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Experiences, causes, and measures to tackle institutional incongruence and informal economic activity in South-East Europe

Abstract

To explain the prevalence and persistence of informal economic activity globally, scholars have recently advanced an institutional incongruence perspective. Institutional incongruence exists where there is a misalignment between what is considered legitimate by a society's formal institutions (e.g. its laws and regulations) and its informal institutions (e.g. norms, values and beliefs). Reporting findings from a series of qualitative focus groups in Bulgaria, Croatia and the Former Yugoslav Republic of Macedonia, this paper explores relationships between such institutional incongruence and informal economic activity. In particular, it sheds light on how informality and institutional incongruence are experienced by individuals in South-East Europe. It furthermore provides insights on the causes of such incongruence, and how it can lead to informal economic activity. Finally, it reports on individuals' perceptions towards different measures to tackle institutional incongruence and informal economic activity, with implications for policy makers in South-East Europe and more widely.

Keywords: Institutional Incongruence; Informal Economy; South-East Europe; Institutions; Trust

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Introduction

It is estimated that around a quarter of economic activity across South-East Europe occurs in the informal economy (Schneider and Williams 2013). This represents a major policy challenge for governments in the region, who are deprived of tax revenues needed for national socio-economic development (Williams et al 2015a). Increasingly, the concept of ‘institutional incongruence’ (Webb et al, 2009) has been advanced to explain the prevalence of informal economic practices globally. Such incongruence exists where there is a misalignment between what is considered legitimate by a society’s formal institutions (e.g. its laws and regulations) and its informal institutions (e.g. norms, values and beliefs). Extant quantitative studies have found a statistical association between institutional incongruence and informal economic activity (see Williams and Horodnic, 2015). Yet how such incongruence is experienced by individuals, at a more micro every day level, has yet to receive significant attention.

This paper advances our understanding of institutional incongruence as an explanation for informal economic activity. It provides a richer, more in-depth and variegated understanding of how institutional incongruence is experienced by individuals in South-East Europe, what the causes of such incongruence are, and of the dynamics of relationships between institutional incongruence and informal economic activity. Furthermore, it provides insights on how individuals in South-East Europe perceive existing and potential measures to tackle institutional incongruence. To do this it draws upon qualitative focus group research undertaken in Bulgaria, Croatia and the Former Yugoslav Republic of Macedonia (FYROM) in 2016.

In this paper, three research questions are answered: How are informal economic activity and institutional incongruence experienced by individuals in South-East European settings? What are the causes of institutional incongruence in these settings? How are measures to tackle institutional incongruence and informal economic perceived by individuals in South-East European settings? An institutional perspective provides the guiding theoretical framework for this paper.

This paper contributes to knowledge in several ways. First, it provides insights on how institutional incongruence and its relationship with informal economic activity is experienced by individuals in South-East Europe. To date, much of the research examining institutional incongruence and informal economic activity has been quantitative, and focussed at a macro country level (Williams and Horodnic, 2015). Scholars have identified a need for more fine-grained micro level research into the informal economy (Webb et al, 2013). As well as for studies using alternative research methodologies, e.g. focus groups (see Godfrey, 2011). This paper engages with both of these issues. Secondly, this research not only demonstrates the existence and significance of institutional incongruence but also sheds light on its causes. Thirdly, this paper responds to calls for cross-country research on informal economic activity (Williams and Horodnic, 2015), and institutional incongruence more specifically. Our findings elaborate a richer understanding of this phenomenon than would be possible using single country data. Finally, our findings provide insights for policy makers. They shed light on how different measures to tackle institutional incongruence and informal economic activity are

perceived by individuals across three counties, including identification of challenges to be overcome and their limitations. In so doing, it contributes to wider policy debates outlined for the European Union (Williams and Horodnic, 2016).

The paper is structured as follows. First, we review existing literature on the informal economy, especially from an institutional perspective. Next, we explore extant research on the informal economy in South-East Europe, and policy measures to tackle informal economic activity. The research methodology is then presented. This is followed by discussion of individuals' experiences of informality and institutional incongruence, analysis of the causes of institutional incongruence, and assessment of how measures to tackle institutional incongruence and informal economic activity are perceived by individuals in South-East Europe. The paper concludes with discussion of its contributions, its policy implications, and areas for future study.

Literature review

Informal economic activity an institutional perspective

The informal economy is a persistent and expanding part of the global economy (Schneider and Williams, 2013). Reflecting this, there now exists an extensive body of literature, from varied disciplines, examining informal economy phenomena. This includes work in economics (Johnson et al, 2000), management (Godfrey, 2015; Webb, 2009) and sociology (Barsoum, 2015; Samson, 2016). Across these disciplines, the subject of motivations for informality has now received significant attention (see for example Schenider and Williams, 2013; Snyder, 2004; Webb et al 2009; 2013). In particular, scholarly debate has focussed on whether informal economic activity is a result of '*marginalisation*' and the '*exclusion*' of individuals from the formal economy (see Barbour and Llanes, 2013; Cortes, 1997) , or is the result of a more voluntary '*exit*' (Snyder, 2004). Significantly, recent work has found support for both explanations – with their importance contingent on individual factors like gender, class, age etc. (Jones et al, 2006; Littlewood et al 2018; Williams and Horodnic, 2016).

This work on motivations for informality, and indeed wider informal economy scholarship, has recently taken an institutional turn (see Webb et al, 2009, Welter and Smallbone, 2011; Williams et al 2015), with scholars increasingly applying institutional concepts and theory to explain informal economic activity. Examples of such work include Uzo and Mair (2014) who examine informal rule adoption in the Nigerian film industry, Williams et al (2016) who assess through an institutional lens the impact of starting up unregistered on firm performance, whilst Tonoyan et al (2010) explore the determinants of corruption in transition economies linked to country-specific institutional configurations. Finally, Schindler (2016) examine relationships between middle class residents and informal workers in Delhi, India, reflecting on the regulation of informal working and processes of legitimation and institutionalisation.

