government-protected minimum standards of income, nutrition, health and safety, education and housing assured to every citizen as a social right, and not as a charity" (Wilensky 2002, 211). He then went on to claim that countries that invested greatly in their social security had a correspondingly high annual growth per capital, low inflation and low unemployment. In the same vein, Esping-Andersen (1990) argued that governments should prioritize welfare policies that encourage extensive and universal state programs which will promote a broad sense of social solidarity and provide social integration through the distribution of risk across generations, classes, and educational levels.

For the purposes of this study, inspired by the definition of welfare state in the Oxford Dictionary of Sociology (2003) and in keeping with its incipient stage in Kosovo, welfare state will imply no more than the government's responsibility to ensure the security and adequacy of a decent standard of living for all its citizens, through social security and labor market policies as mechanisms that provide protection for citizens at times of vulnerability.

Each government's approach to ensuring a certain level of welfare for its citizens comes in different arrangements between state and market. Depending on ideology and political agenda, resources and the social coalitions supporting it, a government may take on one or more of the following eight roles in this regard; (1) it can play no role at all, (2) it can regulate the provisions of the resources by market-based institutions, (3) it can mandate other institution to provide the resources, (4) it can encourage other institutions to provide the resources, (5) it can finance, but not provide, the provision of the resources out its own budget, (6) it can directly finance and provide benefits in form of cash, (7), it can directly finance and provide goods and services and (8) it can both finance and provide cash benefits, goods and services (Rainwater and Rein 1984, 117). The character and the size of the welfare state will depend on the combinations in which the government engages. To that extent, scholars surveying welfare-state types and variation of social policies in all countries found that welfare state models are not linearly distributed, but rather they cluster into regime types (Aidukaite 2009; Bonolli 1997; Castel and Mitchel 1993; Esping Andersen 1990; Ferrera 1996; Korpi and Palmer 1998; Leibfried 1992; Staroff 1994).

Welfare state typology and regimes continue to constitute a major focus of academic debate, as there is yet no agreement between scholars on the ultimate cluster of regime types capable of encompassing and classifying all variations of welfare state models found in the world. Similarly, the rise and the variation of welfare state in any particular country or region in the first place have been met by the same intensity of discussion in the literature. Scholars engage on an ongoing exchange of arguments that aim at explaining the circumstances under which a particular welfare state regime came to be developed and why. A remarkable contribution to the intensity of these debates was prompted by the latest fundamental transformation in Central and South East European countries upon the fall of communism. This transformation created various hybrid and at times unpredictable welfare state regimes, which did not fit well into the main cluster models prevailing in academic discussion at the time.

While the rise and the variations of welfare state have been a subject of strong discussion amidst scholars, most of the literature suggests that there is a connection between welfare generosity and inequality, and conclusions extracted from cross-national data on individual and household incomes over the course of past decade indicate a significant and negative link between the two. A point increase in welfare spending as a percentage of GDP presumably decreases poverty rates by four percentage points (Brooks and Manza 2007), while in turn lower levels of poverty and inequality are said to ensure a strong effect on the state of the economy and economic growth. Nevertheless, given the acknowledgment that economy and the welfare state are interconnected (Esping-Andersen 1990), we find in our literature review very few discussions of a potential link between the welfare state and informal economy.

Origins of welfare states

The emergence of welfare states and their pattern variations open up the way for many questions with regard to the driving forces behind the emergence and the application of a particular model of welfare state in the first place. This matter concerns a large part of the literature on the welfare state, involving several explanatory approaches.

The “industrialist” approach sees economic growth and its demographic implication as the original cause of the emergence of welfare states (Wilensky 1975). According to this approach, welfare states first emerged in societies undergoing major economic growth due to rapid industrialization. Together with record economic growth, went unprecedented medical and health-related technological advances and new social problems surfaced. The increase in the longevity of the population became evident, with significant socio-demographic implications. As the aging of population became more and more prevalent, growing pressure was exerted on governments to provide support and assistance to this segment of the population (Brooks and Manza 2007). The logic of the industrialist approach identified public social provision as a “functional prerequisite” of industrial capitalist democracies, proclaiming it as a “path common to all societies undergoing a transition from agrarian to industrial capitalism” (Brooks and Manza 2007, 14).

Differently to industrialist theory, the “radical” neo-Marxist approach posits the socio-political implications of capitalism, namely class antagonism and struggle, as the root cause of the emergence of welfare states. Put simply, welfare states rose out of the need of capitalist states to attain legitimacy and secure popular support. Social provisions provided by the welfare state were the concession that the capitalist elite had to make in order to ease the pressure from below and to ultimately prevent any major clash of classes (Brooks and Manza 2007).

The “power resource” approach claims that welfare states were the consequence of growing working class influence on governments. Eventually, the working class managed to establish a social consciousness that became politically represented through left-wing parties. Countries with strong left-wing parties and impactful labor unions promoted the presence of working-class interests in the development of social policy, contrary to those with strong right-wing parties that mainly insisted on the liberalization of market through lesser state intervention (Aidukaite 2009; Esping-Andersen 1990). Various studies have strongly supported this theory concerning the rise, variation and development of welfare states (Aidukaite 2009). For instance, regions dominated by left-wing parties and influential labor unions, such as the Scandinavian countries, generally register higher levels of spending on social protection programs that aim at providing universal services and support, while countries whose governments are dominated by right-wing or center coalitions, such as in todays' East-Central European countries or the United Kingdom, display a higher propensity to implement limited and means-tested welfare state support only to targeted citizens, and to allocate lower levels of spending to welfare.

Adding to, yet challenging the "power resources" approach, the "path dependency" approach claims that the variation and development of welfare states is engraved in an enduring history of social policies. While early developments of social policy channeled states into particular paths, according to the initial power conditions, any ensuing attempts to make substantial changes out of that institutionalized path is met by strong opposition (Brooks and Manza 2007). Therefore, the variations of welfare state became to some extent "locked in" each society's historical experiences. The approach suggests that countries which have historically invested heavily in their welfare state, such as Sweden for instance, are resistant to later fundamental transformations in welfare state, regardless of external or internal pressures to do so (Park 2005).

Deriving from neo-liberal ideology and policies, the phenomenon of globalization has also stressed its impact on welfare state. The "globalization" approach asserts that social policies in each country will inevitably converge to an ever more liberal welfare regime. The growing international mobility of capital puts mounting pressure on domestic governments to maintain national competitiveness and to steer their economic systems to become ever more market-oriented (Brooks and Manza 2007; Park 2005). Significantly increasing or failing to decrease welfare spending amounts to higher taxes on capital, labor and income, as well as to market interventions, creating an unfavorable environment for foreign direct investment. This weakens the countries' capability to cope with domestic spending and demands and with it the ability to ensure generous and universal social welfare policies; most welfare states as we know them would eventually disappear (Park 2005).

Lastly, the "embedded preference" approach has recently attracted considerable attention. It provides a strong critique of globalization theories, dismissing the possibility of a linear convergence of welfare states into a liberal regime and their eventual disappearing due to globalization pressures. Simultaneously, it grants contextual support to two other models by explaining how "power resource" and "path dependency" theories developed in the first place. Both imply particular policy preferences of the aggregate public opinion. However, both their theoretical frameworks began without prior questioning what caused a given political configuration in the power resources approach, and specific historical developments of social policies in the path dependency approach. The "embedded preference" approach points out three causal factors to explain the variations of particular preferences concerning the welfare state; citizens policy attitude based on social-structural location, relevance of the role of major institutions such as religious organizations, families, unions, political parties and schools, and collective memories. The two former factors are central to a sociological model of both political behavior and preferences. Citizens' social location limits the aggregate policy preferences due to strong surrounding social factors, while a regular exposure to major social institutions affects their collective identity contributing to the prevalence of a particular public policy preference. The third factor entails the significant relevance of past experiences from specific events, policies or institutions. Hence, collective memories from past interactions shape the citizens' aggregate policy preferences. As such, it explains generous and universal welfare state in social democracies as a citizens' preference for social provision, while limited and targeted welfare state in liberal democracies as a result of greater preference for private alternatives (Brooks and Manza 2007).

Regardless of their major contributions, each of the above approaches faces criticism. While the radical approach fails to cohere to the contemporary developments of the welfare state, industrialist-related theories do not manage to explain a lot the variations of welfare state development past the mere necessity of modern states to provide social provisions for aging populations. Power resources theories fail to take into account external pressure from international institutions such as the EU, IMF and World Bank on domestic welfare configuration (Deacon 2000), especially on post-socialist countries. Moreover, power resources theory seems to ignore the fact that the political constellation in many post-socialist countries is rather fragmented and not as well set in as in the established party systems in western capitalist countries (Aidukaite 2009). Path dependency theories have proved incapable of providing a fitting explanation to welfare state variations emerging out of post-socialist countries, which mostly embraced a fundamental transition to a liberal welfare state model, or explain Great Britain's fundamental transition from social democratic to liberal model in the

1970s. Meanwhile, claims by the globalization approach for an inevitable disintegration of welfare state seem quite premature, in the light of vast evidence showing almost no decline or breakup of welfare states since the 1980s despite increasing pressure by globalization (Park 2005). In addition, globalization theories minimize down to extinction the consideration of domestic politics associated with decision-making processes about welfare state policies. Lastly, the embedded preference approach, much like path dependency, fails to give enough credit to the influence of international institutions on vulnerable transition countries.

Welfare state regime types

Besides the discussion on the origin and variations of welfare state in the first place, clustering such variations into conceptual types is a major field of interest in the research on welfare states. Several types of welfare states attempting to classify and label specific regimes, such as Esping-Andersen's, are established as pioneering contributions while others are often a critical response to the shortcomings of such clusters, or represent complementary additions to them.

Esping-Andersen (1990), deriving from Titmuss' (1958) well established trichotomy of residual, industrial achievement, and institutional welfare states, distinguishes three types of welfare state regimes based on the level of decommodification and the kind of social stratification it produced. The former refers to the extent to which "a service is rendered as a matter of right, and (...) a person can maintain a livelihood without reliance on the market", whereas the latter indicates the level of the intensity and range of redistribution of resources and services (Esping-Andersen 1990, 21-22). Based on these core features, he identified liberal, conservative-corporatist and social democratic welfare states.

The liberal type of welfare state is characterized by low decommodification, limited and means-tested support, privatized pension funds, and modest social insurance programs, embodying individualism and a primacy of the market. Thus, governmental budget allocation dedicated to social protection spending is rather low and limited. Its beneficiaries are mainly low-income, below poverty line, state dependent citizens. Liberal welfare states are mainly found in the United States, Canada, Australia, as well as the United Kingdom and Ireland in Europe (Arts and Gelissen 2002).

The conservative-corporatist type, on the other hand, entails a moderate degree of state support, limited to low income benefits, and pension support related to professional and occupational status. Given its catholic influence and legacy, the conservative-corporatist model endeavors to preserve traditional family structures, by discouraging women to participate in the labor market, and it follows the principle of subsidiarity, which means that the state will interfere once the family's capability to provide for its members is exhausted (Esping-Andersen 1990; Fenger 2007). This welfare state model prevailed mainly in Western Europe, including countries such as Italy, France, Germany, Finland and Switzerland (Arts and Gelissen 2002).

Lastly, the social-democratic welfare type, making up the opposite pole to the liberal one, displays generous and universal social protection to all its citizens regardless of their contribution. Countries belonging in this type, namely Belgium, the Netherlands, Austria, and in particular Norway, Denmark and Sweden, are committed to a full employment strategy, for it is only viable to maintain this high level of welfare spending if as many citizens as possible are employed and are active contributors (Arts and Gelissen 2002; Esping-Andersen 1990). This classification of welfare state regimes has stood up for decades, as it still does, as the groundwork of welfare state typologies.

Nevertheless, it has faced criticism. Friendly critics argue that Esping-Andersen's work is "neither exhaustive nor exclusive and therefore needs revision" (Arts and Galissen 2007, 138), while others more fundamentally criticize his theoretical and methodological stances; the strongest critics assert that such typologies have no explanatory significance and therefore do not contribute to theorizing about the development of the welfare state (Arts and Gelissen 2002; Baldwin 1996). One crucial and common criticism of Esping-Andersen's scheme encountered in the literature is the failing to include 'Southern' or 'Mediterranean' countries in his scheme, as well as the recent incapability to adequately fit post-communist countries within the three-type model (Aidukaite 2011; Ferrera 1996; Ferrera 2005; Manning 2004).

Leibfried (1992, cited by Arts and Gelissen 2002; Ferrera 1996) led the way of criticisms on the exclusion of "southern" European countries. Leibfried distinguishes four welfare state regimes, based on the different policy models with which welfare state institutions fulfill their role in combating poverty and inequality; the modern model (the Scandinavian welfare state), the institutional model ('Bismarck' welfare state), the residual model (Anglo-Saxon welfare state), and the rudimentary model

(Latin Rim welfare state). Even though Leibfried takes into account different indicators to those Esping-Andersen employed when designing his typology, three out of the four Leibfried's types greatly converge with those in Esping-Andersen's original model. The fourth original type includes the countries that were left out or misplaced in Esping-Andersen's typology, namely Spain, Greece, Italy, Portugal and France. According to him, the reason why these countries should belong to a distinct group of model is their poorly articulated social minimum and right to welfare (Ferrera 1996).

Ferrera (1996) and Bonoli (1997) explicitly supported the inclusion of the "southern" type of welfare state, and not just as an underdeveloped subcategory of any another type (namely, Esping-Andersen's conservative type), but rather as a completely separate one (Arts and Gelissen 2002). Ferrera proposes a four-pronged welfare state typology, based on different dimensions to both Esping-Andersen's and Leibfried's; eligibility rules, requirements under which benefits are distributed, regulations of financials of social protection, and structural arrangements of social security schemes (Ferrera 1996). Despite those definitional differences, he comes up with an almost identical typology to Leibfriend's. Ferrera identifies the Anglo-Saxon, Bismarckain, Scandinavian, and Southern models.

The distinguishing features found in Southern welfare states that produce the necessity for the introduction of a specific type are the absence of minimum social protection coupled with generous old age pensions, the provision of healthcare as a social right, and most importantly, high levels of clientelism in social security financing and the distribution of cash benefits (Arts and Gelissen 2002). Bonoli (1997) also proposed an addition of a southern European type, and was especially critical of Esping-Andersen's decommodification approach. Alternatively, he based his scheme on social expenditures as a percentage of GDP and the percentage of social expenditure financed by contributions (Bonoli 1997). The main resulting difference in his four-type scheme was that Switzerland was included in the Southern model, together with Italy, Spain, Greece and Portugal (Bonoli 1997, 361).

Criticism of the exclusion of post-socialist countries from Esping-Andersen's typology only started to develop once the assumption that these countries would all follow a liberal welfare state model encountered evidential inconsistencies. The transition of post-socialist countries turned out to be more complex than expected, and several recent studies have shown that post-socialist welfare state policies cannot be fitted into any of Esping-Andersen's types (Aidukaite 2011; Fenger 2007) and particularly not into a liberal regime (Aidukaite 2011; Cerami and Vanhuysse 2009). Fenger (2007) replicated Esping-Andersen's methodology substituting new available data for post-socialist countries, showing that the latter differ noticeably from the typology provided by Esping-Andersen.

Based on these, some scholars have emphasized the developing differences among the newly transformed post-socialist countries with regard to their welfare state policies, advocating for distinguishing subgroups or subcategories within the existing typology, rather than classifying these developments into new and separate typology (Bohle 2007; Lendvai 2008), while others argued for a separate post-socialist type of welfare state based on significant historical and socio-economic similarities (Aidukaite 2009; Aidukaite 2011; Cerami and Vanhuysse 2009, Fenger 2007). Such a model would share traits from both the liberal and conservative types, while incorporating specific features found in post-socialist societies. High coverage but low benefits levels, supremacy of the social insurance system, identification of wide-ranging social policies with the Soviet past, and low level of trust in state institutions are some common features attributed specifically to a post-socialist or Eastern European welfare system (Aidukaite 2011; Fenger 2007). Differences within the group are noticeable (Manning 2004), but nevertheless less pronounced than between this group of countries and other Western welfare states.

Yet other authors took a fiercer swing at typologies as a whole, going as far as to questioning their basic scientific significance. Kasha (2002) concludes that each country displays such a variety of welfare policies on pensions, social assistance, unemployment benefits, housing etc., as a response to historical developments, variations in the policymaking process, influence of foreign practices, and involvement of different policy actors (Fenger 2007), that the different overlappings of all these factors make the emergence of a coherent and distinct regime clusters impossible. Baldwin (1996), claimed that when studying variations we must concern ourselves with the question 'why' just as much as 'what'; hence, he finds welfare state typologies, as for that matter all typologies, to have no explanatory significance and to contribute very little to theorizing of welfare states (Arts and Gelissen 2002).

In response to criticism, Esping Andersen (1997) pointed out that his typology is made up of ideal types that are vulnerable to different historical pressures and develop into qualitatively different trajectories; therefore, hybrid forms are empirically possible and may be developed as types (Arts and Gelissen 2002). Nevertheless, he believed that ideal types are completely relevant in that they enable one to "see forest rather than the myriad of unique trees" (Arts and Gelissen 2002, 139). Typologies are important to our study because they will guide us in seeking out a country's commitment to particular welfare state policies, as we will later on look at possible correlations between welfare state regimes and the informal economy.