This overall institutional turn in informal economy scholarship is apparent in Webb et al's (2013: 599) definition of the informal economy as "*economic activities that occurs outside of formal institutional boundaries but which remain within informal institutional boundaries for*

large societal groups”. We adopt this as a working definition of informal economic activity in this paper, as it aligns with the overarching institutional perspective we deploy.

Our paper contributes to this burgeoning body of literature deploying institutional perspectives to study and explain informal economy phenomena. More specifically, in this paper we draw upon neo-institutional theory, particularly from a sociological perspective, which is founded on the notion that organisations, groups and individuals, and their behaviours, are shaped by their institutional environments (Scott, 2001). According to Scott (2001) such institutional environments comprise three components, or pillars. The regulatory pillar involves formalised rules, laws and associated sanctions promoting certain behaviours and restricting others. In the context of this paper, this regulatory pillar relates to formalised rules about for example the payment of taxation, declaration of work, terms of employment etc. The second normative pillar refers to the wider norms and values present in a society about what constitutes appropriate and acceptable behaviour. In this research, these would pertain to attitudes towards informal economic activity (i.e. the social acceptability of evading tax, working informally, or purchasing informal goods and services). The final cultural-cognitive pillar relates to how certain behaviours become taken-for-granted based on shared understandings. In this research this might relate to how informal activities are enacted unthinkingly, for instance routine purchasing from an informal vendor, or individuals not expecting or asking for receipts.

Institutional theory posits that organisations, groups and individuals behave in ways, which reflect regulatory, normative and cognitive conditions in their institutional environments. Adherence to these rules ensures legitimacy. In the regulatory pillar, this legitimacy is gained through compliance with legal requirements, in the normative pillar it is based on moral conformity, and in the cultural-cognitive pillar it comes from adopting a common frame of meaning or approach (Scott, 2001). Institutions exert pressure for compliance and adherence on organisations, groups and individuals. Different pressures are primarily associated with each pillar. Coercive pressure is largely associated with the regulatory institutional pillar and the enforcement of formal rules and laws. Normative pressure is associated with the normative pillar and demands to conform to societal expectations. Finally, mimetic pressure is related to the cultural-cognitive pillar, whereby organisations and individuals act in ways that reflect shared understandings and common beliefs, which are culturally supported. In this paper, institutional theory is deployed as the guiding theoretical framework. It is used to examine how institutions, and in particular conditions of institutional incongruence, may encourage informal economic activity in South-East Europe. Institutional theory was adopted reflecting the paper’s focus on understanding individuals’ everyday experiences of informality and the institutional forces informing this. More specifically, a sociologically informed institutional lens is adopted, as this was considered to most allow for nuanced analysis of interactions between institutions and individuals at a micro level.

Institutional incongruence

Institutional incongruence exists when there is misalignment between what is considered legitimate by a society’s formal (regulatory) institutions (e.g., its laws and regulations), and its informal (normative and cognitive) institutions (e.g., norms, values and beliefs). Institutional

incongruence has been the subject of increasing attention in informal economy scholarship (see for instance Godfrey, 2015; Webb et al 2009; Williams et al, 2015), where it has been deployed to explain the existence and persistence of the informal economy. Webb et al (2009: 495) for example, argue “*the informal economy exists because of the incongruence between what is defined as legitimate by formal and informal institutions*”. Meanwhile, Williams and Horodnic (2016) examining institutional incongruence and informality across 28 European states, find a strong association between the degree of non-alignment of formal and informal institutions and participation in the informal economy.

However, whilst institutional incongruence is increasingly utilised to explain informal economic activity at a macro national and cross national level, the dynamics of relationships between institutional incongruence and informal economy activity at a micro level, and how it is experienced by individuals remain less studied. There is also a dearth of finer-grained in-depth analyses of the causes of institutional incongruence, and why individuals might engage in informal activity that is considered illegitimate by formal institutions, rules and regulations, but is normatively and cognitively legitimate. This paper sheds further light on these dynamics.

The informal economy in South-East Europe

Our study draws upon focus group data from Bulgaria, Croatia and FYROM. Contributing to a growing body of work on informal economic activity in South-East Europe, including in Bulgaria (Goev, 2009), Croatia (Klarić, 2011), and FYROM (Garvanlieva et al, 2012). Meanwhile, scholars have also engaged in some analysis at a regional level, and across countries, examining the wider nature of informal work (Williams and Horodnic, 2015), and informal purchasing (Littlewood et al, 2018), in South-East Europe. Yet, much of this work has been quantitative. We find no studies to date examining institutional incongruence and informal economic activity across a number of South-East European states, and especially at a micro level and at the depth it is considered in this paper.

Tackling informal economic activity

How governments can best tackle informal economic activity is the subject of increasing attention (see for example Barsoum, 2015; Mitrus, 2014; Williams and Horodnic, 2016). Williams (2014) provides a useful conceptual framework for classifying available policy measures for tackling the informal economy, identifying five potential overarching policy choices available to governments. These are: doing nothing, de-regulating informal work, eradicating the informal economy, moving informal work into the declared economy, and a mixed or hybrid approach contingent on the nature of the informal activity. Moreover, Williams (2014) goes on to distinguish between direct and indirect controls. Direct controls seek to establish compliant behaviour by ensuring the benefits of working in the declared economy outweigh the costs of working in the informal economy, with this accomplished through the use of deterrence measures (sticks) or making declared work more beneficial (carrots). Indirect controls focus on developing the ‘social contract’ between the state and its citizens, by fostering a high trust high commitment culture.

Within a pan-European context, Williams and Horodnic (2016) provide an overarching examination of the relevance of a variety of policy options to tackle undeclared work. This includes an assessment of not only the validity of pursuing the conventional rational actor approach which seeks to increase the penalties of detection, but also the relevance of social actor approaches, and the possibility of combining both of these approaches. Their study also suggests a need for a deeper examination of causes, and why for example citizens may hold a negative attitude towards payment of taxes, or why working informally is normatively acceptable. The findings outlined in this paper contribute towards developing a more nuanced understanding of these dynamics at an individual level, which can in turn inform policy development.

In this section, relevant literature has been reviewed and we have identified that an institutional perspective is adopted as the guiding framework for this research. We have also discussed what we know and do not know about the informal economy in South-East Europe, and how this paper contributes to knowledge. Finally, we have discussed work on tackling the informal economy, and highlighted the potential policy implications of our study. In the next section, we explain our research methodology.

Methodology

Focus group method

This paper draws upon qualitative focus group research undertaken in 2016 in Bulgaria, Croatia and FYROM. Nine focus groups were carried out, three in each country involving a mix of “*policytakers*” (after Brockmann et al, 2015). This included small business owners, managers, professionals, employees, students, retired people, and the unemployed. The eighty-three participants were of varied ages, included male and female representation, and covered multiple business sectors. All were drawn from urban areas, including but not exclusively from the capital cities of the respective countries, namely Skopje, Sofia and Zagreb. It is not suggested, and nor was it intended, that this sample was representative. Participants were selected based on maximum variation sampling to gain diverse insights on how institutional incongruence and informal activity is experienced by individuals in South-East Europe. For instance, experiences of and attitudes towards informality may be quite different between business owners versus their employees or the unemployed, or retired people compared with students. These groups experience the institutional environment differently. They also have varied life experiences, e.g. retirees who have lived through periods of socialist rule, conflict and economic transition, versus students who may have largely grown up in peaceful free market economies. The focus groups lasted between one and two hours.

Prior to the focus groups, a small number of open-ended discussion questions were devised informed by previous research, and the study’s research questions. In developing these questions best practice in designing focus group questions was adopted (see Kruegar and Casey, 2009). The questions related to: participants understanding of the ‘informal economy’, including its boundaries (see Bagnasco 1990); their experiences of such activity; what motivated such activity, attitudes towards informal economy activity; the difficulties

government actors (i.e., inspectors) faced in tackling informal activity, and their effectiveness; and the perceived efficacy of different measures for addressing informal economic activity. Members of the research team would pose questions and then moderate discussions amongst participants. Generally, interventions were limited and focused on prompts to facilitate further deeper discussion, ensuring that discussions did not divert too significantly from the research topic area, and making sure that all participants were given the opportunity to express their views (Greenbaum, 1999; Kruegar and Casey, 2009).

Data analysis

The focus groups, which were recorded, were initially translated and transcribed. Members of the research team were fluent in the languages in which the focus groups were conducted ensuring accurate translation and transcription. All the focus group transcripts were then read and annotated with initial thoughts noted down and discussed amongst the team. One member of the research team then took the lead in identifying preliminary thematic codes. The focus groups from each country were analysed in turn. It was felt to be important to first analyse data from each country individually to gain a richer understanding of their specificities, before conducting cross-country (case) analysis (Eisenhardt and Graebner, 2007). Cross country analysis and comparison then occurred entailing a search for patterns and the identification of recurrent themes (Barbour, 2005), but also recognising areas in which data contradicted. In these latter instances, deeper probing was undertaken to explain differences (Frankland and Bloor, 1999). This more axial coding (Strauss and Corbin, 1998) process led to the identification of higher level, cross-country, thematic codes relating to our study's research questions. These higher-level codes were then reviewed by other members of the research team. Throughout, this analysis and coding process was highly iterative, and entailed repeated comparison with and tying of emerging findings and themes to the literature. During the coding we also remained cognisant of potential limitations associated with focus groups, for example group effects including self-censoring and conforming (Sim, 1998).

Experiences of informality and institutional incongruence in South-East Europe

It is estimated that the informal economy is equivalent to around 25% of Croatia's total GDP, and provides around a quarter of national employment (Schneider and Williams 2013). In Bulgaria, the informal economy equates to around a third of the national GDP (Murphy, 2012). Finally, in FYROM in a recent World Bank Enterprise Survey 55.6% of firms reported that they compete against firms operating informally. Informal economic activity is pervasive across all three countries. It is widely experienced by individuals and firms in the workplace and marketplace. Across the focus groups, participants identified this high prevalence of informality and its varied forms.

The phenomenon of undeclared working was widely acknowledged in the focus groups, as illustrated in the quotations below:

"I work with people who have no contracts, and most of them don't pay for social security coverage". (Bulgaria focus group participant)

“There are many people having two jobs that are willing to conceal income from the second job ... many rely on moonlighting to supplement their take-home pay” (Croatia focus group participant)

“Each employee is reported but some of them may be reported for half working time instead of full time” (FYROM focus group participant)

The above quotations describe varied practices of undeclared working including second “moonlighting” jobs, jobs where not all contributions are paid, and jobs where work is only partially reported. In the latter instance of underreported working it is common for employees to be paid part of their wage ‘under the table’ in an envelope. This phenomenon of ‘*envelope wages*’ has been identified previously by Williams and Horodnic (2015), and was explicitly described in the focus groups:

“All workers in the company are employed in that way, a part on the bank account, and another part in an envelope” (Croatian focus group participants)

Related to this phenomenon of envelope wages, the cash economy was another widely discussed facet of undeclared working in South-East Europe, for example:

“I worked at a store for preparing home-made meals, 8 or more hours a day, although we were registered as working for 4 hours a day. The rest of the money, we received in cash. This is very common” and *“This is common in manufacturing, hairstyling, painting walls... the transaction is paid in cash”* (FYROM focus group participants)

The second of the above quotations describes how goods, and especially services, may be paid for informally with cash. Such experiences of informal transacting, including the avoidance of or misuse of receipts, were reported by additional focus group participants:

“I have had a small repair in my apartment recently and the handyman said: ‘The price differs depending on whether you want a receipt or not’ (Croatia focus group participant)