Welfare state transformations in post-socialist countries

The major transformation experienced by post-socialist countries took place in the context of a critical economic and social juncture, with dramatic decline in income for most of the population, due to soaring inflation and record unemployment levels (Aidukaite 2010; Fenger 2007; Kornai 2006). Such circumstances created the urgent necessity for emergency welfare state programs, and the new government's legitimacy "to a large extent depended on their ability to provide adequate social policies in answer to these problems", leading to the introduction of *ad hoc* unemployment, disability, sickness and early retirement programs (Fenger 2007, 14). This marked the first phase of changes in social policies.

During a second phase, more articulated and elaborated decisions with regard to social policies took place. Firstly, unemployment benefits deemed as "unsustainable expenses" were cut off (Manning 2004). Secondly, newly established governments that aimed at fencing off all affiliations with Communism limited their political behavior to emulating West European governments (Kornai 2006). As a result, political representatives "were caught between preexisting commitments to provide for their populations, and intense pressures to restructure their economies, cut social expenditures, and adopt more market-conforming welfare models" (Cook 2007, 47). Esping-Andersen (1996) suggestively anticipated that the new welfare systems emerging in the post-socialist spaces would eventually converge to a liberal model. This did happen to a large extent, as transitional programs dependent on external aid called for the elimination of state monopolies over social provision, the privatization of healthcare and the reform of pensions schemes, and the replacement of universal social assistance with means-tested programs targeting only the poor (Cook 2007). However, this projection was contrasted by a more particularistic approach that sought to demonstrate that post-socialist states eventually followed non-conventional paths based on their differing political constellations, constituencies' preferences, geographical positioning, economic stability, and vulnerability to international institutions and external political actors (Aidukaite 2010; Cook 2007; Manning 2004; Polese, Morris, and Kovacs 2014).

The final phase witnessed a degree of economic stabilization in these countries, as several of them retrieved levels of economic production close to those they had enjoyed prior to the transition. A review of the developments in East-Central European countries with socialist pasts, namely Slovenia, Czech Republic, Hungary, Poland, Slovakia, Estonia, Latvia, and Lithuania, reported remarkable variation in social and economic performance, pension schemes, health care, unemployment programs, and social assistance practices, since the start of social policy reforms (Manning 2004). While Slovenia and the Czech Republic leaned towards a West European model – a mix of social-democratic and conservative-corporatist types, characterized by higher social spending, higher state involvement and decommodication –, most of the Visegrad countries (Hungary, Poland and Slovakia) exhibited something in-between the liberal and the conservative-corporatist types, and the Baltic countries moved rather more towards a liberal model (Aidukaite 2009; Manning 2004). Other classifications of welfare states in post-socialist counties may be found in the literature (see Deacon 2000; EBRD 1999; UNDP 1999; World Bank 1996).

These countries' paths towards a particular welfare state type or hybrid regimes is indicative of the practical application of some theoretical approaches to welfare state variations discussed in the second section of this chapter. The Baltic countries' adoption of liberal welfare state policies was greatly influenced by the negative economic performance determined by their soviet legacy (Aidukaite 2011). This made them be particularly in need of external help, which came in the form of loans and credits by the International Monetary Fund (IMF). Since these came attached to the IMF's neoliberal globalization agenda, this made a liberal welfare state regime a condition for eligibility (Manning 2004). Much the same could be said concerning Central-Eastern European countries, namely Hungary, Poland, Bulgaria, and Romania. In addition to economic vulnerability, it was cautiously suggested that the positive attitude of these countries in relation to globalization pressures was influenced by the countries' political endeavor to join Euro-Atlantic structures (Aidukaite 2009).

Unlike the preceding sets of countries, Slovenia and the Czech Republic bluntly rejected the neo-liberal agenda, especially with regard to privatizing pension funds. Both countries experienced more economic stability upon the transition to a market-based economy, making them less dependent on external help. Moreover, in the case of Slovenia, key policy actors who rejected such proposals by the World Bank came from the Ministry of Labor, the trade unions, and the pensioners' lobby, displaying a power resource configuration, and a particular embedded preference for rejecting right-wing social policy tendencies (Manning 2004). Illustratively, the magnitude of the rejection of the privatization of pension schemes led to a government resignation in 2011 upon the result of a referendum. Others have suggested that the reason why Slovenia and the Czech Republic were so comfortable with their transitional reforms in social policies was their geographical location (Aidukaite 2011; Cerami and Vanhuysee 2009). This argument suggests that countries located closer to the Western Europe border have experienced a faster and more successful transformation due to their strong economic and cultural ties with the West (Aidukaite 2011). However, no single theory can fully explain the dynamics of developments and changes in the post-socialist societies. The welfare state developments in these regions were subject to the causal interplay of societal, economic, political, cultural, and historical aspects in each given country (Aidukaite 2009).

Nowadays, despite remarkable changes in financial and economic growth, most post-socialist countries are still lagging behind the old capitalist democracies regarding economic and social parameters, with the possible exceptions of Slovenia and the Czech Republic. Several studies show that the post-socialist countries, most of them nowadays are new EU members, remain below the rest of EU members in terms of minimum wage, social protection expenditures, labor market policy, poverty, inequality and unemployment (Aidukaite 2011)

Welfare programs in Kosovo

Kosovo underwent the same severe social and economic transition that swept over the entire region of former socialist societies. However, even though many similarities of Kosovo's transition may be spotted in the familiar pattern across the regional context, closer attention must be paid to her specific socio-historical and political circumstances, in order to understand the uniqueness of that transition. To begin with, Kosovo is the most blatant case of external influence in domestic policymaking, exerting itself on a disintegrated political configuration. Its post-conflict legacy, devastated economy, social disintegration, and massive international presence upon the military intervention in 1999 made Kosovo especially vulnerable to international influence coming in the shape of aid, loans, and credits.

Kosovo made a transition from a generous and universal welfare system that was in place in the Socialist Federal State of Yugoslavia, to a neoliberal welfare state in the wake of eventful political developments. The former Socialist Federal state of Yugoslavia had a very generous welfare system, comprising social insurance and social protection. The former covered pension funds, social insurance in case of temporary unemployment, and health insurance, whereas the latter was more focused on the most vulnerable social strata, who could profit from goods and services provided by companies and local municipalities (Stamboliva 2012). Following the end of the war in 1999 and the resulting institutional void, Kosovo adopted what became known as an “emergency welfare program” (Inglot 2008). This was designed as a product of international intervention and took very little consideration of the socio-historical characteristics of Kosovo. Interestingly, what was initially designed an emergency welfare program went on to become the “normal” institutional blueprint, as today’s Kosovo has built its welfare system on that legacy of neoliberalism, residualism and selectivity (Stamboliva 2012).

Kosovo’s current social welfare programs had their origin in the massive humanitarian assistance delivered in the summer of 1999 upon the intervention of the international community. The process that became known as the “social welfare transition” was a multifaceted transformation of the humanitarian assistance network, the two major carriers of which were the World Food Programme (WTP) and the United States Agency for International Development (USAID) (Cocozzelli 2009). As the result of a devastating war, many families had been left without a family guardian or breadwinner, over 1200 children had lost both parents, many former employees of over 200 state-owned enterprises were left with no jobs and no regular financial incomes. The number of families receiving regular salaries from their occupation and/or from private business concerns decreased, while the number of families living off humanitarian aid and remittances increased tenfold. The unemployment rate was estimated at around 74%, immediately after the war, dropped to 45-55% within a couple of years (Riinvest 2001).

Eventually, as the international emergency aid program came to an end, there was the need to transform the NGO-supported humanitarian assistance system into a well-established state-based welfare program (Cocozelli 2009). On the verge of the emerging social policies and welfare state programs, Kosovo was under complete administration from a western-based International Body with executive powers. The model of welfare programs which were to be implemented during the reconstruction period inevitably carried the stamp of neo-liberal features and principles. Regardless of initial claims registered in the European Commission and the World Bank report (1999) that that Kosovars should be closely involved in designing and implementing the reconstruction and recovery programs, little of the locals' outputs or insight were taken into effective consideration. The newly proposed social policies were driven by the economic ideology of neo-liberalism as a panacea for all post-conflict societies (Pugh 2014).

The reformed welfare state system had three particular schemes, namely, social assistance, war victims' benefits, and pension schemes; all of which were premised on individualist interpretation of social rights, and featured modest benefits that could guarantee only the bare minimum personal expenses (Cocozelli 2009).

The Social Assistance Scheme remained effectively the same once the administered province of Kosovo declared its independence in 2008, with minor changes in application criteria and the maximum size of beneficiary families. Differently to social assistance, the need for changes in the pension system was widely recognized. Two years after the end conflict, in 2001 the international leadership initiated a pension policy design intended to be sustainable in the long term. This initiative was funded by USAID and led by representatives of the United Nations Mission in Kosovo (UNMIK), the European Union (EU), the International Monetary Fund (IMF), the World Bank (WB), the International Labor Organization (ILO) and the Department for International Development (DFID) (IKS 2016c).

Prior to the upcoming new pension model, Kosovo had been covered by the Yugoslav pension system, which was an intergenerational solidarity "pay-as-you-go" system, through which active workers paid contributions to fund the benefits of current pensioners. The Province of Kosovo had its own autonomous pension fund which was responsible for collecting contributions and providing benefits, but that was only up until the revocation of the autonomy status by the Yugoslav authorities in March 1989

(Group for Legal and Political Studies 2012). Albanians who were then active in the labor market had paid their contributions to an authority which would never return pension benefits to them. The new pension system knowingly excluded a generation of past contributors from their future social and legal right to collect pension benefits.

The new Pension Scheme, as currently in force, is a three-pillared system. The first pillar provides basic pension coverage to all senior residents over 65 years of age, with a sui-generis residence requirement only, unlike any other system in the region, and it is fully funded by the general revenues of the central government budget. Irrespective of past contributions, all retirees were put in the same category, which practically can be considered a social assistance benefit to prevent elderly poverty, rather than a pension. In addition to the first pillar, a particular scheme for Disability Pension and Early Pensions for the employees of TREPCA mines was introduced in 2004.[2] Both subcategories could also be considered practically as social assistance benefits, rather than pensions. The monthly values ranged from 50-70 EUR, and 40-45 EUR respectively (IKS 2016b).

The second pillar is based on personal contributions, which are mandatory for all the employees in form of a 10% tax on the gross wage, paid by the employee and the employer, 5% each. This scheme is managed by the Kosovo Pensions Savings Trust (KPST), an independent institution licensed and supervised by the Central Bank of Kosovo (CBK), while contributions are collected by the Tax Administration of Kosovo (TAK) (IKS 2016b).

The third pension pillar enables the establishment of supplementary pension funds contracted with private insurance companies, either by the employers for their employees, by the employees themselves as additional insurance, or both. This pillar is barely used (IKS 2016c).

Throughout the time when Kosovo was under the international supervision, between 1999 and 2008, the only active pension program was the first pillar, known as Basic Pension. It initially budgeted in July 2002 at €28 per month for every eligible senior citizen, and was mainly based on the value of minimum-calorie Food Basket of 2,100 calories per day per adult (Cocozelli 2009; IKS 2016b). From 2004 to 2008, the

[2] A large industrial complex located in the north of Kosovo, which had been one of the largest enterprises in former Yugoslavia.

monthly pension was gradually increased from €28 to €40. The number of beneficiaries also increased every year. The Kosovo Basic Pension compared unfavorably to pension programs in the region in terms of the level of benefits in relation to the average annual wage. It also compared unfavorably to the level of the former pension benefits under the Federal Socialist State of Yugoslavia.

As to this day, Kosovo employs a model of pension programs according to the principles of a design determined in the 2001-2003 period (see table 1). Modifications, improvements and extensions have continually been made since the independence in 2008, but none of those challenged or questioned the determination to move from a solidarity system to a contribution-based system. Little consideration was taken of the fact that this substantial transition left a full generation of contributors under the Yugoslav pension scheme with only a basic pension originally budgeted at only €28 per month.

It certainly was very challenging to develop a new system of pensions that would ease the transition and be acceptable and attractive to both the current and past contributors, sustainable in terms of fiscal stability and economic growth, and promoting a labor market in a society overwhelmed by a fundamental transformation of political, societal, economical system (Group for Legal and Political Studies 2012). Where does this pension system stand today?

Scheme	Target group	Age	Earnings tested	Pension tested	Benefit type and amount
Basic age pension	All	65+	No	Yes	Flat (€75/month)
Contributory pension	Beneficiaries based on law from before 1999	65+	No	Yes	Education-linked (€158-240/month)
Disability pension	100% disability	<65	Yes (categorical)	Yes	Flat (€75/month)
Work disability pension	Work accident or professional disease	<65	Yes (categorical)	Yes	Flat (€75/month)
Family pension	Beneficiaries based on law from before 1999 or family of work disabled	Spouse <65	Yes (categorical)	Yes	Flat (€50/month + 20% per eligible child)
Trepca early pension	Involuntarily unemployed; >50% disability	50-64	Yes (categorical)	Yes	Flat (€105/month)
KPST	All	65+	No	No	Phased withdrawal (min €150/month) or annuity

Table 1. Basic features of Kosovar old-age and disability pension schemes (IKS 2016b)

Nowadays, pension schemes are subject of strong criticism for excluding various groups such as rural residents, farmers, self-employed, and those who did not manage to contribute sufficiently to their pension funds due to the high levels of active informality, unemployment, job uncertainty, the low level of fiscal compliance, and the low wages practiced in the country. Kosovo has the smallest contribution rate in the region, suggesting that it is unrealistic to expect that most individuals will succeed in accumulating sufficient funds for a retirement pension (Group for Legal and Political Studies 2012). Even if we assume that all the registered contributors pay their contributions regularly, taking into account the current average wage (€340) and KPST's investment policy and performance so far, those contributors cannot expect a satisfactory pension upon their retirement.

Things seem even worse for those who are to retire in the near future, since the accumulated contributions to their pensions fund will be insufficient to generate a sustainable pension for their years in retirement (Group for Legal and Political Studies 2012). Strong criticism has also been addressed to the contributory pension scheme for its vulnerability to political influence and potential mismanagement of the funds (as noted in Kosova Sot 2016), as well as inadequate and ineffective mechanisms to insure a regular collection of pension contributions. Most importantly, today's pension program benefits are largely unsatisfactory for all categories of beneficiaries, as they fail to meet the minimum monthly consumptions of goods, leaving the pensioners in a miserable socio-economic state of elderly poverty (Group for Legal and Political Studies 2012).

On a more positive note, despite the poor financial and functional support that these social schemes provide, up to now they seem to be contributing to maintain some degree of social peace. According to figures dating back to some ten years ago, if the available social transfers were to be stopped, the poverty rate would have risen by 12%. Basic pension transfers also seem to have a considerable influence in tackling poverty; if they were to be withdrawn, the poverty rate would have risen by 9% (Murati and Berisha 2010). The remaining social benefits seem to have a very modest effect, and those who are entitled to them most likely remain below the poverty line. Given that all pension and social assistance schemes are funded either by the general revenues of the central government budget and/or by mandatory individual contributions, both strongly depend on the state's ability to enforce taxes on registered economic activities as well as to provide the incentives to comply with the formal economy and the related contributory responsibilities. This poses the crossing point between the practices of informality, low compliance rate, and the effectiveness of welfare programs, and paves the way for our next step into the discussion.

3. The informal economy and welfare state policies

The informal economy and welfare state policies may be seen as interdependent, to the extent that they both depend on the state's capability to make its presence effective, and that this interacts with their respective incentives and resources. The former is indicative of the state's failure to enforce the registration and compliance of economic activities, including employment relations, to formal rules, because of its incapacity both to track and trace these activities and to provide incentives for economic subjects to comply with their formal economic responsibilities. The latter depends on the state's ability to fund welfare state programs, providing social protection schemes that may work as incentives for compliance – the lack of which can in turn result of the state's fiscal inability, due to economic informality.

Inadequate social protection schemes and the inability to provide compliance incentives with formal rules both break social trust in formal institutions. As a result, noncompliant behavior becomes increasingly popular, while the effectiveness of actual social protection schemes becomes hindered. Therefore, the further development of an informal sector depends on the state's (in)ability and (un)willingness to develop labour market policies that create incentives to formalization (Heinze and Olk 1982), while the type, size and effectiveness of these policy schemes is in turn negatively influenced by the spread of informal economic practices (Aidukaite 2010; Aidukaite 2011).

Labor market policies – which include government intervention targeted at groups with difficulties in the labor market, training, employment incentives, startup incentives, unemployment benefits, early retirement, and social security schemes – must be dealt with carefully. Practices of welfare state have been viewed as a risk to human capital and economic development, because of their exposure to cheating and moral hazard (Perkins 2016). One example of this kind is the welfare system provision of 'the right to guaranteed income' which was in place in the United States before 1996. It provided single-parent families with benefits for as long as remained eligible; these benefits were in a sum of US$ 13,000 of which US$ 7,500 in cash while the rest was earmarked to housing allowance, medical care, and other non-cash benefits (Pejovich 1999). Soon enough, the right to guaranteed income encountered abuse by its recipients since they "had the incentives to pursue activities that would allow them to remain on welfare indefinitely, such as remaining a single parent, not looking for employment, disinvesting in human capital, and seeking covert work", and it even created incentives for other citizens to become single parents (Pejovich 1999, 168).