“There are many market traders who do not issue fiscal receipts or they give fiscal accounts written with lower price” and *“In my view, if you go to the public markets in every small city in Macedonia you won’t find anyone who has cash registers”* (FYROM focus group participants)

The focus groups also provided insights on business owners experiences of informal economic activity, who described facing “*unfair competition*” from informal firms, those utilising undeclared work or not paying tax, as well as facing problems with non-payment by “*shady*” informal firms. These issues and costs of informality to business are illustrated by the quotations below:

“It’s hard because after we finish a job, many clients try to hide and refuse to pay ... shady customers,” and *“You pay 800 leva for taxes; the guy across from you pays 300, covers his employee on the minimum base rate, but pays a 1000 in cash. Your employee might decide to move over to him”* (Bulgaria focus group participants)

In discussions so far, we have explored individuals’ experiences of informality across the three countries. We turn next to their experiences of institutional incongruence. As explained in the

literature review institutional incongruence exists when there is misalignment between what is considered legitimate by a society's formal institutions and its informal institutions. In the focus groups, it was evident that across the three countries there was significant social acceptability of informal economic activity. This acceptability is illustrated by the focus group quotations below:

“Small-scale undeclared workers should be left alone. This type of work should be controlled, but left to exist” (Croatian focus group participants)

“I do not ask for receipt from them because mechanics do not earn much money, and it will be additional stress for them if they pay taxes for their work” and *“If you go to a certain hairdresser for many years. She can't keep the store open, closes it, but you still call her for her services at your house. I think it is ok. People are trying to survive”* (FYROM focus group participants)

This seeming acceptability of informal economic activity can be contrasted with focus group participants generally negative perceptions of formal institutions and institutional actors across the three countries, which were distrusted and disidentified with, as illustrated by the focus group quotations below:

“Such things ruin the confidence in the system. Then a taxpayer thinks: Where did my money go? I pay taxes for what? ... in such circumstances citizens do not trust the state apparatus” (Croatia focus group participant)

“Politicians are representatives of the people. But in reality they aren't” (FYROM focus group participant)

In this section, we have explored individuals' experiences of informality, and of institutional incongruence as manifested in an acceptance of informal economic activity and distrust and rejection of formal institutions and institutional actors. In the following section, we explore further individuals' motivations for informality, and both the role and causes of institutional incongruence within this.

Causes of institutional incongruence in South-East Europe

Individuals engage in informal economic activity for varied reasons. These reasons encompass drivers of “exit” (see Snyder, 2004) as well as “exclusion” and “marginalization” (see for example Barbour and Llanes, 2013; Cortes, 1997), which can also operate simultaneously, and are contingent on individual level factors (see Littlewood et al, 2017; Williams and Horodnic, 2016). Across the focus groups, both exit and exclusion drivers of informality were discussed, for example:

“The employer offers: ‘You will get more if you are not fully registered’ and the worker considers and concludes ‘Maybe I need currently more money’, and he or she agrees a lower registered salary and receives part remuneration in an envelope” (Croatian focus group participant - exit based drivers)

“Employers look for people in a ‘check-mate’ position, ones that have nowhere to go, to turn to. They know they will keep quiet”. (FYROM focus group participant – exclusion based drivers)

“This is completely understandable given that most people in Croatia are forced to work informally in order to survive. The term ‘black work’ sounds quite negative, but looking through the lens of everyday life in Croatia it is nothing more than pure survival. Ok, it is not a survival strategy in every single case” (Croatian focus group participant – mix of exit and exclusion drivers)

Institutional incongruence provides the backdrop against which these drivers of exit and exclusion play out. Varied relationships exist between such drivers and institutional factors. For example, voluntary exit from the formal economy by individuals may be a logical response to state failure to enforce regulations. Meanwhile, the failures of institutional actors may result in or compound the exclusion/marginalisation of particular individuals pushing them into informality. However, whilst it is important to recognise the interaction between institutional factors and these drivers of exit and exclusion, in this paper we are especially interested in unpacking the phenomenon and causes of institutional incongruence, and how it drives informality in South-East Europe, and it is to this, which we now turn.

We focus first on those factors undermining the legitimacy of formal institutions. Across the focus groups, a lack of trust and even active distrust of government institutional actors was widely expressed. This encompassed a lack of trust in their competence in using taxation revenues for national socio-economic development, but also a lack of trust and even active distrust of their motives, integrity and benevolence towards citizens (Mayer et al 1995). Problems of corruption, cronyism, misuse of public funds and offices for personal gain, were widely raised in the focus groups, suggesting a breakdown in the ‘social contract’ (Godfrey 2011) between the state and its citizens. This lack of vertical trust is illustrated by the following focus group quotations:

[Participant 5] “Trust...There is no trust.” [Participant 7] “Exactly, I just don’t trust the whole system. I would pay contributions on a higher base of 800 lv otherwise” and “There is a saying; the fish rots from the head down” (Bulgaria focus group participants)
“You see, every month when I have to pay VAT I enter that number and always ask myself: “Where does this money go?” You simply click the button, and it feels like you threw it the garbage bin” (Croatian focus group participant)

In addition to an absence of trust in government actors, focus group participants also identified issues of incompetence and perceived unfairness in regulatory enforcement. It was widely regarded that enforcement agents lacked the tools to tackle modern forms of undeclared working and wider informal activity, and in this context, with the risk of detection low, it is unsurprising that individuals and firms would choose to engage in informal economic activity. This point is illustrated below:

“The National Revenue Agency continues to think that contemporary workers are like seamstresses, sitting at their desk waiting to be inspected and caught” (Bulgaria focus group participant)

Secondly, a narrative of unfair enforcement was evident across the focus groups in all three countries, as evidenced in the focus group quotations below:

“They tend to focus on the ‘soft’ or ‘easy’ targets. This usually means targeting regular citizens and small companies, whereas large influential companies are left unpunished” (Bulgaria focus group participant)

“The big fly will make a hole in the spider’s web, the small one will get eaten by the spider. I have remembered this and I think it applies” (FYROM focus group participant)

In a context of perceived unfair enforcement, informal economic activity becomes more socially acceptable.