Another example of moral hazard in welfare policies is the case of preference of disability over unemployment benefits. For some time now, welfare programs of the kind of disability benefits in Europe have been prone to mismanagement and abuse by people without actual health incapacities, who used disability benefits as an alternative income support upon ineligibility to unemployment benefits, or/and as a pathway to early retirement (Marie and Castello 2011). In the Netherlands during the 1990s, as disability benefits were higher than unemployment benefits, this stirred up an overpopulation of disability schemes, with estimates suggesting that as much as half of their recipients were in fact hidden unemployed (de Mooij 1999). He advocated that reducing welfare benefits for the unemployed reduces the social security premium for the working population, and it exerts pressure on inactive potential breadwinners. Lower income replacement rates induce the search intensity of the unemployed, as well as their likelihood of accepting a job offer (de Mooij 1990). Thus, he estimated that employment would increase by 1.5%, and effective unemployment would drop by 0.8% if unemployment benefits were cut by 5% while disability benefits remained unaffected. Similarly, a reduction in disability benefits by 5%, while maintaining unemployment benefits unaffected, would reduce unemployment by 0.7%. Since lower unemployment benefits increase hidden unemployment and recipients of disability benefits are not exposed to any pressure by the government to do job hunting, he concluded that a decrease in the welfare benefit for the disabled is "an effective policy in reducing total unemployment and, in particular, hidden unemployment" (de Mooij 1999, 712).

Marie and Castello (2011) concur that disability benefits reduce labor force participation. They looked at Spain's disability pensions and analyzed for employment effects of an increase in the benefits of disability pensions. Their results show a negative causal relationship. All individual characteristics of recipients aside, they estimated that had not the benefits generosity increased by 36% "the employment of disability insurance (DI) recipients would have been 8% higher" (Marie and Castello 2012, 209).

Overall, these studies indicate that while welfare expenditures often may be helpful in reducing poverty, they have no positive return on the economy as they fail to successfully accommodate their recipients into the labor market, and they tend to create long-term dependency (Ahmend and Miller 2000, cited in McDonald and Miller 2010; Lichter and Jayakory 2002), as recent contributions have argued that welfare state benefits are influencing the "development trajectory of the personality profile of the population towards greater employment-resistance" and "have been followed by a substantial decrease in work motivation" among the nations of the Western world (Perkins 2016, 6).

Supporters of welfare state argue otherwise. Anthony King (1983) argued that in the absence of welfare provision "it is very doubtful whether the seemingly inevitable economic and social vicissitudes of the latter part of the twentieth century would be easily borne by increasingly well-informed, well-read, well-travelled, potentially restive urban population" (King 1983, 22). In that same line of argument, Wilensky (1983) expressed criticism of economists' dealing with welfare policies as shortsighted, for not taking into account welfare policies' impact on social consensus. He also questioned the claim that welfare state provision and expenditure impact negatively the economic performance. In fact, ever since after World War II the "heavy spending corporatist democracies have done as well or better than the welfare state laggards", by any measure of economic performance (Wilensky 1983, 56). That includes the heavy spenders such Germany, the Netherlands, Austria, Belgium and Norway, which have consistently performed better in annual growth, inflation and unemployment as compared to the rest of rich democracies between 1950 and 1974 (Wilensky 1983).

Recent studies with regards to the effect of welfare policies on economic development claim that an increase in expenditure in these policies may directly provide jobs, and also affects employment levels via job training and educational opportunities, supplying the job market with higher levels of education and professional skills (McDonald and Miller 2010; Wolfe 2002). In addition, welfare programs have the capacity to "increase employment levels during specific market inefficiencies by providing training to recipients for key industries, such as technological and medical related fields" (McDonald and Miller 2010, 721). Welfare may foster employment indirectly as well, through sponsoring organizations and industries that produce government-related goods and services (Devereux, Head, and Lapham 2000; Jones

1990; McDonald and Miller 2010, 721). Basically, welfare state programs project social protection mechanisms as a return investment strategy, through which recipients experience a raise in human capital allowing them to invest in economic activities (McDonald and Miller 2010).

As a result, some scholars contend that generous welfare state programs actually promote economic growth by creating a flow of capital, which eventually will lead to a return of recipients to the workforce, allowing them to collect and spend capital, and partake in fiscal responsibilities (McDonald and Miller 2010; Ploug 2005; Wolfe 2002). McDonald and Miller's (2010) empirical analysis focused on testing three particular models: employment, investments and direct economic growth. The first model (employment) revealed that "welfare expenditures aggravate unemployment in the short term, but reduce unemployment a year later", suggesting that while welfare state programs may at first encourage free-riding amongst recipients, they do have a positive effect in returning them to workforce later on (McDonald and Miller 2010, 728). Secondly, their findings show that welfare state expenditures tend to hinder investments both in the short and the long term, meaning that funds allocated to welfare state programs might potentially have been allocated elsewhere with higher return to investment. And lastly, their estimates showed welfare state expenditure to have no significant correlation with economic growth. Nevertheless, as noted by the authors, the lack of direct effect on economic growth does not exclude a potential indirect effect, through the channel of employment. The confirmed positive effect of welfare state on employment suggests an indirect positive effect on the economy.

More to our main point, welfare state benefits may also be effective in fighting informality. Heinze and Olk (1982, 197) believed that the relationship between the formal and informal sectors depends "entirely on what sort of economic, social, and unemployment policies are pursued". Policies leading to improvement in employment and welfare may minimize the operation space of the informal economy and stigmatize informal economic behaviors. Bosch and Esteban-Pretel's (2015) and Fugazza and Jasques's (2003) works address this matter.

The former discuss unemployment benefits in economies with high informality and their impact in the labor market. In particular they looked at the effects of introducing unemployment benefits in middle-income countries such as Mexico. Bosch and Esteban-Pretel (2015) point at the large portion of workers, ranging up to 75%, who are not entitled to unemployment benefits in developing countries. Workers who are more likely exposed to job insecurity largely work in the informal sector. Attracting workers into the formal sector and sustaining their job security may be achieved by introducing unemployment benefits. However, the effect of such policy can only be as successful as the tradeoff between the incentives provided to exit the informal sector and get a formal job, and the incentives to become eligible for unemployment benefits and move back into informal sector right away. In a country with high informal economy, such inflow and mobility is hardly resistible.

In order for any unemployment benefit policy to be effective, Bosch and Esteban-Pretel (2015) urge the attention towards the interplay between contributions and replacement rates, and the importance of monitoring mechanism that must go along, given the evidence of abuse threatening these policies. Hence, higher benefits in ration to contributions make formal employment more attractive in comparison to informal employment, because such benefits are accessible only to formal jobs. But if higher contribution rates in ratio to the replacement rates or benefits are to be imposed, this may decrease the value of formal employment and increase the incentives of individuals to operate informally since no taxes are being paid and they can continue to collect unemployment benefits for some times. The institutional quality in the monitoring process is of significant relevance, an increase of which lowers the value of occupying an informal job and provides the positive effect to the mobility from informality to formality (Bosch and Esteban-Pretel 2015). Failure to balance the incentives could downplay the relevance of welfare provisions in the fight against informality. In the case of Brazil, which is characterized by a large informal sector of nearly 50%, Ulyssea (2010) dismissed increasing unemployment benefits as an effective policy to decrease informality and improve labor market performance, because that would afford little incentives to exit unemployment and informality.

Fugazza and Jasques (2003) provide empirical support to the negative relationship between the investment on labor market policies and informality. According to their conclusions, raising the generosity of unemployment benefits seems to have desirable equilibrium properties, even if monitoring practices are not found to be fully efficient. Any decision to decrease unemployment benefits for the sake of increasing formal sector would result counter-effective. Based on these results, they urged policy makers to opt for positive approach raising the incentives for citizens to transit and stay in the regular sector through an increase in unemployment benefits, instead of a traditional deterrent approach aiming at decreasing the motivation of citizens to operate in the informal sector through fines and punishments.

Adding to the above, Williams and Renooy (2013), in a study that included 27 European Member States plus Norway, found significant negative correlation between the levels of undeclared economy and social protection expenditures, social protection effectiveness, and labor market policy expenditures (see figures 5, 6, 7). However, they are careful to state that the correlation should be treated with caution because even though they suggest that a relationship exists, their results cannot prove a cause-effect relationship.

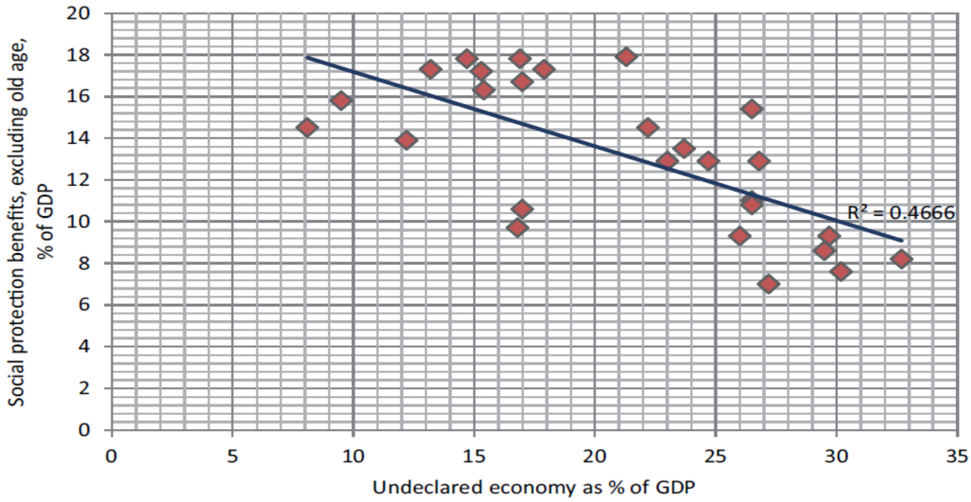

Figure 5. The relation between social protection expenditure and informal economy in the EU27 and Norway (Williams and Renooy 2013, 27)

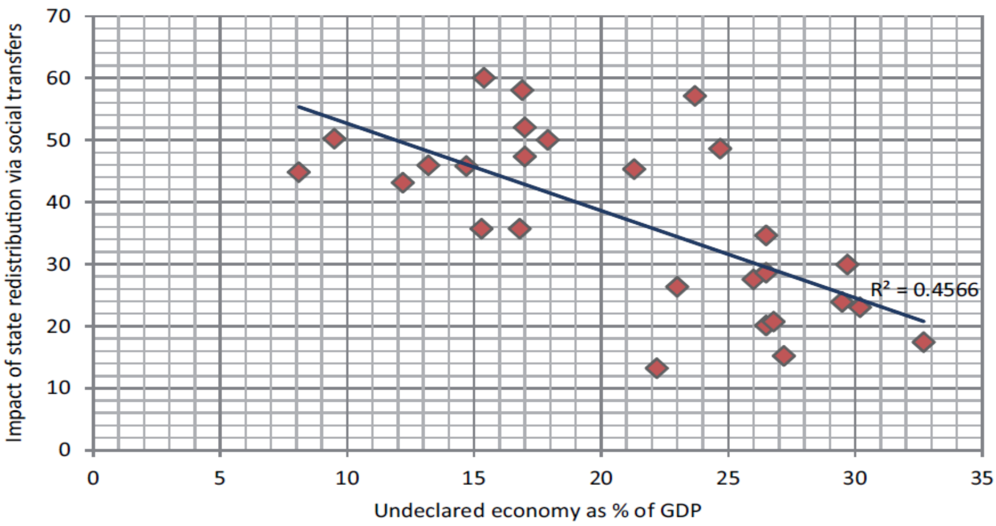

Figure 6. The relation between social protection effectiveness and informal economy in EU27 and Norway (Williams and Renooy 2013, 28

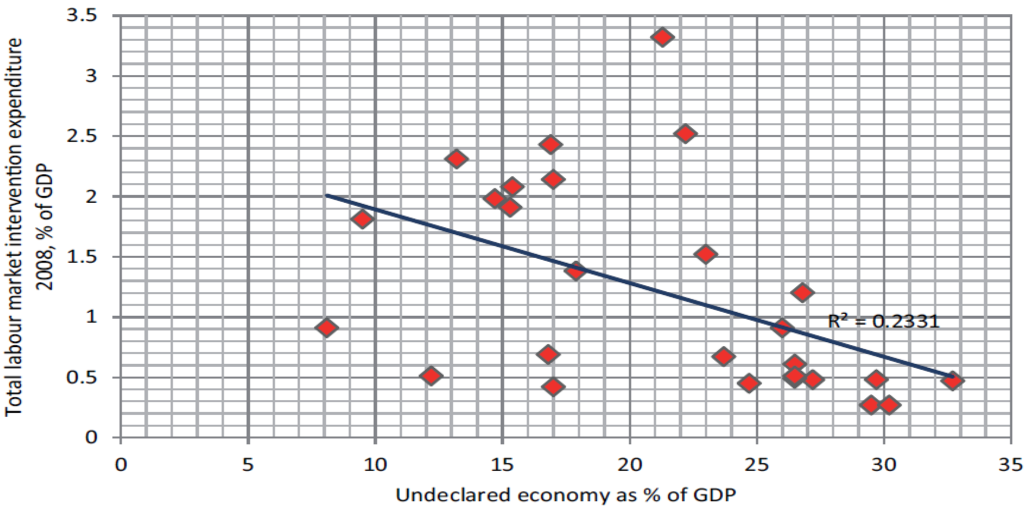

Figure 7. The relation between labour market policies and informal economy in the EU27 and Norway (Williams and Renooy 2013, 26)

Several studies have shown that countries with lower GDP and higher socio-economic inequalities generally suffer more from informal economy (Aidukaite 2011, Williams and Renooy 2013). As we have discussed, these characteristics are indicative of low economic development, poor institutional quality and, suggestively, of impotent welfare state schemes. In the European context, these countries, usually situated in Central and South Eastern Europe, share a former socialist past. The informal economy is on average much higher in these countries (over 25%), as compared to the North-West European countries (around 11%) (Williams and Renooy 2013). A few exceptions are evident within the post-socialist countries, namely the Czech Republic, Hungary, Slovenia and Slovakia. These countries are doing better in terms of minimum wage, as well as social protection expenditures, due to economic stability and their governments' better ability to collect taxes and support social protection funds (Aidukative 2011). The same cannot be said for the remaining post-socialist countries, namely Romania, Bulgaria, Croatia, the Baltic States, and Kosovo, which have the highest informal economy rates in Europe. As such, it may be argued that many citizens in these countries shirk paying taxes as response to the governments' failure to provide adequate support in cases of social risks, leaving them dependent on the market and the family as "the two most important agents for guaranteeing an adequate standard of living" (Aidukatite 2009, 35; Aidukaite 2010).

Expectedly, countries with large informal sectors are less likely to allocate expenditure to welfare state programs, and vice versa, for the reasons already discussed throughout the literature review. Besides, a large informal sector in a given country is of itself indicative of lack of rule of law, poor enforcing and monitoring mechanisms, high corruption and low public trust towards institutions, all of which discourage compliance behavior. Insofar, as these qualities preserver, welfare state programs are exposed to abuse and moral hazards, and their effectiveness against unemployment and informality is rather poor and at times counter-effective.

CHAPTER II: HYPOTHESES AND RESEARCH DESIGN

We employed a sequential mixed method research design (Creswell 2012). One reason for choosing this kind of design was that when we commenced our data collection process, we had only the overall research problem and preliminary hypotheses drawn from the literature review to guide us. As applied in this research, the core purpose of the mixed methods approach included the gathering and analysis of qualitative data for exploratory purposes, furthering those preliminary guidelines into an explanatory analytical model. Quantitative data collection and analyses then followed, in order to test the resulting hypotheses.

Since studies about Kosovo that address both terms of the relationship assumed in the research problem are scarce – a few are already published with regard to either the informal economy or welfare state programs in Kosovo, but to the best of our knowledge none have explicitly addressed the possible correlation between the two –, we decided to begin research with collecting and analyzing qualitative data. We did field research from January to March 2017 in Prishtina, capital city of Kosovo. During this period, besides collecting and reading documental sources that provided the historical, political and legal framework for our subjects, we conducted eight semi-structured interviews with public officials and professionals, who were then or had previously been engaged in selected institutions, agencies, and workgroups in some way related to our subject matters. The selection of participants was based on their previous and actual contributions to, and likely first-hand knowledge of, the issues relevant to the study. The participants' consent was obtained after they had been fully informed of the purpose of the study and of the intended uses for the interview materials. None of them requested that they remain anonymous, and all consented for their interview to be voice-recorded and cited in this dissertation. Each interview lasted between 30 and 45 minutes. The list of the interviewees is as follows:

> Agron Demi, former Executive Director and current Policy Analyst at GAP Institute; Mr. Demi has previously been engaged in the Parliamentary Committees on Health, Labor and Social Welfare, and on Budget and Finance at the Assembly of Kosovo, as a legislative assistant;

Arbresha Loxha, Researcher at the Group for Legal and Political Studies; Ms. Loxha authored the 2012 Policy Report on 'The Pension System in Kosovo', and her research focus is on Financial Economics and Welfare Policies;

Arment Merovci, Head of the national strategy for preventing and fighting the informal economy, money-laundering, financing terrorism, and financial crimes, at the Ministry of Finance;

Jeton Demi, Senior Official for Public Relations at the Kosovo Pension Savings Fund (TRUSTi);

Jusuf Azemi, President of the Trade Unions of Kosovo;

Lumnije Hashani, Senior Official for Legislation on Economic Matters at the Kosovo Chamber of Commerce;

Safet Krasniqi, Head of the Tax Investigation Unit at the Tax Administration of Kosovo (TAK);

Valon Leci, Director of the Department of Finances and General Services, Labor Inspection Agency at the Ministry of Labor and Social Welfare.

Unfortunately, in spite of repeated attempts, we were not able to interview any official or expert of the Ministry of Labor and Social Welfare concerned with the types and effectiveness of welfare state programs. Nevertheless, the Department for Public Relations did make available to us via e-mail precious details about specific welfare programs and the prerequisites to become a beneficiary, along with quantitative data on the annual expenditure for each program.