An additional factor identified by focus group participants undermining the legitimacy of formal institutions included disidentification with “*elites*” in power, but also with the compliant. This was evident in focus group statements like: *“Look at that idiot, paying his taxes”* (Bulgaria focus group participant).

Across the focus groups participants furthermore identified various wider ‘*institutional imperfections*’ (after Webb and Ireland, 2015), that would either force or encourage participation by individuals and firms in the informal economy. According to Webb and Ireland (2015) such ‘*imperfections*’ can take various forms including, institutional voids, institutional weaknesses, institutional inefficiencies and institutional instabilities. Policy failures are an example of institutional inefficiencies. Croatian participants for instance criticised public procurement systems and government funded workplace training programmes, whilst Bulgaria participants identified problems in social security provision and particularly pensions, in both instances it was suggested that due to these limitations, it was unsurprising that individuals would choose to work undeclared, especially young people. Relatively ‘*flat*’ tax systems in the three countries were also identified as perpetuating a sense of unfairness and encouraging informal activity. In FYROM, participants further highlighted rapid and repeated policy and legal changes (institutional instabilities) which made it difficult for firms and individuals to adhere to regulations even if they so wished. Other ‘*institutional imperfections*’ identified included the suggested existence of “*loopholes*” (institutional voids) that permit firms and individuals to operate informally, whilst participants highlighted limits to civil society and trade union activity (institutional weaknesses) in protecting marginalised workers and holding government to account. The quotations below illustrate some of these institutional imperfections:

“Civil society is not active enough, people are not included ... and the state doesn’t seem to listen at all” (Bulgaria focus group participant)

“Haven’t the Government been inducing such behaviour with ‘Workplace training without employment’ [Active Labour Market Measure]. I believe that this measure motivates people to work on an undeclared basis. If one earns HRK 1600 or now HRK 2400..., this is not sufficient to buy even a ticket for public transport to get to the job. Of course, he or she will get some additional amount in an envelope.” (Croatian focus group participant)

“There are people who have found loopholes in the law; therefore they avoid paying. In that way they reduce their expenses and increase their profits” and “which policies and laws? We don’t know the laws. It is very bad that the laws are changing very fast. That is a big problem in the society.” (FYROM focus group participants)

So far, discussions have focussed on how in South-East Europe, factors including a lack of trust, failures of enforcement, disidentification and wider institutional imperfections undermine the legitimacy of formal institutions and institutional actors. We turn next to informal institutions, the norms, values and beliefs through which engaging in informal economic activity comes to be viewed as socially acceptable, and which provide legitimacy to those engaging in such activity. In particular, we discuss how these develop, become widespread and persist in South-East European contexts.

Across the focus groups, participants expressed significant normative acceptance of informal economic activity. For example, it was accepted that if a plumber or hairdresser came to your house that you would pay them in cash and be unlikely to get a receipt. Similarly, it was recognised that people might need, or choose, to have a second ‘*moonlighting*’ job or to be paid partially through ‘*envelope wages*’. Examining this further, in the focus groups from all three countries, participants identified the existence of an underlying attitude accepting or even encouraging non-compliance, described variably as a “*Croatian mind-set*”, “*Bulgarian mentality*” or Macedonian “*custom*”. Participants often suggested this was a long-standing historical tradition or something culturally embedded. Although, some also linked it to more recent historical developments in the three countries, and the legacies of authoritarian socialist rule and the transition to capitalism. These perspectives are illustrated in the focus group quotations below:

“It is a part of Croatian mentality to always strive to evade taxes and contributions” and “there was no individual responsibility in the previous time (socialist period). It was quite normal to take small things like office equipment from the working place” (Croatian focus group participants)

What is clear from the research is that current prevailing perceptions in South-East Europe where informal economic activity is normatively acceptable have developed over time, and accordingly tackling such activity and changing such perceptions will also take time.

When focus group participants discussed the social acceptability of informal economic activity in South East Europe, they often indicated some form of normative (isomorphic) pressure at play. This is evident in the focus group quotations below:

“[Participant 1]: taxi drivers for instance issue receipts rarely even though they should always do that: [Facilitator]: Do you ask them to issue one in such occasions? [Participant 1]: Not really (laugh)... I have actually never requested a receipt in a taxi.” (Bulgaria focus group participant)

“[Facilitator] What will happen to the person that reported their neighbour working on an undeclared basis? How would other people perceive the one who reported?”

[Participant 3] *Traitor (everybody started laughing)*. [Participant 4] *I agree*. (Croatia focus group participants)

This normative pressure also manifested in how individuals discussed their social and reciprocal motivations for engaging in informal economic activity. For example, focus group participants often explained not asking for receipts or paying for services in cash on the basis that by doing so they were helping the individuals involved. For instance, one participant stated that they do not ask mechanics for receipts due to the “*additional stress*” paying tax would cause, whilst another was similarly happy for their hairdresser not to declare earnings due to her financial difficulties. Furthermore, it was suggested that such activity was often a reciprocal exchange of favours that was both normatively acceptable and something with which the government should not interfere.

The previous discussions have argued that there is widespread normative acceptance of informal economic activity in South-East Europe, grounded in historical traditions and culture and maintained through normative pressures in society, as well as through norms of reciprocity and support for those in need. Building upon this, the focus groups also revealed significant cognitive habitual taken-for-granted-ness around engaging in informal economic activity. This manifest in statements like:

“Painting your apartment or something similar on an undeclared basis we are doing it from habit” and *“I believe that the majority of people have a habit to pay in cash for small maintaining services – like repairing the washing machine”* (Croatia focus group participants)

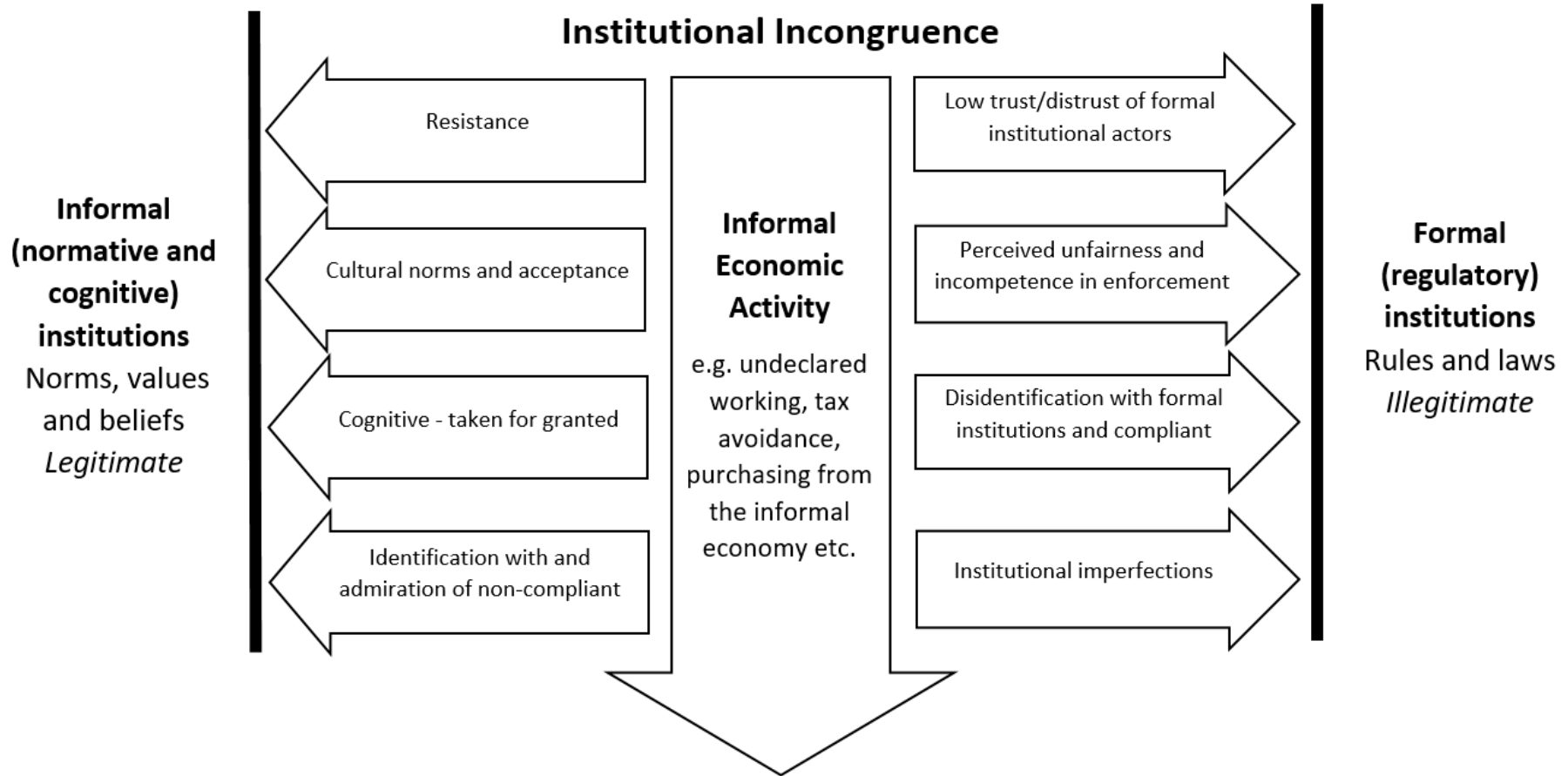
Exploring this cognitive dimension further, we also see mimetic isomorphism at play whereby individuals act in ways that reflect shared understandings that are culturally supported. In this case looking to friends, family, neighbours, and even competitor firms, before mimicking them in engaging in informal activity on the basis that to do otherwise would be “*foolish*” or against their own interest, with such activity also culturally supported. This is illustrated by the focus group quotations below:

“Peter doesn’t pay, Ivan doesn’t pay, and Blago doesn’t pay because they either have no money or there is no interest, why would I be the loser who pays? I would stop paying too” (Bulgaria focus group participant)

“It is very obvious that if our colleagues, friends or family do not pay taxes that we will follow their example. No one is fool to be around that kind of people and to be the only one who will pay his dues” (Macedonia focus group participant)

Two final points in relation to how informal economic activity comes to be seen as legitimate, are processes of identification with those who engage in such activity, and how such activity may be justified as a form of resistance. In the case of the former, focus group participants across the three countries used phrases like “*resourceful*” and “*savvy*” to describe those engaging in informal activity, and even expressing admiration for those who cheat the system: “*We are smart; we will find some way to cheat somehow*” (Bulgaria focus group participant). Whilst in relation to the latter, informal activity was justified and romanticised by some

Figure 1: institutional incongruence and informal economic activity framework



participants as a form of resistance to elites, unfairness and perceived failing institutions, for example: *“This is a way to fight against the corrupted system”* (Croatia focus group participants)

In this section, we have shed light on the causes of institutional incongruence in South-East Europe. We have identified how formal institutional actors may lose legitimacy and fail in their regulatory role, and also how informal institutions, norms and beliefs, become established and entrenched, with this situation giving rise to informal economic activity. Key drivers of institutional incongruence, identified in our analysis and outlined in the preceding discussions, are summarised in Figure 1. These include those undermining the legitimacy of formal institutions: (1) lack of trust in the competence and integrity of formal institutions and actors; (2) perceived unfairness and incompetence in enforcement; (3) disidentification with formal institutional actors and compliant individuals; and (4) wider institutional imperfections. They also include those legitimising informal activity: (1) cultural norms and acceptance; (2) cognitive taken-for-grantedness of engaging in informal economic activity; (3) identification with non-compliant; (4) resistance to formal institutions and institutional actors. We would expect that as these drivers intensify institutional incongruence increases and with it informal economic activity.