When contacted, each participant was duly informed about the purpose of the research and the research question, and was provided with the reasons for their selection and what is expected of them. Given the introduction to the guidelines of our research, the participants were prepared prior to our encounter. Agron Demi and Arberesha Loxha, from the civil society, provided us insights on both informal economy and welfare state system. Similar questions were asked to both of them that included initial broad questions on the state, practices and reasons of informal economy in Kosovo, the business environment, the evolution and evaluation of the current pension system and social assistance programs, and the role of the government in the matter. Sub-questions that targeted the assumed relation between informal economy and welfare state programs followed, either through presenting our theoretical guidelines and asking for their professional and/or scientifically based inputs, or derived from the interviewees' initial development on the broader questions.

Arment Merovci, as the representative from the Ministry of Finance in our study, was mainly asked about the role and the success of the national strategy for preventing and fighting informal economy, his evaluation of the nature and practices of informal economy commonly in Kosovo, as well as the role of public trust in state institutions' ability to enforce compliance behavior on citizens and businesses. Similar topics were discussed with Safet Krasniqi, with the particular interest on the mission and performance of tax investigation unit at the Tax Administration of Kosovo. Jeton Demi was asked specifically about the state of pension funds in Kosovo, obstacles and challenges recognized by the institution, and how sustainable is the current pension model. The purpose of this interview with Demi was to obtain firsthand information on the contributory pension system in Kosovo. Jusuf Azemi, president of the trade unions in Kosovo, provided us with information about the terms and conditions of labor force in the private sector. That included the issue of widespread informality in the private sector, how much is the labor law obeyed by private business, and how does the contributory pension system reflect on the capacity of institutions to ensure participation of businesses and workers. In that line of contribution was also the interview with Valon Leci, representative from the Labour Inspection Agency. He was asked about the performance of the agency in tackling the informal economy by enforcing the law on labor, and the challenges that this agency faces due to the low number of human resources and labor inspectors. Lastly, Lumnije Hashani was asked about the business environment in Kosovo, economic informality, rule of law, and particular challenges and burdens that private businesses face on regular basis.

Upon completion of the field research, we transcribed the interviews. The outcomes will be used below in chapter IV. Besides descriptive information which is useful in its own right, these have contributed decisively to unravel the research problem into a set of related hypotheses in a context-sensitive way, also leading to further a more targeted review of the theoretical literature. The hypotheses are as follows:

Hypothesis 1: Inefficient welfare state programs and a high level of informal economy reciprocally contribute to, and reinforce each other.

Hypothesis 1(a): Poorly funded and managed welfare programs contribute to higher levels of the informal economy.

Hypothesis 1(b): Poorly funded and managed welfare programs contribute to lower citizens' trust in public institutions and perception of government quality.

Hypothesis 1(c): High levels of informal economy hinder the size and effectiveness of welfare state programs, which in turn contributes to sustaining the relationships stated in hypotheses 1(a) and 1(b).

Hypothesis 2: Social capital contributes to the levels of informal economy.

Hypothesis 2(a): Trust among citizens contributes to lower levels of informal economy.

Hypothesis 2(b): Shared civic norms against undeclared economic practices and free-riding practices contribute to lower levels of informal economy.

Hypothesis 2(c): Citizens' engagement in associational activities (horizontal networking) contributes to lower levels of informal economy.

Hypothesis 3: The greater the asymmetry between formal and informal institutions, the greater is the propensity to participate in the informal economy.

Hypothesis 3(a): Citizens' distrust towards public institutions contributes to higher levels of informal economy.

Hypothesis 3(b): Citizens' perception of governance quality contributes to lower levels of informal economy.

At this point, we have reached the second stage of sequential mixed methods design, by using a quantitative correlational method to assess our hypotheses and the analytical model as a whole. A quantitative correlational design implies the use of statistical tests to assess whether and to what extent two or more variables behave concomitantly, as required by the hypothetical statement that one of them affects the other, or that they affect each other (Creswell 2012).

These hypotheses were tested using 31 indicators, listed in the summary table below. The table displays the name, brief description, methods used to extract, source and unit of measurement of each indicator. The indicators concern 29 European countries, including Kosovo, for the year 2013.[3] The year of 2013 is last time there was a proper study that measured the informal economy in Kosovo. Given that the level of informal economy is a key variable in our study, we were limited to that year. On the other hand, our decision to include all these countries in our test was based, besides a general comparative interest, on the absence of longitudinal data allowing to conduct statistical tests for Kosovo alone. Therefore, our design strategy was to build up a multi-country database so that we can first run cross-sectional correlation tests, and then discuss the results comparatively by zooming in on the position that Kosovo occupies in relation to other countries.

The selection and construction of indicators were inspired by, or indeed collected out of the literature review. Indicators 2 to 5 in the summary table were taken from Williams, Kedir and Nadin (2013), which originally inspired us to follow up on their statement of a relationship between the informal economy and welfare state systems. We borrowed and replicated their operational definitions to retrieve the data on Kosovo and added this to the dataset.

Variable	Description	Operational definition and Sources	Unit of Measurement
(1) Informal Economy	Measure of undeclared economy practices	Calculation of the size of informal economy was done with Multiple Indicators and Multiple Courses (MIMIC)[4] estimation procedure. (Schneider 2015)/ For the case of Kosovo the calculation of the size was done with interviews with private business managers (Riinvest 2013)	% of GDP
(2) Social Protection Expenditure	Measure of states' social protection expenditure as part of their welfare state systems	Encompasses all interventions from public to private bodies intended to relieve households and individuals of the burden	% of GDP

[3] The countries are Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Great Britain, Greece, Hungary, Iceland, Ireland, Italy, Kosovo, Lithuania, Latvia, the Netherlands, Norway, Poland, Portugal, Romania, Slovenia, Slovakia, Spain, Sweden and Switzerland.

[4] Refer to Schneider (2011) and Schneider and Williams (2013) for detailed explanation.

		of defined risk or need. It includes expenditures for the following services: Sickness/Heath care, Disability, Old Age, Survivors, Family/Children, Unemployment, housing and Social exclusion[5] (Eurostat; Ministry of Finance 2013)	
(3) Social Protection Expenditure (excl. Old Age pension)	Measure of states' social protection expenditure, excluding old age pensions, as part of their welfare state systems	Encompasses all interventions from public to private bodies intended to relieve households and individuals of the burden of defined risk or need, but old age pension benefits (Eurostat; Ministry of Finance 2013)	% of GDP
(4) Labor Market Policies	Measure of states' labor intervention policies in accordance of their welfare state systems	Encompasses all state interventions explicitly targeted at groups of people with difficulties in labor market: unemployed, employed but at risk of involuntary jobs loss, inactive people but in search of entering labour market[6] (Eurostat; Ministry of Finance 2013)	% of GDP
(5) Social Protection Effectiveness (excl. pensions)	Measure of states' social protection effectiveness in tackling poverty rates	Calculated comparing at-risk-of poverty rates before social transfers with those after transfers –pensions are not considered as social transfers in these calculations (Eurostat)	Reduction in % of the risk of poverty rate, after social transfers
(6) Voice and Accountability	Measure of the perception on political process, civil liberties, and political rights	Aggregated measure constructed by averaging together data from the underlying source that	Scale of 0 to 10, 10 = the highest rank

[5] See Social Protection metadata at http://ec.europa.eu/eurostat/cache/metadata/en/spr_esms.htm#unit_measure1488807446916

[6] See Labour Market Policy metadata at http://ec.europa.eu/eurostat/cache/metadata/fr/lmp_esms.htm

		correspond to the voice and accountability[7] (World Bank)	
(7) Political Stability	Measure of the perception of the likelihood that a government in power may be destabilized or overthrown by possible violent means, including domestic violence and terrorism	Aggregated measure constructed by averaging together data from the underlying source that correspond to the political stability[8] (World Bank)	Scale of 0 to 10, 10 = the highest rank
(8) Government Effectiveness	Measure of public service quality, the independence of the civil service from political pressures, and the government's commitment to policies	Aggregated measure constructed by averaging together data from the underlying source that correspond to the government effectiveness[9] (World Bank)	Scale of 0 to 10, 10 = the highest rank
(9) Regulatory Quality	Measure of perceptions of the ability of the government to implement policies and regulation that allow and promote private sector	Aggregated measure constructed by averaging together data from the underlying source that correspond to the economic regulatory quality (World Bank)[10]	Scale of 0 to 10, 10 = the highest rank
(10) Rule of Law	Measure of the extent to which people abide by the rules of society, and have confidence on the judiciary system	Aggregated measure constructed by averaging together data from the underlying source that correspond to the rule of law[11] (World Bank)	Scale of 0 to 10, 10 = the highest rank
(11) Control of Corruption	Measure of the perception of the corruption	Aggregated measure constructed by averaging together data from the underlying source that	Scale of 0 to 10, 10 = the highest rank

[7] See Worldwide Governance Indicators' representative source for voice and accountability at http://info.worldbank.org/governance/wgi/index.aspx#doc

[8] See Worldwide Governance Indicators' representative source for political stability: ibid

[9] See Worldwide Governance Indicators' representative source for government effectiveness: ibid

[10] See Worldwide Governance Indicators' representative sources for regulatory quality: ibid

11 See Worldwide Governance Indicator's representative sources for rule of law: Ibid

		correspond to the corruption perception[12] (World Bank)	
(12) Governance Quality	Measure of the government quality	Calculated mean value of indicators ,6, 7, 8, 9, 10 and 11 (Author's calculation)	Scale of 1 to 10, 10 = the highest rank
(13) General Trust	Measure of trust in other people	A3: Generally speaking, would you say that most people can be trusted, or that you can't be too careful[13] in dealing with people? (ESS 6).Expressed in mean value per country (Author's calculation)	Scale of 0 to 10, 0= you can't be too careful, 10 = most people can be trusted
(14) Trust in other's Help	Measure of trust in other people's willingness to help out	A4: Do you think that most people would try to take advantage[14] of you if they got the chance, or would they try to be fair? (ESS 6) Expressed in mean value per country (Author's calculation)	Scale of 0 to 10, 0= most people would try to take advantage of me, 10= most people would try to be fair
(15) Trust in other's Fairness	Measure of trust in people' willingness to be fair to you	A5: Would you say that most of the time people try to be helpful[15] or that they are mostly looking for themselves? (ESS 6). Expressed in mean value per country (Author's calculation)	Scale of 0 to 10, 0= people mostly look out for themselves, 10= people try to be helpful
(16) Trust	Summary measure of people's trust in others	Calculated mean value of indicators 13, 14 and 15 per country (Author's calculation)	Scale of 0 to 10, 0=no trust , 10= complete trust
(17) Trust in Parliament	Measure of trust towards parliament	B2: Please tell me on a score of 0-10 how much you personally trust each of the institutions I read out; Parliament (ESS 6). Expressed in mean value per country (Author's calculation)	Scale of 0-10, 0= no trust at all, 10=complete trust

12 See Worldwide Governance Indicator representative sources: Ibid

13 'Can't be too careful': need to be wary or always somewhat suspicious

14 'Take advantage': exploit or cheat; 'fair': in the sense of treat appropriately and straightforwardly

15 The intended contrast is between self-interest and altruistic helpfulness

(18) Trust in Legal System	Measure of trust towards legal system with regard to the its fairness and effectiveness	B3: Please tell me on a score of 0-10 how much you personally trust each of the institutions I read out; The legal system (ESS 6).Expressed in mean value per country (Author's calculation)	Scale of 0-10, 0= no trust at all, 10=complete trust
(19) Trust in Politicians	Measure of trust towards politicians	B5: Please tell me on a score of 0-10 how much you personally trust each of the institutions I read out; Politicians (ESS 6). Expressed in mean value per country (Author's calculation)	Scale of 0-10, 0= no trust at all, 10=complete trust
(20) Trust in Political Parties	Measure of trust towards political parties	B6: Please tell me on a score of 0-10 how much you personally trust each of the institutions I read out; Political Parties (ESS 6). Expressed in mean value per country (Author's calculation)	Scale of 0-10, 0= no trust at all, 10=complete trust
(21) Trust in Formal Institutions	Summary measure of citizens' trust towards formal institutions	Calculated mean value of indicators 17, 18, 19, and 20 per country (Author's calculation)	Scale of 0 to 10, 0= no trust at all, 10=complete trust
(22) Legitimacy of Claiming Unentitled State Benefits	Measure of people's willingness to accept cheating on state benefits	QE20_1: How would you rate various actions or behaviors; Someone receives welfare payment without entitlement (Eurobarometer 79.2). Expressed in mean value per country (Author's calculation)	Scale of 1 to 10, 1 = absolutely acceptable, 10= absolutely unacceptable
(23) Legitimacy of Avoiding to Pay Public Transportation Fare	Measure of people's attitude towards free riding practices	QE20_2: How would you rate various actions or behaviors; Someone uses public transport without a valid ticket (Eurobarometer 79.2). Expressed in mean value per country (Author's calculation)	Scale of 1 to 10, 1 = absolutely acceptable, 10= absolutely unacceptable

(24) Legitimacy of Undeclared Income	Measure of people's attitude toward informal economic practices	QE20_6: How would you rate various actions or behaviors; A firm hires an individual and all or part of the wages to him/her are not officially declared (Eurobarometer 79.2). Expressed in mean value per country (Author's calculation)	Scale of 1 to 10, 1 = absolutely acceptable, 10= absolutely unacceptable
(25) Legitimacy of Unregistered Salary	Measure of peoples' attitude towards informal economic practices	QE20_7: How would you rate various actions or behaviors; Someone evades taxes by declaring or only partially declaring their income (Eurobarometer 79.2). Expressed in mean value per country (Author's calculation)	Scale of 1 to 10, 1 = absolutely acceptable, 10= absolutely unacceptable
(26) Civic Norms	Measure of people's attitude towards free riding and cheating	Computed measure based on the aggregated mean value from the variable number 21, 22, 23 and 24 per country (Author's calculation)	Scale of 1 to 10, 1 = absolutely acceptable, 10= absolutely unacceptable
(27) Membership to chamber of commerce/Industry/Agriculture	Measure of people's associational networking	QE_4: Are you member of any of the following types of non-governmental organizations or associations; Chamber of Commerce/Industry (Flash Eurobarometer 373).	1 if mentioned, 0 If otherwise
(28) Membership in Professional Association	Measure of peoples' associational networking	QE_4: Are you member of any of the following types of non-governmental organizations or associations; Professional association such as doctors, teachers, farmers etc? (Flash Eurobarometer 373).	1 if mentioned, 0 If otherwise
(29) Membership in Trade Unions	Measure of peoples' associational networking	QE_4: Are you member of any of the following types of non-governmental organizations or associations; Trade Union? (Flash Eurobarometer 373).	1 if mentioned, 0 If otherwise

(30) Membership in organization with specific activity in economic, social, environment, cultural or sport interest	Measure of peoples' associational networking	QE_4: Are you member of any of the following types of non-governmental organizations or associations; Organization with a specific economic, social, environmental, cultural or sporting interest? (Flash Eurobarometer 373).	1 if mentioned, 0 if otherwise
(31) Associational Activity	Measure of peoples' engagement in horizontal networking through different membership in certain associations	Aggregated measure based on the average number of groups cited in variables 27, 28, 29 and 30 for each country (Author's calculation)	

Table 2. Summary of Indicators

The values for indicators 2, 3, and 4 as used by Williams, Kedir, and Nadin (2013) were not available for Kosovo in the Eurostat database, hence we calculated those based on annual governmental spending recorded in the *Financial Mirror* of the Ministry of Finance (2013), as percentage of Kosovo's GPD in 2013 (World Bank), converting the GDP value obtained from the World Bank data expressed in US$ to EUR currency using the appropriate exchange rate. Unfortunately, we could not compute indicator 5 for Kosovo, for want of data. Nevertheless, we still found it reasonable to include this indicator, in order to make an educated assumption as to where Kosovo would likely perform in this indicator, based on theoretical support provided in the literature review, the correlational models for this particular indicator as compared to the others where Kosovo is present, and the qualitative data obtained in our interviews.

Indicators 6 to 11 were taken from Torgler and Schneider (2003), which used Worldwide Governance Indicators to test for correlation between tax morality and institutional quality. However, we manipulated the unit of measurement for convenience, by turning the original percentage scale into a 1-10 scale. Moreover, we computed a summary 'governance quality' indicator (12), as the mean value of indicators 6, 7, 8, 9, 10, and 11.

Another set of indicators inspired in the literature review comprises those numbered 13, 22 through 25, collected in the European Social Survey; and 27 through

30, from Eurobarometer. These operationalize two dimensions of social capital as defined by Putnam (1993), and Knack and Keefer (1997). Indicator 13, as used by Knack and Keefer, measures people's generalized trust in others. To that, we added indicators 14 and 15, which grasp two more precise meanings of trust in others' fairness and selflessness. We also computed a new summary indicator named 'trust' (16), as the mean value of the three preceding ones. Indicators 22 through 25 stand for civic norms as a measure of people's attitude towards cheating and free-riding (Knack and Keefer 1997), while 27 through 30 operationalize the concept of horizontal association (Putnam 1993) or associational activity (Knack and Keefer 1997). We emulated Knack and Keefer's methodology in computing two distinct variables, namely, civic norms (26) and associational activity (31). Unfortunately, we were not able to obtain data for Kosovo in regard to the later variables. This was, firstly, because Kosovo was not part of the Eurobarometer 79.2 and Eurobarometer 373, which were the source of extraction for these two variables. Secondly, no alternative studies were available either from domestic and international actors that provided us with any raw statistical data on the two respective variables. Despite that, we decided to include this indicator in our study for the same reasons and purpose as in indicator 5.

Lastly, indicators 17 through 20, found in the European Social Survey, provide operational approaches to institutional asymmetry as defined in Gerxhani (1999) and Williams and Franic (2016). We added summary indicator 21 'trust in formal institutions', as the mean value of the former indicators.

The hypotheses were tested using the bivariate Pearson correlation coefficient and ordinary least squares linear regression. We used IBM SPSS v.20 software for all data processing.

CHAPTER III: EMPIRICAL FINDINGS

1. Welfare state

In order to test our first core hypothesis, we used three indicators for welfare state policies' expenditure, namely expenditure on social protection benefits, with and without old age benefits, and on labour market policies, testing for bivariate Pearson correlation coefficient with informal economy. We found a strong significant negative correlation between all the welfare expenditure indicators and the size of informal economy. This finding supports our core hypothesis (1), which presumes that inefficient welfare state programs and high economic informality reciprocally contribute to each other. Results yielded from our test are in line with Williams and Renooy (2013) original findings.

As figure 8 shows, the lower the countries' levels of expenditures on social protection benefits, the larger is the informal economy (r_p= -.755**). Moreover, we found that 58% of the variance of the size of informal economy is correlated with the variance of the social protection benefits (adjusted R^2= 0.586). As such, we found that countries which allocated higher proportion of GDP on social protection benefits register smaller informal economy. In addition, figure 9 displays that social protection benefits (excluding old age benefits) and informal economy register an even higher significant negative correlation (r_p= -.829**), and social protection benefits (excluding old age benefits) accounts for as high as 67% of the size for the informal economy (adjusted R^2= .675).

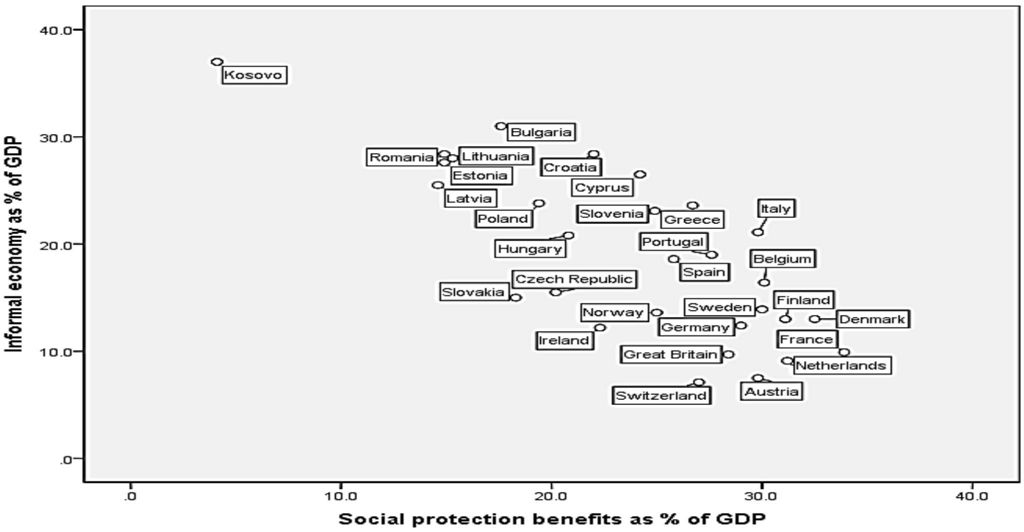

Figure 8. The negative correlation between informal economy and social protection benefits (Schneider 2015; Eurostat; Ministry of Finance 2013, computed by the author; Riinvest 2013)

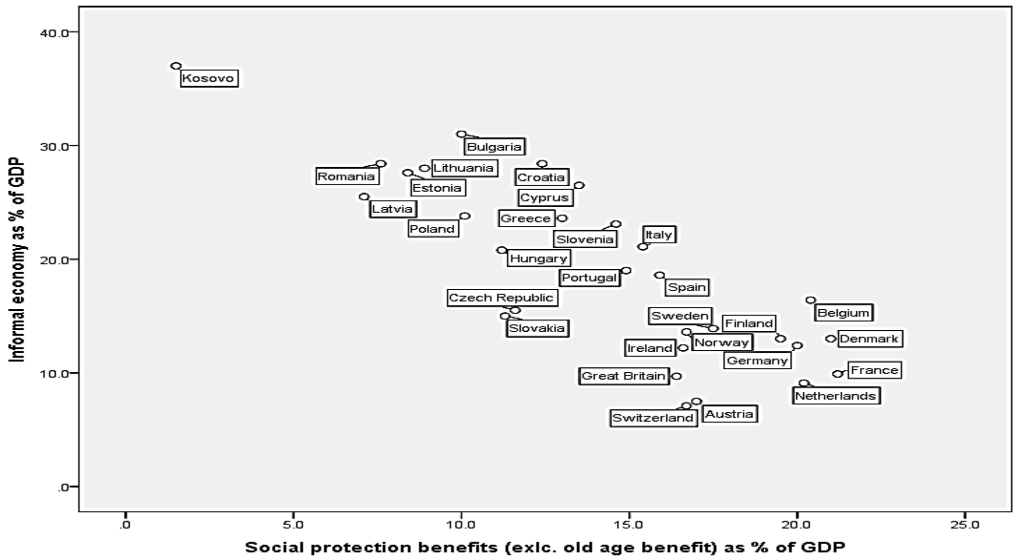

Figure 9. The negative correlation between informal economy and social protection benefits, excluding old age benefits (Schneider 2015; Eurostat; Ministry of Finance 2013, computed by the author; Riinvest 2013)

Figure 10 displays a lower, but still significant correlation between the size of informal economies and the amount of states' expenditures on labor market interventions (r_p= -.628), accounting for 37% of the variance in the former (adjusted R^2= .371). These results show that countries that interfere more in their labor markets through protection policies tend to have significantly lower levels of informal economy.

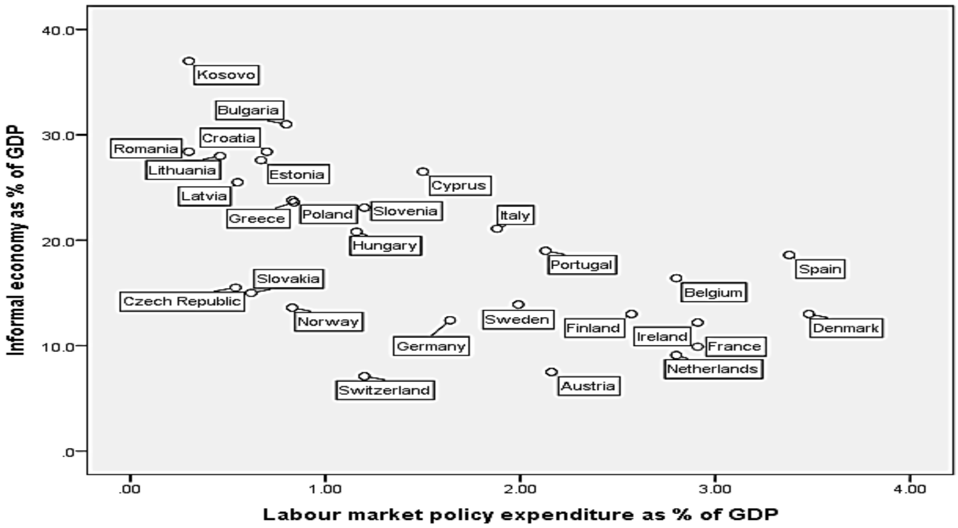

Figure 10. The negative correlation between informal economy and labour market policy expenditures (Schneider 2015; Eurostat; Ministry of Finance 2013, computed by the author; Riinvest 2013)

Our findings seem consistent with a structuralist approach. As argued above in the literature review, the latter advocates for more market regulation, state intervention and higher social protection spending in order to minimize informal economic practices. However, we express caution with regards to the result, given that although they do suggest that such a relationship exists, our current results are not equipped to provide evidence for the causal direction, and indeed our hypotheses on this matter are stated in terms of reciprocal relationships between the two, rather than liner causation.

More specifically concerning our sub **hypothesis 1(a),** we used the social protection effectiveness indicator, excluding expenditure on old age pensions. The results, as displayed in figure 11, show a significant negative correlation with the size of informal economies (r_p= -.697), accounting for 47% of total variance (R^2= .467). Countries that register lower reduction in risk poverty rate after social transfers are distributed, tend to have significantly higher levels of informal economy. This finding supports our sub-hypothesis 1(a), which states that poorly managed welfare programs contribute to the size of informal economy, and sub-hypothesis 1(c) which acts as circular in respect to sub-hypothesis 1(a) by stating that informal economy contribute to the size and the effectiveness of welfare state programs.

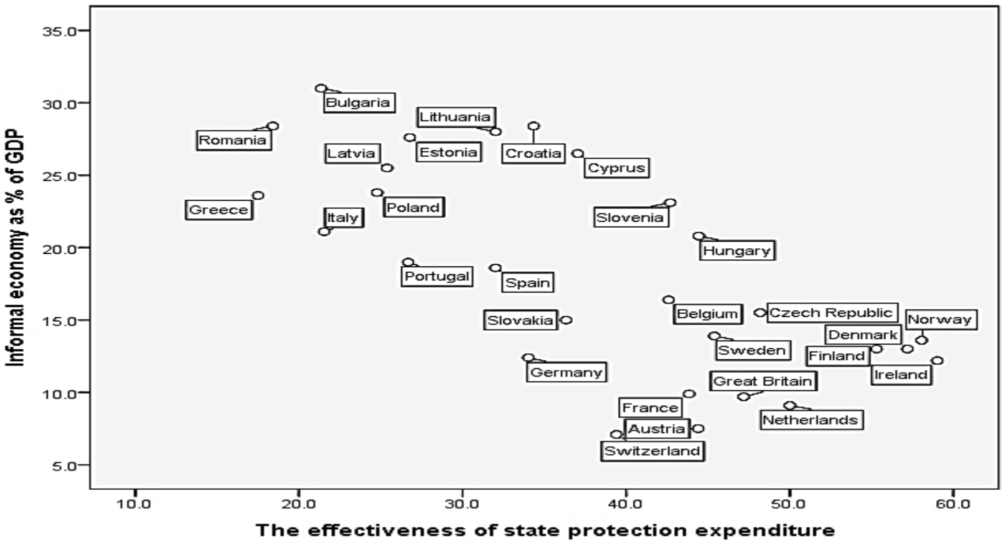

Figure 11. The negative correlation between informal economy and the effectiveness of state protection expenditure (Schneider 2015; Eurostat)

A statistically significant correlation was also found between welfare benefits expenditures and effectiveness, and citizens' perception of governance quality and trust in public institutions. In order to assess our assumption in hypothesis 1(b) that poorly funded and managed welfare programs contribute to lower citizens' trust in public institutions and perception of governance quality, we used social protection benefits, with and without old age benefits, state protection effectiveness and labour market policy as indicators of welfare programs' funding and management, and tested for correlation with trust in formal institutions and governance quality indicators.

Figures 12 and 13 display positive correlations between social protection benefits and governance quality, as well as trust in public institutions respectively. Countries that spend more on social protection benefits significantly tend to have higher governance quality (r_p= .712), and trust in formal institutions (r_p= .537).

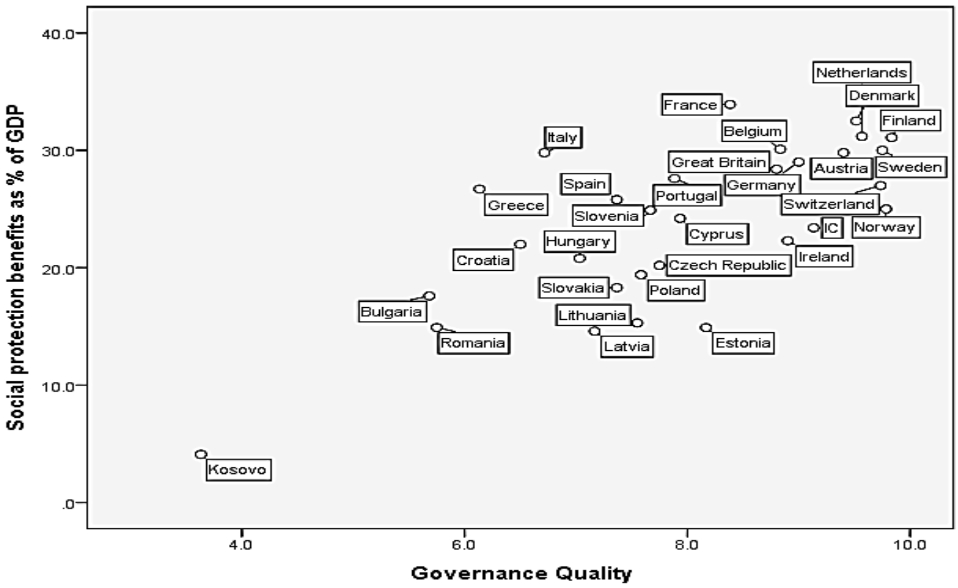

Figure 12. The positive relation between social protection benefits and governance quality (World Bank, computed by the author; Eurostat; Ministry of Finance 2013, computed by the author)

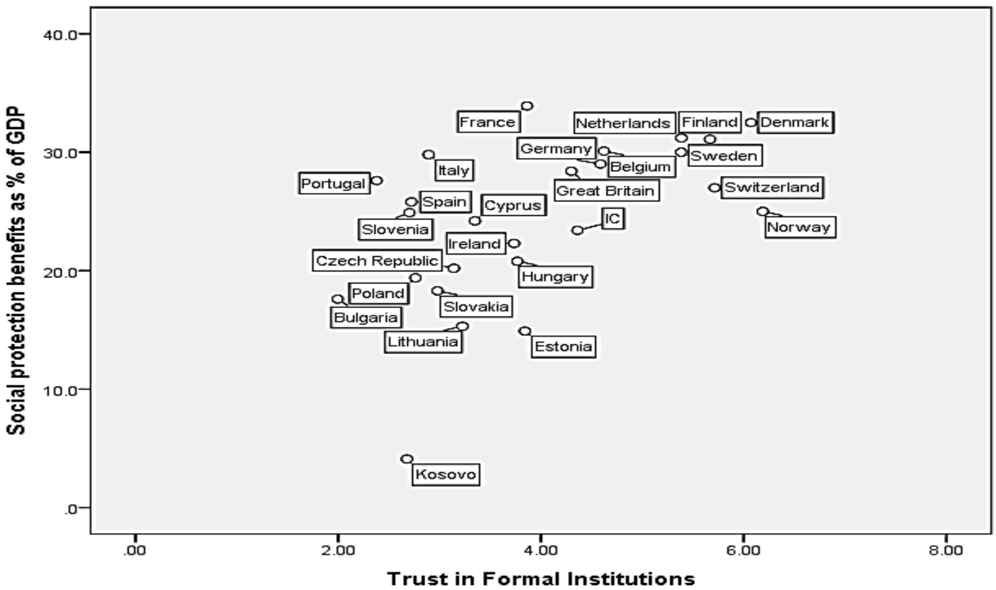

Figure 13. The positive relation between social protection benefits and trust in formal institutions (European Social Survey 6, computed by the author; Eurostat; Ministry of Finance 2013, computed by the author)

A similar outcome was yielded by correlation tests between social protection benefits, excluding old age benefits, on the one hand, and governance quality and trust in public institutions, on the other. As displayed in figure 14 and 15, both tested for significant positive correlations (r_p= .804, and r_p= .635, respectively).

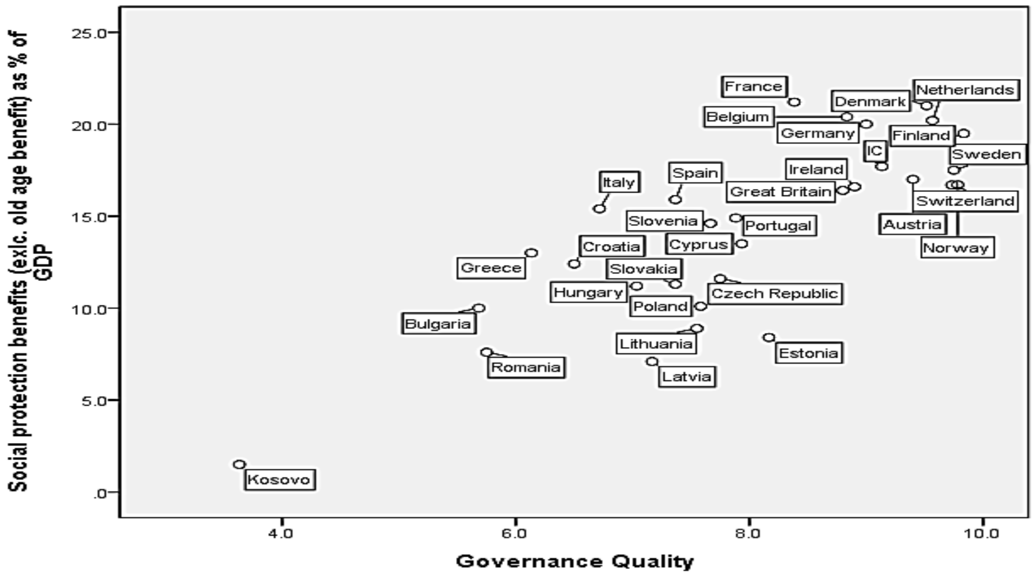

Figure 14. The positive relation between social protection benefits (excluding old age benefits) and governance quality (World Bank, computed by the author; Eurostat; Ministry of Finance 2013, computed by the author)

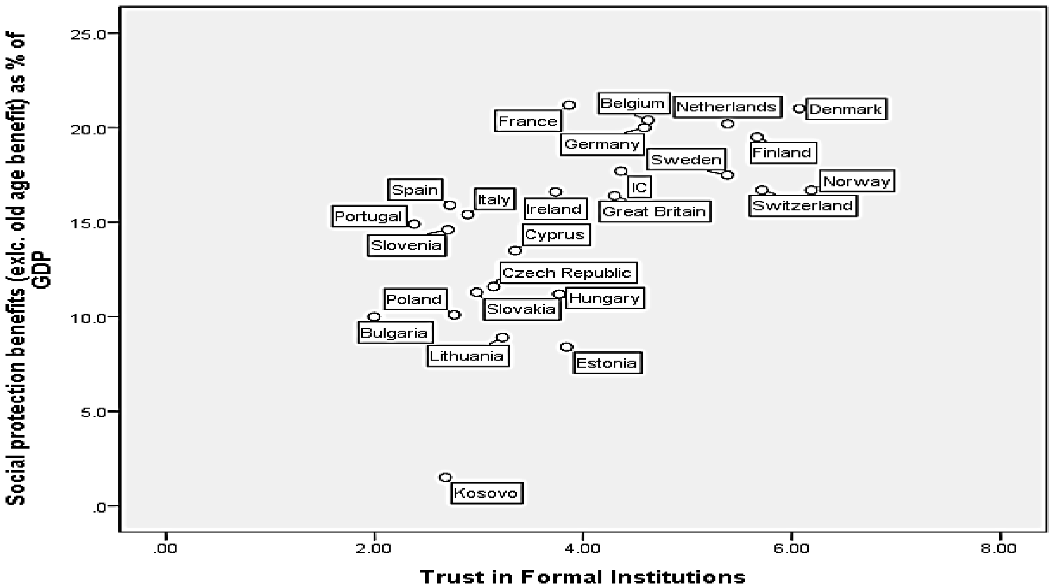

Figure 15. The positive relation between social protection benefits (excluding old age benefits) and trust in formal institutions (European Social Survey 6, computed by the author; Eurostat; Ministry of Finance 2013, computed by the author)

Figure 16 below displays the significant positive correlation found between another welfare program indicator, namely labour market policy and citizens' perception on governance quality (r_p= .566). However, contrary to our expectations, we found no statistical significance between expenditure in labor market policies and trust in formal institutions.