Before moving on to discuss the perspectives of policytakers towards measures to tackle informal economic activity, we would highlight two final points. First, the causes of institutional incongruence vary between countries, with different causes more or less significant in different cases. For example, different institutional imperfections exist in Bulgaria, Croatia and FYROM. Secondly, whilst adopting an institutional perspective, we remain cognisant of individual agency. This is illustrated by the following quotation, *“I pay, what do I care about the others, they could refuse to pay if they don’t want to”*. This is a reminder that ultimately individuals, and organisations, still possess a degree of choice in how they respond to institutional forces. Indeed, there remains scope for further enquiry into why some individuals in particular contexts choose to adhere to laws and regulations, pay taxes etc., whilst others facing largely the same circumstances and pressure subvert or avoid them.

Tackling Institutional Incongruence and the Informal Economy

In addition to shedding light on how informality and institutional incongruence are experienced by individuals in South-East Europe, and on the causes of such incongruence, our research also provides insights for efforts to tackle institutional incongruence and informal economic activity. The focus group participants were asked their opinions of varied ‘direct’ and ‘indirect’ controls (Williams, 2014), on informal economic activity. This included discussion of the perceived efficacy of different control measures, as well as any barriers to the successful implementation of such measures.

Turning first to direct controls, stronger support was found for the use of ‘carrots’ (including measures like simplifying compliance, providing support and advice to start-ups, offering tax incentives, and both supply side incentives e.g. amnesties, voluntary disclosure etc. and demand

side incentives e.g. service vouchers), than *'sticks'* such as increased penalties and improved detection. This support is reflected in participant statements like:

"No repression, rather some incentives. Something that will stimulate the official economy and work in it" (Croatian focus group participant)

Historically, governments in South-East Europe have focused on the use of *'sticks'* and negative reinforcement to punish non-compliant (bad) behaviour (Williams and Horodnic, 2015), rather than incentives to reward compliant (good) behaviours. However, recently there have been some moves to engage more with incentive measures, and our findings support these developments.

Nevertheless, amongst focus group participants, there remained scepticism regarding the ability of country governments to deploy direct controls, whether carrots or sticks, either effectively or fairly. This speaks to wider distrust in government, perceived systemic unfairness, and degrading of the social contract. It also shows the connection between direct and indirect controls, and that just improving detection and penalties, and/or only offering incentives, is unlikely to be sufficient to tackle pervasive informal economic activity. Indirect controls aim to reduce institutional incongruence either by changing formal or informal institutions. Formal institutions may be changed in various ways, including: moving towards more progressive systems of taxation; ensuring wider procedural fairness; distributing the benefits of taxation more equitably e.g. redistributive justice; improving procedural justice systems so that citizens feel they are being treated respectfully, responsibly and impartially; enhanced transparency and accountability of the state to citizens; and more direct democracy, including greater citizen inclusion and participation in budgeting. In the focus groups, indirect controls of various kinds, aimed at changing for the better formal institutions in the three countries, were largely regarded positively, as illustrated in the statements below:

"I would like to know how the tax revenues have been spent ... I think that people would like to know" (Croatia focus group participant)

"[Participant 2] the tax system needs to change. Progressive taxation: the low-income people would pay the minimum, while high-income people would pay more than 10% ... [Participant 9] No more flogging a dead horse." (Bulgaria focus group participants)

Indirect controls, and measures aimed at changing informal institutions, were also discussed in the focus groups. Examples of such measures include tax education, normative appeals, awareness raising of the benefits of declaring working, wider information campaigns, political and societal leadership, and receipt lotteries to change expectations about giving and receiving receipts. Whilst participants generally perceived the need to challenge prevailing norms and beliefs that informal activity was acceptable, their views on different measures were mixed. For example, many participants expressed doubts about campaigns highlighting what public money is spent on, such as *'this school was built by taxes paid to country government X'*, eliciting comments like:

“I find it really stupid. They want to prove that they did something! Of course, this was a minimum they should have done [i.e. building roads, buying police cars...] ... such messages would have a counter effect in my case” (Croatian focus group participant)

Further concerns identified were the potential for politicisation, or as one participant stated, *“the government is marketing its everyday work”*, also for deception, and the value for money of such measures.

The receipt lottery was similarly hotly debated. Some participants viewed it as a positive measure whilst others saw little value in it:

“I must admit that my perception and attitudes have changed in this respect. Now I expect to get a receipt by default, which was not the case before” and *“I believe that this programme is useless”* (Croatia focus group participants)

Interestingly, it was suggested that because of the lottery, people might become more active in asking for receipts from strangers but still not from people they know, their friends and family. Some participants also suggested that whilst they participated in the receipt lottery they ensured that, any receipts sent in were legal *“so as not to harm anybody”*. Overall, focus groups participants were somewhat sceptical of current indirect measures to change informal institutions, this suggests that further thought and refinement by policy makers is perhaps needed.