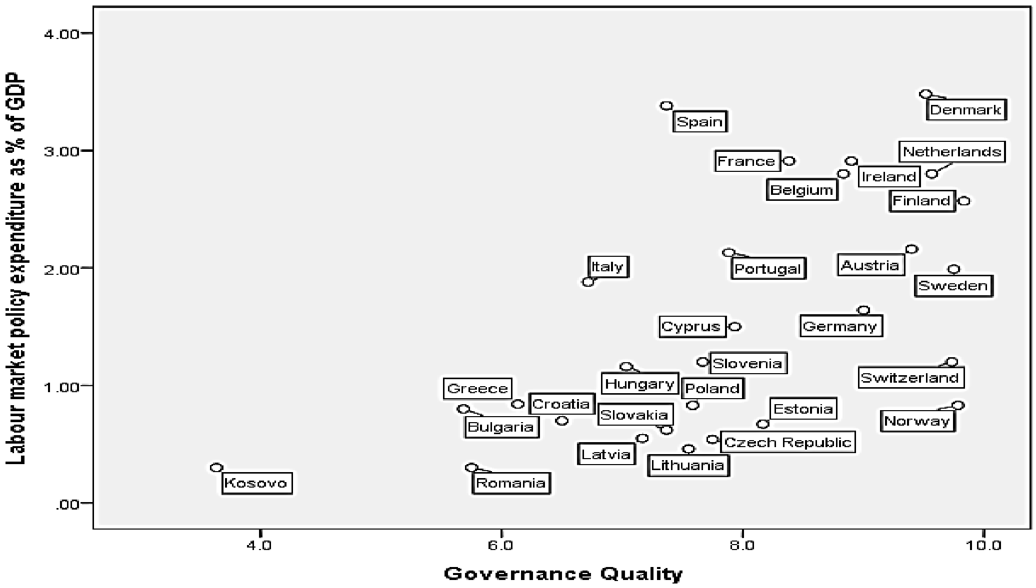

Figure 16. The positive relation between labour market policy and governance quality (World Bank, computed by the author; Eurostat; Ministry of Finance 2013, computed by the author)

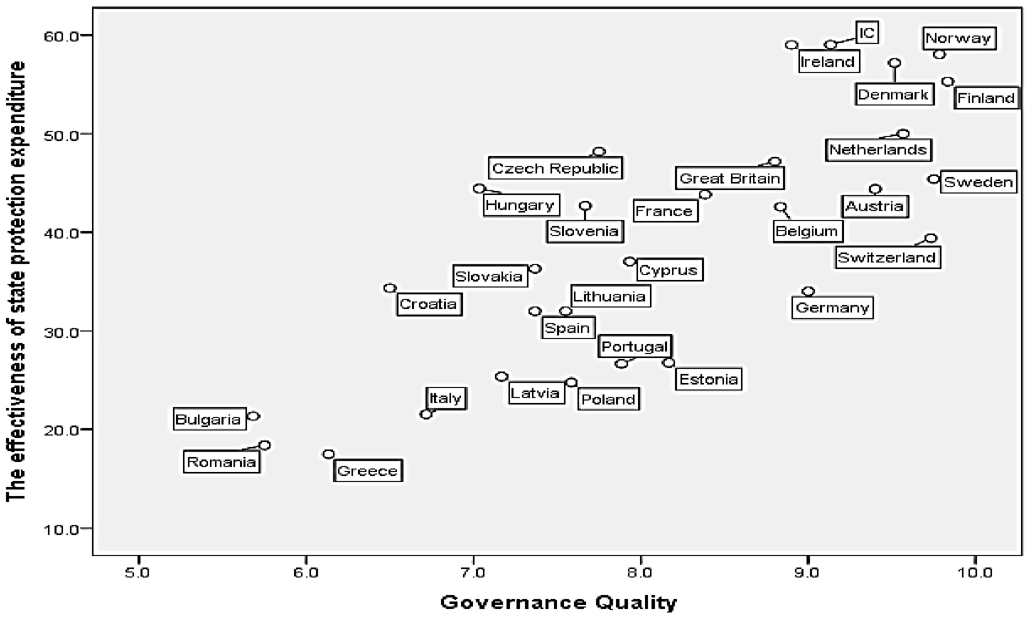

Figure 17. The positive relation between state protection effectiveness and governance quality (World Bank, computed by the author; Eurostat)

Lastly, figures 17 and 18 display positive correlations between successfully managed welfare programs, higher governance quality (r_p= .780) and trust in formal institutions (r_p= .684).

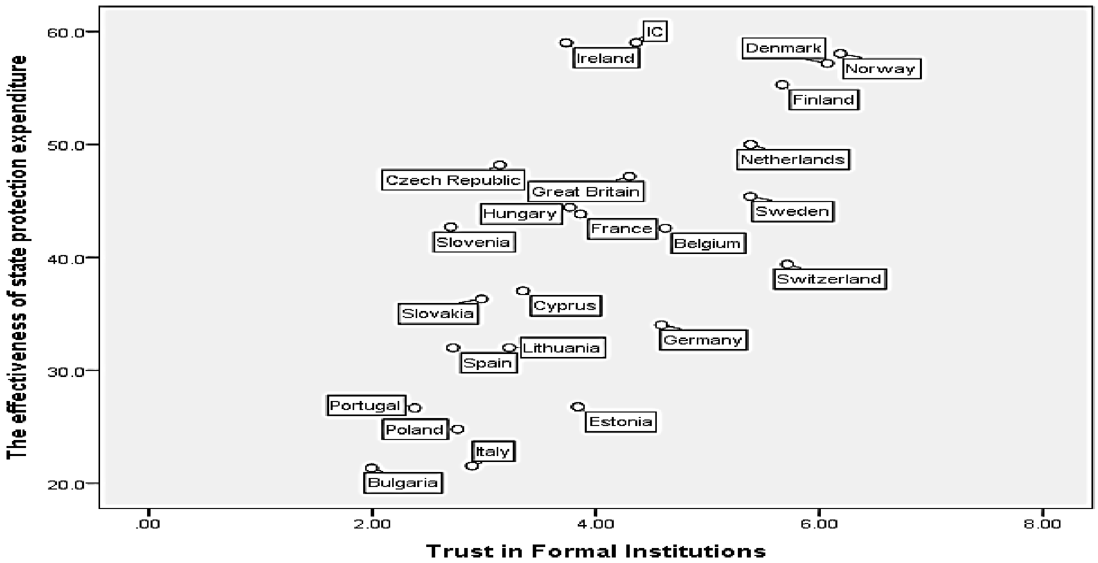

Figure 18. The positive relation between state protection effectiveness and trust in formal institutions (European Social Survey, computed by the author; Eurostat)

Therefore, with the exception of the presumed relationship between expenditure in labour market policies and trust in formal institutions, the significant correlations found in the rest of the cases endorse our hypotheses that countries that experience higher welfare state programs funding and effectiveness, also rate significantly higher governance quality, citizens' trust in formal institutions, and lower sizes of informal economy.

2. Social capital

Our second core hypothesis was tested by using three indicators, those of social trust, associational activity and civic norms, in relation to informal economy. Given our theoretical assumption that social capital contributes to lower levels of informal economy, the purpose of the test was to assess whether those indicators partake in a statistically significant correlation with the size of informal economy. We found out that two out of three indicators, namely social trust and associational activity, are significantly correlated with informal economy, unlike that of civic norms.

Figure 19 displays that countries that register higher social trust tend to have significantly smaller informal economies (r_p= .638), accounting for 38% of the variance in the size of informal economy (adjusted R^2= 0.380). This outcome statically supports our sub-hypothesis 2(a).

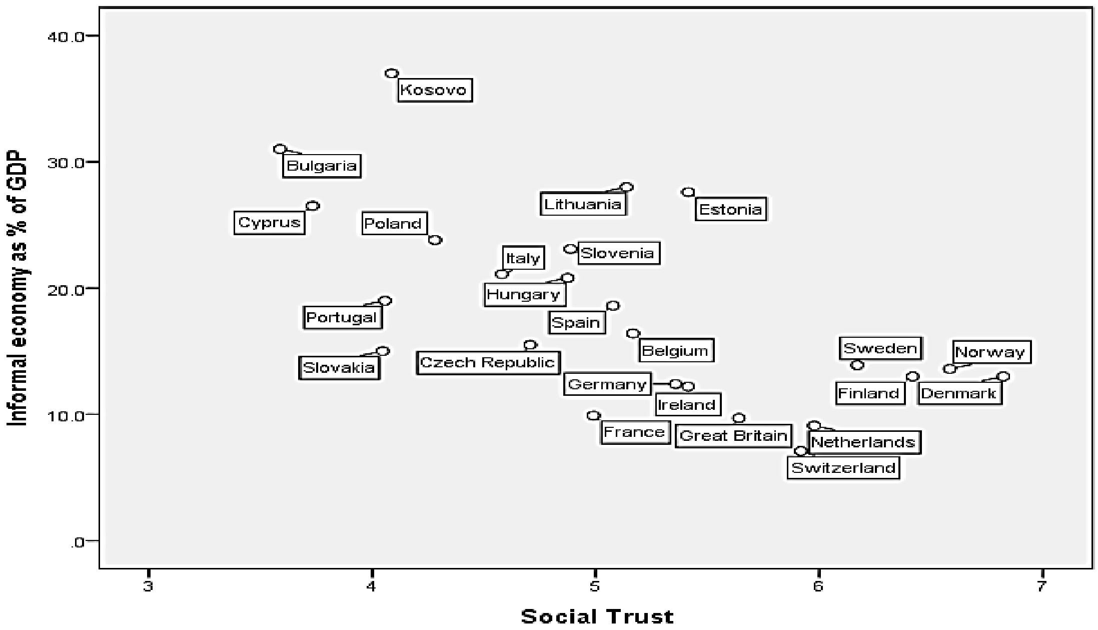

Figure 19. The negative relation between informal economy and social trust (Schneider 2015; European Social Survey 6, computed by the author; Riinvest 2013)

Figure 20 also illustrates the statistically significant negative correlation found between informal economy and associational activity (r_p= -.659), accounting for 46% of the variance (adjusted R^2= .460). Countries that engage in more associational activity, or horizontal networking in Putnam's terms, tend to have smaller informal economies. This empirical outcome supports our sub-hypothesis 2 (c).

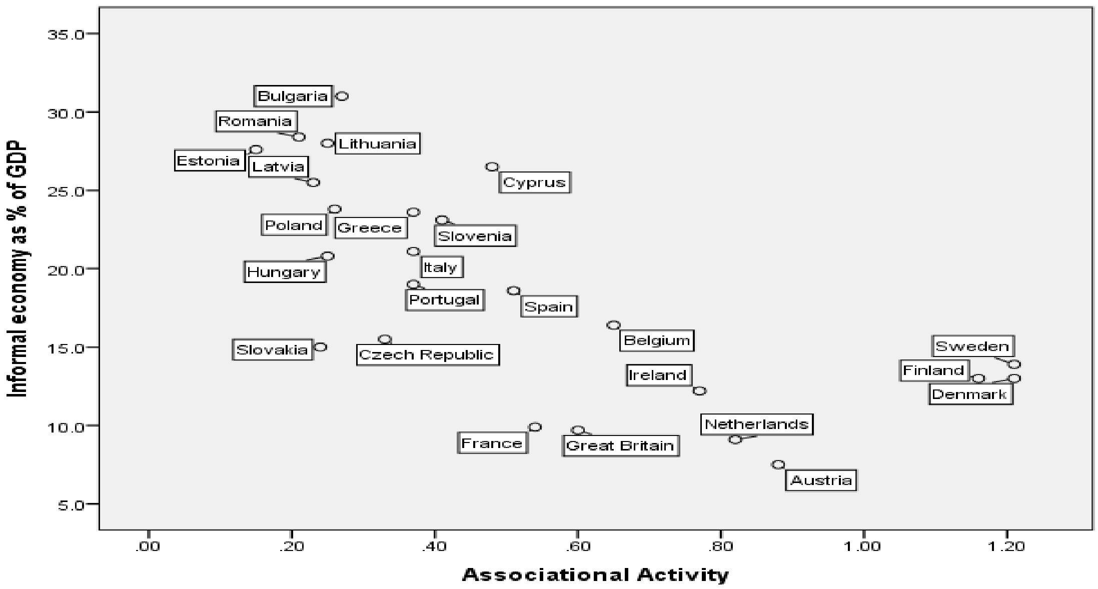

Figure 20. The negative relation between informal economy and associational activity (Schneider 2015; Eurobarometer 373, computed by the author)

Contrary to our hypothesis 2(b), however, that shared civic norms against informal economic practices and free-riding practices contribute to lower the levels of informal economy, we have found no statistical significant correlation between civic norms and informal economy.

3. Institutional asymmetry

Our third core hypothesis assumed that greater asymmetry between formal and informal institutions contributes to greater propensity to engage in the informal economic sector, and it was tested using trust in formal institutions and perception of governance quality as the two respective representative indicators for the two sub-hypotheses 3(a) and 3(b).

Figure 21 displays a significant negative correlation between the size of informal economies and trust in formal institutions (r_p= -.667), which accounts for 42% of the variance (adjusted R^2= .419), which lends support to our sub-hypothesis 3(a).

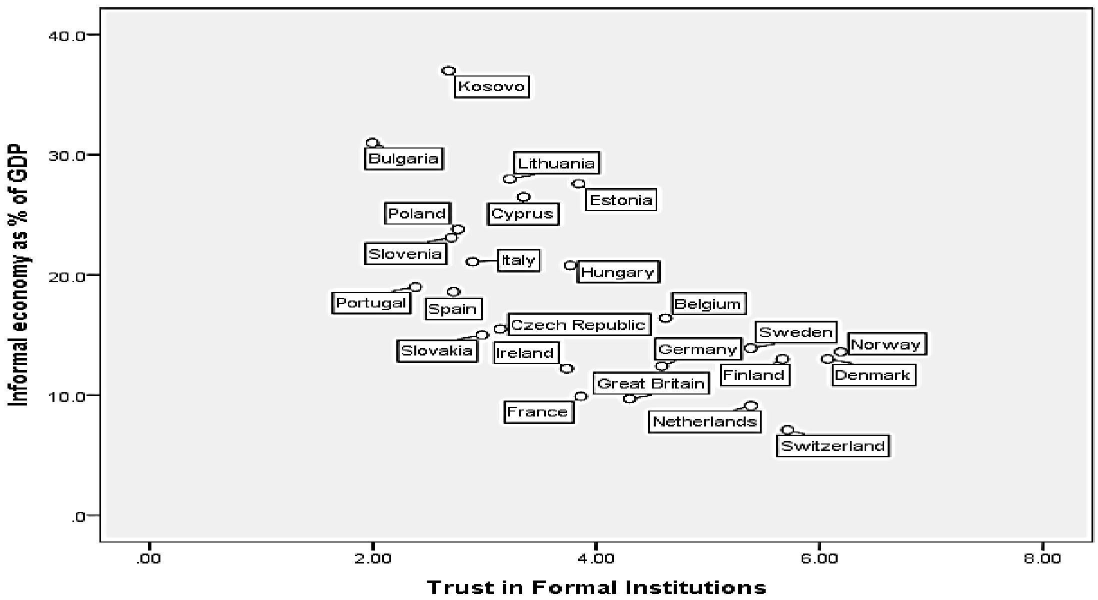

Figure 21. The negative relation between informal economy and trust in formal institutions (Schneider 2015; European Social Survey 6, computed by the author; Riinvest 2013)

Lastly, figure 22 displays a statistically strong negative correlation between the size of informal economies and governance quality (r_p = -.845), the highest correlation among the entire set of indicators, accounting for 70% of variance (R^2= .703), also signifying the higher variance score. Accordingly, countries that have higher perception on governance quality have smaller informal economy. The outcome of this correlation confirms our hypothesis 3(b) that perceived governance quality contributes to lower levels of informal economy.

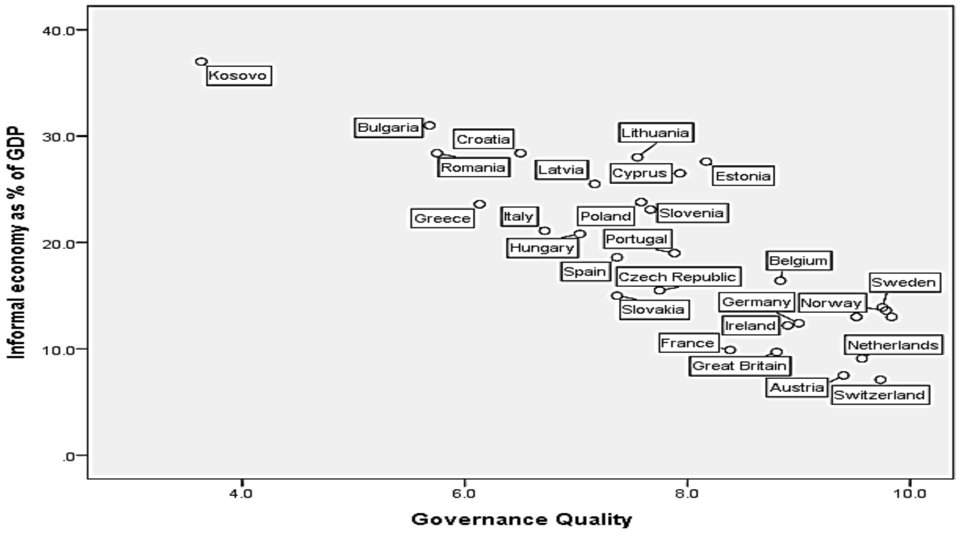

Figure 22. The negative relation between informal economy and governance quality (Schneider 2015; World Bank, computed by the author; Riinvest 2013)

Taken together, both correlations support that institutional asymmetry affects the size of informal economies. This is important to our argument in that hypothesis 3 represents the closing end of the sub-hypothesis 1(b), in terms of the significance that the formal institutions carry in their relation to the size of informal economy and welfare state. We thus find that countries that enjoy higher governance quality and trust in formal institutions, and also exhibit higher welfare state expenditure shown by the relationship confirmed above concerning sub-hypothesis 1(b), tend to experience lower levels of informality. Even though we cannot provide proof of a linear cause-effect relationship, an empirical relationship between welfare programs, formal institutions and informal economy is evident.

4. The case of Kosovo

We shall now zoom in on the position that Kosovo occupies in relation to other countries, with regard to our core hypotheses. Figure 1 displays Kosovo standing alone as the country with the highest informal economy rate of 37%, and the lowest social protection benefits, of only 4.1% of GDP (Ministry of Finances 2013). The closest group in terms of social protection benefits expenditure and size of informal economy are other former socialist countries of Romania, the Baltics, and Bulgaria. At the other end of the linear distribution we find a constellation of North West European countries, the cases with highest social protection expenditures and lowest informal economy. In-between, generally we find South European countries and some Central East European countries with socialist past such as Slovenia, Slovakia, the Czech Republic, Hungary, Croatia, and Poland which to a considerable extent lean towards post socialist countries in the higher end of figure. If a categorization of countries with regard to the relation between informal economy and social protection benefits were to be made, we would have three particular categories; North-West European countries at the lower end of informal economy sizes, South European and Central East European post-socialist countries which experienced a rather successful political and economic transition to market-based economy at the middle, and East and South East post-socialist European countries, including Kosovo, at the higher end.

An almost identical pattern can be found in the figure 2, as indeed throughout the remaining figures. Strikingly, Kosovo’s social protection benefits, once old age benefits are excluded, drop to only 1.5% of GDP (Ministry of Finances 2013), a decrease by around 65%, unlike in any other European countries (Eurostat 2013). This uncovers an important characteristic of Kosovo’s welfare system, which definitely revolves around pensions expenditures.

As we have described, Kosovo employs a neo-liberal welfare system, founded on three main schemes. Such kind of systems is heavily reliant on healthy market-based economy, effective state mechanisms capable of taxing economic activities, and citizens’ individual contributions to pension funds. The literature review has shown us that Kosovo is, at best, still in a developing stage of a mature market economy. In spite of progress having been made, formal institutions remain fragile and prone to mismanagement, incompetency and corruption allegations. According to our interviewee Mrs. Arberesha Loxha, from the Group for Legal and Political Studies, it was only recently that the government has shown any interest in addressing the issue of informality. Measures to tackle this problem have been introduced, in the form of a new fiscal package which lowered the rate of Value Added Tax (VAT) for basic products, a nationwide campaign of fiscal coupons reimbursement as an incentive to insert the practice of businesses to release fiscal coupons for each purchase, increased supervision of the building sector and of petrol businesses (interview with Loxha 2017). With the exception of the reimbursement campaign, which has been received very well in public (interviews with Krasniqi; Loxha), the rest of the measures are yet to mark any considerable success. Changes in VAT rate were met with strong criticism and assessed as counterproductive (interview with Loxha). Concerns remain about the successful fiscal control of petrol businesses (interview with A. Demi), and the building sector remains the largest sector operating informally (interviews with Azemi; A. Demi; Krasniqi; Merovci).

It is vital to emphasize that Kosovo continues to be politically challenged within its own territory. Although publicly declared otherwise, Kosovo continues not to have absolute control over around 13% of its territory in the north, which is mainly populated by Kosovo Serbs. For Agron Demi from GAP Institute, this represents one source of economic instability in Kosovo. He goes on to say that the petrol derivatives as well as other products are often smuggled in Kosovo from Serbia through alternative routes, and cases of that happening are fairly evident. Lack of control over that region harms economic competition in the rest of the territory. Notably, labor and tax inspection is rather absent in that part of the territory, as none of the representatives of the relevant institutions during our field research felt confident to confirm the presence of the state's institutional authority over there.

The private sector has struggles of its own. Corruption, lack of rule of law, administrative barriers to some extent, and unfair businesses environment are often listed as the major fallbacks that the market economy faces in Kosovo (Interviews with Hashani; Loxha 2017). As such, labor laws are blatantly violated in the private sector, and very little has been done in that regard. From our field research, it is evident that human resources lack both in the labor inspection department as well as tax administration (Interviews with Krasniqi; Leci). There are 52 labor inspectors in Kosovo, assigned to supervise over 110,000 registered businesses, and the responsibility this puts upon these inspectors is all but unbearable. Basing his stand on analysis conducted by GAP, Mr. Agron Demi notes that while according to labor laws, each business should be inspected at least once a year, based on the human capacities available to the respective institution this means that "one inspector should work in average every day of the week, including weekends, and visit at least 50 businesses a day", pointing out at the problem with implementing the legislative framework, where "laws have been passed but the requisites and enough budgetary support have not been met" (interview with A. Demi). Recommendations to increase the number of inspectors and human resources have been reported, from both domestic and international actors (interviews with Azemi; A. Demi; Hashani; Krasniqi; Leci), however, they have never been addressed.

Thereupon, practices such as informal employment in the private sector go as high as 50%, according to Mr. Jusuf Azemi, president of Trade Unions in Kosovo. Azemi goes on to denounce the unfavorable conditions under which employees in the private sector operate; 80% of them experience delays in their monthly salaries, constantly work with short term contract of 3 to 6 months, and pensions contributions are often not paid. These circumstances endanger the welfare of the employees, who enjoy the returns of their work only in short term, and retirement plans are deemed a luxury (interview with Azemi). In addition to job insecurity, hazardous workplace conditions are also a serious concern, especially for those operating in the building sector. Therefore, Azemi fears that a cultural acceptance of these terms and conditions has been established, and working without a contract and favorable working conditions is no longer a serious issue for the active labor force. Moreover, the high level of unemployment reassures the socio-economic pressure on employees to adjust to the current labor environment without resistance.

Taking all the above into consideration, unsurprisingly Kosovo continues to have the lowest contribution rates in the region. Expressed in numbers, in 2013, only 62% of the registered contributors had actively contributed to the contributory pension fund, 14% of the newly registered contributors were 40 year old or above, which was the average age of an active contributor, and the average balance of an active contributor prior to retirement was around EUR 4000.00 (TRUST 2013), which should last no longer that two and a half years based on a monthly pension in of EUR 150.00.

No positive significant changes were marked in the next years. Quite the opposite in fact. In 2014, 2015, and 2016 the percentage of registered contributors who had actively contributed decreased to 60%, 58% and 57% respectively (TRUST 2014; 2015; 2016). Moreover, in the annual reports of TRUST itself, concerns about the low number of active contributors is often addressed as an indicator of the high levels of informal economy evident in Kosovo. This goes on to show that current pension schemes are unsustainable (interview with A. Demi). Retirement age in Kosovo is 65, while the life expectancy is 74 (World Bank), meaning that for the most part of retirement an average retiree will not be covered by his pension savings and hence will become an immediate burden to the government budget, due to the basic pension entitlement for every senior citizen. Azemi was confident that no more than 30% of the employees in the private sector will inherent a full pension upon retirement (inerview with Azemi). Based on the current trends, the number of citizens who will rely on the only the basic pension, due to their early exit from the contributory scheme, will increase greatly during the next 15 to 20 years (Interview with A. Demi). Nevertheless, Jeton Demi from TRUSTi insisted that the current pension model is the best solution possible, regardless of certain glitches, and believed that the model is sustainable. He stated that

> Kosovo has experienced the optimal moment to mark its transition of pension system. We are witness that solidarity social schemes are becoming a heavy burden for the budget of many countries, particularly of those countries that are experiencing a disharmony in the population's age, and although Kosovo is not exposed to this problem in the medium term, recent statistics show that the number of retirees is increasing in higher rates than before (interview with J Demi).

Jeton Demi also told that to his knowledge, no study on the demographic trends in Kosovo had preceded the decision in 2001 to employ the current model. According to him, the current pensions system was built upon the premise that it would unload the burden on the central budget that would otherwise have been caused by the extremely high unemployment rate following the war. In addition, considering the numbers of young population registered in Kosovo, "it was seen as a good opportunity that citizens, in the long term, will have time to contribute sufficiently to their personal pension funds to provide them a comfortable life upon retirement". Nevertheless, Mr. Jeton Demi admits that challenges and obstacles have been experienced in fulfilling its potential, naming the lack of economic development, poor rule of law, and informal economy as the main challenges.

According to figure 3 above, the lowest levels of labour market intervention expenditures are found in our case study, together with Romania, with only 0.3% of the GPD dedicated to policies that explicitly target groups of people with difficulties in the labor market such as the unemployed, people at risk of involuntary job loss, and inactive people but who are in search of entering the labor market (Eurostat). Similarly to the previous figures, Kosovo is situated in the category of the East and South East post-socialist European countries that mark the highest rates of informal economy and lowest expenditures on labor market interventions.

Kosovo has very limited programs of labor market intervention, with correspondingly limited budgets. It has a Centre for Professional Training providing professional training, an Employment Office proving services and assistance for those who are unemployed and in search of entering the labor market, and provides early pensions for two particular groups; former Kosovo Protecting Troops members and former employees of Trepca (Budget Law 2013). Understandably, Kosovo is unable to finance further such programs, given its economic instability and the situation discussed above. Moreover, Mr. A. Demi asserts that Kosovo has no economic foundation to finance the current social programs, let alone extend them – targeting his critique at the recent law that ensures pensions for war veterans and invalids. According to this law, all former members and contributors to the Kosovo Liberation Army who participated in the war and who are currently unemployed are entitled to pensions provided by the government. The number of beneficiaries who will benefit from these pensions amount to as high as 50,000 people (Interview with A Demi). This law, in its current form, has been met by strong criticism by both domestic and international actors, including the International Monetary Fund, labeled as highly unfeasible and seriously risky to budgetary sustainability (Interviews with A. Demi; Loxha). It has also been subject to manipulations and abuse by individuals who, in their attempt to become eligible for the pension, have resigned from their workplaces in the formal sector and have urged their employer to unregister them from the official payroll, while making themselves available to keep on working for informal wages, or have searched for new jobs in the informal sector (interviews with Azemi; A. Demi; Merovci). Such experiences may stir up the assumption that under the current institutional capabilities for control, the introduction of other social programs, as for instance unemployment benefits, may be prone to similar backfiring effects.

Allegations of abuse and mismanagement are also made about other social programs as well (interview with A. Demi), which question the effectiveness of state protection programs. Admittedly, we have no data for the effectiveness of the welfare programs in tackling poverty in of Kosovo for the referring year. However, we have two main reference points enabling us to project where Kosovo might have stood in the relation discussed concerning sub-hypothesis 1(a). Firstly, a study by Murati and

Berisha (2010) argued that if the current available social transfers were to be terminated, the poverty rate would have increased by 12%. Although their study included data from 2009, since then to 2013 no significant increase in benefits value and expenditures has been recorded (IKS 2016b; Ministry of Welfare and Labour 2017). This gives us a rather strong sense of the impact that state protection expenditure could have had in 2013. Secondly, our empirical result showed a negative correlation between informal economy and state protection effectiveness. Based on this, Kosovo might arguably be positioned as the country with the higher informal rates and the lowest impact of state protection expenditures, followed by Romania and Bulgaria. If we go back to Figure 4, Kosovo may fit right in the category of East and South East post-socialist European countries, together with those of Greece and Italy hard-hit by the financial crisis, under the overall negative correlation between the size of informal economies and state protection effectiveness.

The state of welfare state programs and their effectiveness is also related to the governance quality and trust in formal institutions, as suggested by the negative correlations displayed above in figures 12 to 18. Kosovo registers the lowest rates of governance quality, and has one of the lowest rates of trust in formal institutions, together with Bulgaria, Poland, Portugal, Spain, and Slovenia. Arguably, lack of governance quality may be billed to the fact that Kosovo is still a young state in the making, and challenges which it faces today are common features of young states coming out of war and transition. And as a result, the fragility and incompetency of government institutions do not contribute positively to the levels of public trust in them either. Low trust in state institutions is also support by several domestic studies; confirming that trust remains low and no significant positive trend is recorded (KCSS 2014; 2015; 2016). In that regards, Mr. Agron Demi makes an interesting remark that the lack of trust towards state institutions was the product of social-political circumstances evident in the 90s, when Kosovo’s autonomous status was revoked. He believes that such negative attitude is a result of suppressive and violent experiences caused by then state control institutions. For instance, many public institutions and enterprises were subject of usurpation, destruction and looting after the liberation in 2000 (interview with A. Demi). To which one might add the suppression of the right to collect pensions from earlier contributors to the former Yugoslav pension scheme. The ensuing poor performance of formal institutions has to this day limited public trust in them.

Low trust towards formal institutions and lack of governance quality is also correlated to informal economy, as confirmed by our results (figures 21 and 22). The case of Kosovo fits into this correlation as well. It shows support to the theoretical suggestion of institutional asymmetry, which highlights the significance of lack of trust and a negative perception of formal institutions in breeding informality. Such asymmetry is strikingly evident in Kosovo, providing a context to understand her large informal economy. Lack of trust and negative perception towards formal institutions undermine their ability to develop a healthy cooperation with citizens in paying taxes, and respecting their civic responsibilities.

Under such circumstances, common good becomes a farfetched ideal, and abuses of public services and social programs are not seen as irresponsible behaviors but rather as ways for people to get back at those institutions who they particularly feel that have failed them. Citizens' decision to evade may be dictated by such relation; the lower the trust that government and the public institutions will provide the services promised in return, the lower the predisposition for one to adhere to his or her civic responsibility (Wintrobe and Gërxhani n/d). Studies in Kosovo show that Kosovars have rather a firm perception that state has the sole responsibility to provide work for everyone who seeks for one (72% strongly agree), provide an acceptable standard of living for elderly (86% strongly agree) and for the unemployed (78% strongly agree), while simultaneously a majority of people believe that Kosovo has enough funds to help these categories of people (IKS 2016c).

This shows how high the expectations Kosovars seem to have with regards to the role of the state in providing a better welfare, and the failure to do so should inevitably impacts their lack of trust and negative perception towards the state. Formal institutions' ability to provide good social welfare services is determined by the cooperation with their own citizens; the effectiveness of such services, however, is determined by the quality of institutions, and by the prerequisites inhibiting potential abusers who could benefit from state funded welfare programs while at the same time being active in the informal economy (Interview with A. Demi) – which are clearly not in place.

Similar relationships hold between the size of countries' informal economies and the degrees of social trust and associational activity. Kosovo records one of the lowest social trust rates in Europe (Figure 19). Given that our results have confirmed the negative correlation between informal economy and social trust, it is fair to suggest that the decision of the individuals to participate in the informal economy is related to the perception of prevalence of such behavior among other (Wintrobe and Gërxhani n/d). When citizens assume that others are not paying taxes, they tend to evade taxes as well – suggesting that there may be a tipping point at which the perceived number of tax evaders and informal economic practitioners reaches such a level, that practices of informal economy become socially epidemic (Wintrobe and Gërxhani n/d). While operating in such a way is considered against the law, and avoiding such civic responsibilities will damage the integrity and the quality of public and social services, the lack of social trust and the related assumption that not many are contributing to such common goods may diminish the public's willingness to do so. Anna Danielsson, in her field notes on the ubiquity of informal culture in Kosovo, went as stated that "informality nurtures informality" (Danielsson 2015, 119), and "informality appears to form a hierarchical and unequal social activity … at the same time informal economic practices have become commonsensical in the minds of people. Informality is taken for granted and undisputed" (Danielsson 2015, 120).

Even though we do not have empirical data on Kosovo's associational activity, or horizontal networking in Putnam's term, we may nevertheless make an educated assumption as to where Kosovo stands in this regard. First, Danielsson's contribution (2016) calls to attention the relevance of power and social configuration in Kosovo. She uncovers the existence and significance of what Putnam (1993) has called "vertical networking", which are relations based on asymmetrical obligation and exchanges of the patron-client type, and which are harmful to social capital (in Putnam's sense), as they do not provide the right conditions to breed cooperation and trust but rather are exposed to opportunism. Danielsson (2015) points out that many businesses claim that they face obstacles and an unfair environment that go beyond institutional constraints. Businesses with a privileged position act in a way that produces unfair competition, which pushes other less privileged businesses to operate informally. Similar cases are found in post-socialist states where people connected to government continue to enjoy rewards from such vertical networking (Fligstein 1996). Due to this unfair environment and power relations, legal regulations place certain businesses better than others by allowing them, for instance, to "win contracts in openly announced procurement processes, win public bids despite their operating license having been withdrawn, gain licit and illicit profits from processes of privatization, and benefit from the protection and involvement of criminal groups" (Denielsson 2016, 12). Allegations about the existence of such vertical networking that involve high-ranking officials and politicians, supported by the evidenced high level of corruption in Kosovo, suggests that Kosovo may have considerably low amplitude of horizontal networking. This is further backed by the fact that the available statistical data show associational activity to be strongly and positively correlated with social trust (r_p= .790), as displayed in figure 23. This suggests that in countries where social trust is low, so is associational activity. Based on what we already know, Kosovo has one of the lowest social trust rates in Europe, suggesting that Kosovo is also very likely to have low levels of associational activity, or horizontal networking, which in turn are negatively related to informal economy.

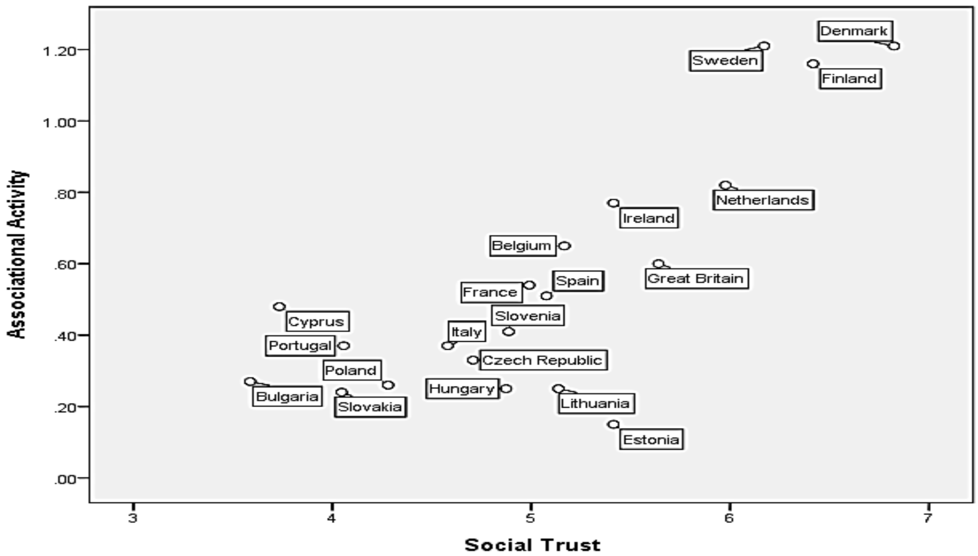

Figure 23. The positive relation between associational activity and social trust (Eurobarometer 373, computed by the author; European Social Survey 6, computed by the author)

CONCLUSION

1. Main findings

The findings of our study are divided in three main sections. Primarily, we sought to address the correlation between the size of the informal economy and welfare state programs, with a particular interest in the case of Kosovo. Our bivariate correlation results displayed that a strong negative relationship is found between indicators of welfare state, namely social protection benefits and labour market policy, and the levels of informal economy among 29 countries, including Kosovo. The outcomes are in line with Williams and Renooy (2013) study. We found that the size of the informal economy is also negatively correlated with the impact or effectiveness of these programs, and that the size and effectiveness of welfare programs are negatively correlated with citizens' trust in public institutions and their perception of government quality. That is to say the higher the informal economy, the lower the welfare state programs expenditures, but also the weaker the impact of these programs in tackling poverty and increasing welfare, which in return, we argue, lowers the trust towards formal institutions and discourages compliance behavior amongst citizens, thereby sustaining the reciprocal relationship stated in our core hypothesis 1.

Our empirical findings show support to our core hypothesis 1 that inefficient welfare state programs and a high level of informal economy reciprocally contribute to, and reinforce each other. Nevertheless, we express our caution with regards to the entirety of our results, because although they do suggest that such a relationship exists, we are not equipped to provide evidence disentangling causal directions or their relative intensities. Our case study fits rightly into our analytical model. Kosovo stands alone as the country with the highest informal economy rate and the lowest social protection benefits, closest to former socialist countries of Romania, the Baltics, and Bulgaria. Strikingly, Kosovo's social protection drops much more sharply when excluding old age benefits than any other European country, which reveals how much Kosovo's welfare system revolves around pension expenditures.

Kosovo's neo-liberal type of welfare state system heavily relies on healthy market based economy, the state's capacity to tax economic activities, and citizens' individual contributions to pension funds, areas in which Kosovo falls significantly short. Consequently, Kosovo's current welfare state programs are weak, unsustainable, and ineffective, and therefore fail to provide incentives for compliance behavior and attract citizens to exit the informal sector.

Secondly, we found that social capital is also to a large extent negatively correlated to the levels of informal economy. With the exception of civic norms, for which we found no statistical significance, social trust and associational activity displayed strong negative relationship with informal economy. The results support that less generalized trust among citizens favors informal economy and that citizen's engagement in associational activities or horizontal networking is also related to the levels of informal economy.

These findings represent original contributions to the theoretical relevance of social capital in relation to informal economy. Both social trust and associational activity contribute to the incentives for cooperation and increase the awareness of civic responsibility and common public good, which arguably hinder the adhesion to informal economy. In that respect, Kosovo has one of the lowest levels of social trust, and expectedly the highest level of informal economy; and while no data on associational activity were obtained regarding Kosovo, we were able to make educated assumptions based on literature review and indirect inferences from our data.

And thirdly, our findings supported an institutional asymmetry approach. We found strong negative correlations between the size of informal economies, trust in formal institutions, and governance quality. Our findings strongly suggest that countries that enjoy higher governance quality and trust in formal institutions experience low informality, and also exhibit higher welfare state expenditure. This illustrates how important is trust in formal institutions and a positive perception on governance quality. It has already been mentioned several times that welfare programs' size and effectiveness is dependent on the formal institutions' quality and ability to collect taxes, but we believe that is also dependent on their approach to provide strong incentives for citizens to comply with their civic responsibilities. To our evaluation, better welfare state provisions, alongside other policy measures that monitor them, could be one step in that direction. A lack thereof discourages compliance behavior of citizens and pushes them to shirk paying taxes, as response to the governments' failure to provide adequate support in cases of social risks, leaving them vulnerable to the market and the family only (Aidukatite 2009; 2010).

In each of the two relationships, Kosovo stands out as the country with the lowest perception of governance quality and among those with the lowest trust in the formal institutions. Therefore, formal institutions do not provide enough incentives to compliant and cooperative behaviors between citizens and the state. Under such circumstances, we argue that citizens fail to relate to the state and see themselves as being on their own. On top of that, interestingly, Kosovars have rather a firm perception that the state has the sole responsibility to provide work for everyone who seeks employment and provide acceptable standards of living for the needing, and they believe that the state has enough funds for that (IKS 2016c). Failing to do so further undermines their trust in formal institutions and nourishes their decision to willingly operate in the informal sector, weakens the impact of these programs due to abuse and mismanagement, and in return breeds more informality.

2. Limitations and suggestions for further research

Our study faced a number of imitations related to the availability and quality of data. First and foremost, the value of our main indicator, informal economy, is subject of two separate measuring procedures found in two separate scientific works. We base the value of informal economy for our case study in the work of Riinvest Institute study in 2013, which is the only available study that measures the level of informal economy in Kosovo. Its estimation of informal economic practices was based on surveys with managers of private companies in Kosovo, while the calculation of the value of informal economy for the rest of the countries in this study was achieved through multiple indicators and multiple courses estimation procedure (MIMIC) found in the work of Schneider (2015). We are aware that the availability of data on informal economy originating from a singular source for all the countries included in our study could have increased the accuracy of our results.

Secondly, lack of data for particular indicators in the case of Kosovo was another limitation. As a result, we were forced to make educated assumptions on associational activity and the effectiveness of state protection expenditures indicators. Availability and accessibility to official data would have helped us to complete our set of database and enable us to provide accurate and confident results regarding our case study.

Thirdly, the lack of longitudinal data, particularly for our case study, disabled us to provide more information on the eventual rise or decline in the levels of informal economy, and its relation with welfare state programs, social capital, and institutional quality throughout transition and recent periods. Longitudinal data would have helped us to develop more robust predictive models capable of exploiting the relationships discussed in our study.

In the face of our limitations, we would encourage further studies to bridge the gap on statistical data with regard to our research question. Further research is needed to replicate and/or adapt survey models of the kind of the European Social Survey and Eurobarometer to measure attitudes, beliefs and behavior patterns in population in the case of our study. Kosovo is often excluded from cross-national studies. It has never been part of the Eurobarometer, and will continue not to partake for as long it is not a member of the European Union, while it has only participated in the round 6 of European Social Survey. We understand that Kosovo is a young state and it has emerged in the international scene only recently, but precisely for that reason the lack of data with regards to our subjects of matter is all the more a problematic issue that must be addressed. Empirical investigation of time series data that could be made available is the future is crucial.

Our study has shown that, in a cross-national database, informal economy is negatively correlated with welfare state programs, institutional quality, trust in formal institutions, social trust and associational activity. Further studies are required to explore this correlation within the case of our study. We suggest one such study would include a single national sample survey in which questions with regard to measuring informal economic practices, perception of welfare state programs, institutional quality, trust in formal institutions, social trust and participation in associational activity are included, which would serve as a single database able to test for correlations.

Finally, further research should go beyond single bivariate correlations and use multivariate statistics to look at the extent to which informal economy, welfare state programs, social capital and institutional capital affect interact with one another, assess causal directions, and more importantly their relative weights in influencing the levels of informal economy. Which, again, will require wider datasets and, admittedly in the case of this research, furthering our analytical skills.

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ANNEX

Correlations						
		Informal economy as % of GDP	Social protection benefits as % of GDP	Social protection benefits (exlc. old age benefit) as % of GDP	Labour market policy expenditure as % of GDP	The effectiveness of state protection expenditure
Informal economy as % of GDP	Pearson Correlation	1	-.775**	-.829**	-.628**	-.697**
	Sig. (2-tailed)		.000	.000	.000	.000
	N	29	29	29	28	28

**. Correlation is significant at the 0.01 level (2-tailed).

Table 3. Correlation values of welfare state indicators and informal economy

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.775[a]	.600	.586	5.1036	.600	40.576	1	27	.000

a. Predictors: (Constant), Social protection benefits as % of GDP

b. Dependent Variable: Informal economy as % of GDP

Table 4. Social protection benefits and informal economy accounting variance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.829[a]	.687	.675	4.5184	.687	59.214	1	27	.000

a. Predictors: (Constant), Social protection benefits (exlc. old age benefit) as % of GDP

Table 5. Social protection benefits (excl. old age benefits) and informal economy accounting variance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.628[a]	.395	.371	6.2370	.395	16.950	1	26	.000

a. Predictors: (Constant), Labour market policy expenditure as % of GDP

Table 6. Labour market policy expenditure and informal economy accounting variance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.697[a]	.486	.467	5.3047	.486	24.611	1	26	.000

a. Predictors: (Constant), The effectiveness of state protection expenditure %

Table 7. Effectiveness of state protection expenditure and informal economy accounting variance

Correlations

		Social protection benefits as % of GDP	Governance Quality	Trust in Formal Institutions
Social protection benefits as % of GDP	Pearson Correlation	1	.712**	.537**
	Sig. (2-tailed)		.000	.006
	N	30	30	25

**. Correlation is significant at the 0.01 level (2-tailed).

Table 8. Correlation values between social protection benefits, and governance quality and trust in formal institutions

Correlations

		Social protection benefits (exlc. old age benefit) as % of GDP	Governance Quality	Trust in Formal Institutions
Social protection benefits (exlc. old age benefit) as % of GDP	Pearson Correlation	1	.804**	.635**
	Sig. (2-tailed)		.000	.001
	N	30	30	25

**. Correlation is significant at the 0.01 level (2-tailed).

Table 9. Correlation values between social protection benefits (excluding old age benefits), and governance quality and trust in formal institutions

		LMP Labour market policy expenditure as % of GDP	Governance Quality	Trust in Formal Institutions
LMP Labour market policy expenditure as % of GDP	Pearson Correlation	1	.566**	.356
	Sig. (2-tailed)		.002	.095
	N	28	28	23

Correlations

**. Correlation is significant at the 0.01 level (2-tailed).

Table 10. Correlation values between labour market expenditures, and governance quality and trust in formal institutions

Correlations

		The effectiveness of state protection expenditure	Governance Quality	Trust in Formal Institutions
The effectiveness of state protection expenditure	Pearson Correlation	1	.780**	.684**
	Sig. (2-tailed)		.000	.000
	N	29	29	24

**. Correlation is significant at the 0.01 level (2-tailed).

Table 11. Correlation values between the effectiveness of state protection expenditures, and governance quality and trust in formal institutions

Correlations

		Informal economy as % of GDP	General trust in others	Trust in other's help and Solidarity	Trust in other's fairness	Social Trust
Informal economy as % of GDP	Pearson Correlation	1	-.568**	-.677**	-.640**	-.638**
	Sig. (2-tailed)		.004	.000	.001	.001
	N	29	24	24	24	24

**. Correlation is significant at the 0.01 level (2-tailed).

Table 12. Correlation values between informal economy and social trust

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.638[a]	.407	.380	6.0824	.407	15.118	1	22	.001

a. Predictors: (Constant), Social Trust

Table 13. Social trust and informal economy accounting variance

Correlations

		Informal economy as % of GDP	GROUP Associational Activity Index
Informal economy as % of GDP	Pearson Correlation	1	-.695**
	Sig. (2-tailed)		.000
	N	29	24
GROUP Associational Activity Index	Pearson Correlation	-.695**	1
	Sig. (2-tailed)	.000	
	N	24	24

**. Correlation is significant at the 0.01 level (2-tailed).

Table 14. Correlation values between informal economy and associational activity

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.695[a]	.483	.460	5.1577	.483	20.586	1	22	.000

a. Predictors: (Constant), Associational Activity

Table 15. Associational Activity and informal economy accounting variance

Correlations							
		Informal economy as % of GDP	Claiming government benefits without being entitled to	Avoiding a fare on public Transportation	Not Registering salary	Not declaring income	CIVIC NORM
Informal economy as % of GDP	Pearson Correlation	1	-.191	.015	-.061	-.109	-.098
	Sig. (2-tailed)		.360	.945	.773	.603	.642
	N	29	25	25	25	25	25

Table 16. Correlation values between informal economy and civic norm

Correlations									
		Informal economy as % of GDP	Voice and Accountability	Political Stability and Absence of Violence/Terrorism	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption	Government Quality
Informal economy as % of GDP	Pearson Correlation	1	-.868**	-.693**	-.824**	-.808**	-.829**	-.796**	-.845**
	Sig. (2-tailed)		.000	.000	.000	.000	.000	.000	.000
	N	29	29	29	29	29	29	29	29

**. Correlation is significant at the 0.01 level (2-tailed).

Table 17. Correlation values between informal economy and governance quality

Model Summary									
					Change Statistics				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change	F Change	df1	df2	Change
1	.845[a]	.713	.703	4.3230	.713	67.183	1	27	.000

a. Predictors: (Constant), Governance Quality

Table 18. Governance quality and informal economy accounting variance

Correlations

		Informal economy as % of GDP	Trust in the Parliament	Trust in the Legal System	Trust in Politicians	Trust in Political Parties	Trust in Formal Institutions
Informal economy as % of GDP	Pearson Correlation	1	-.652**	-.656**	-.659**	-.642**	-.667**
	Sig. (2-tailed)		.001	.000	.000	.001	.000
	N	29	24	24	24	24	24

**. Correlation is significant at the 0.01 level (2-tailed).

Table 19. Correlation values between informal economy and trust in formal institutions

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.667[a]	.445	.419	5.8875	.445	17.616	1	22	.000

a. Predictors: (Constant),Trust in Formal Institutions

Table 20. Trust in formal institutions and informal economy accounting variance

Correlations

		Associational Activity	Social Trust
Associational Activity	Pearson Correlation	1	.790**
	Sig. (2-tailed)		.000
	N	24	20
Social Trust	Pearson Correlation	.790**	1
	Sig. (2-tailed)	.000	
	N	20	25

**. Correlation is significant at the 0.01 level (2-tailed).

Table 21. Correlation values between associational activity and social trust