Finally, across the focus groups, participants often expressed a need for radical whole system change and the adoption of a multipronged strategy to tackle informal activity. This is illustrated by the quotations below, and aligns with the identification in the literature of the informal economy as a *‘wicked problem’* (Williams, 2014):

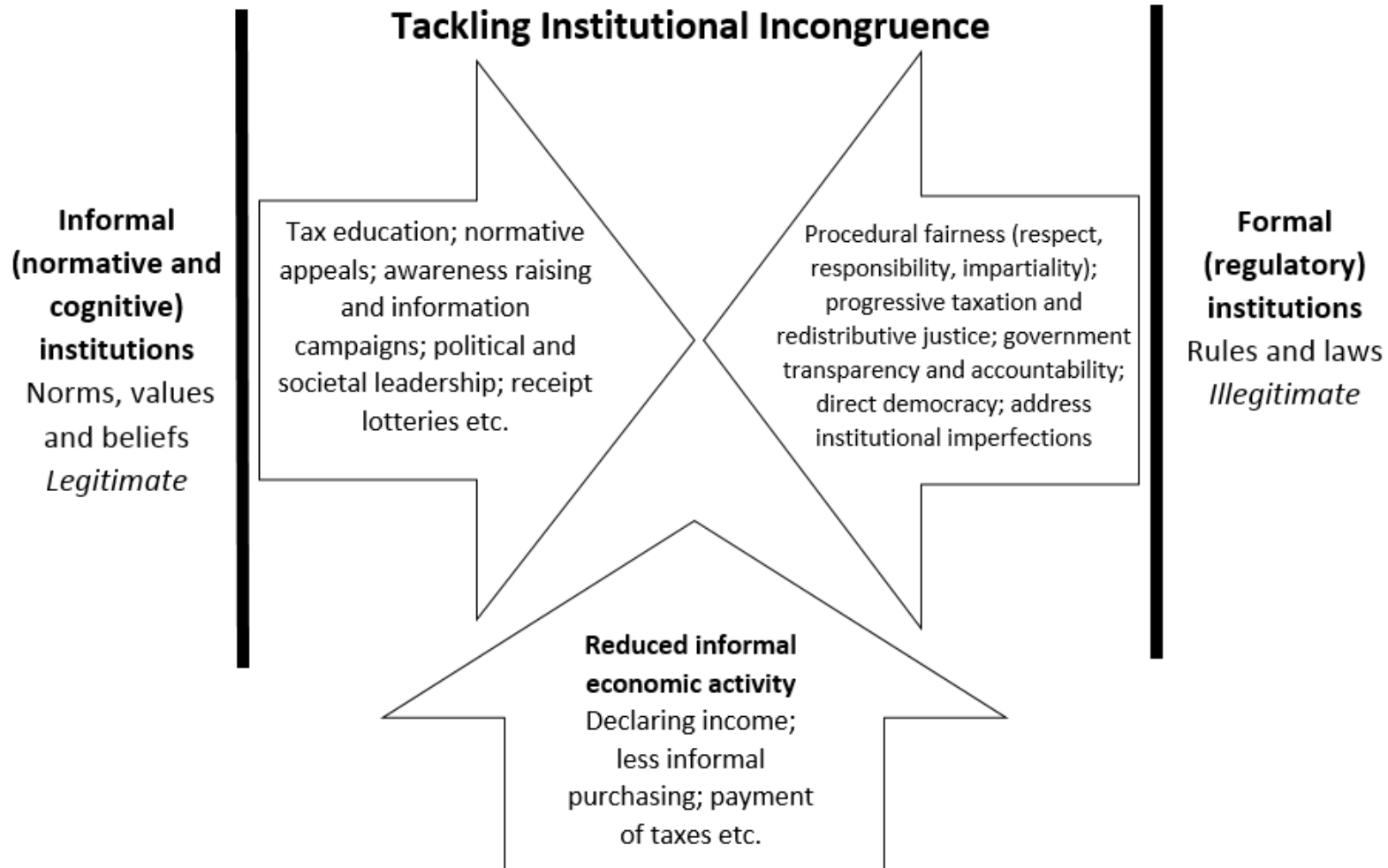
“Those are individual schemes, but one should try with 56 different measures to yield success. I really believe that it is impossible to be successful with only one measure” and *“there is a need to fix the whole system”*, (Croatia focus group participants)

This section has provided insights on how institutional incongruence and informal economic activity can and are being tackled (Figure 2 provides a summary representation of these). In particular, it provides a bottom up *‘policymaker’* perspective towards these measures.

Conclusions

In this paper, we advance understanding of institutional incongruence as an explanation for informal economic activity. We provide rich insights on how informal economic activity, institutional incongruence, and relationships between them are experienced by individuals in South-East Europe. We also shed light on the causes of institutional incongruence, identifying factors at work undermining the legitimacy of formal institutions and institutional actors in South-East European settings; as well factors contributing to the emergence and entrenchment of normative and cognitive institutions that legitimise engaging in informal economic activity. Finally, we provide insights for policymakers through examining the perceptions of policymakers towards different measures to tackle informal economic activity and address institutional incongruence.

Figure 2: Summary of measures to tackle institutional incongruence and informal economic activity



We outline a more nuanced understanding of relationships between institutional incongruence and informal activity. To date, much institutional incongruence scholarship has been quantitative, with less written at a micro everyday level and in terms of the lived experiences of individuals. We have thus responded to calls for more fine-grained perspectives on this subject (Webb et al, 2013), and for the use of alternative methodologies. Our findings also add richness and depth to previous debates in this area, including introducing a framework explaining the causes of institutional incongruence and how this leads to informal activity. To date, institutional incongruence studies have also often been focused on a single country. In this research, data was gathered from three countries providing a more comprehensive picture of how relationships between institutional incongruence and informal activity play out across different countries and the wider South-East Europe region. This paper also has implications for policy, providing insights on how different measures to tackle informal economic activity and institutional incongruence are perceived by policymakers in South-East Europe, identifying measures considered to have the most potential, as well as issues of concern. This complements studies of policy approaches towards tackling undeclared work at the pan-European level (see Williams and Horodnic, 2016).

We identify a number of areas for further study. Firstly, scholars are encouraged to continue to utilise different innovative methodologies to examine informal economy phenomena, including its relationships with institutional incongruence. Secondly, whilst in this paper we have utilised institutional theory as our theoretical framework, we recognise that deeper engagement with identification theories, trust based theories, and social contract theory amongst others, would all be beneficial in extending our work, and provide further insights on why people engage in informal activity. Geographically, our work only draws upon data from three South-East European countries, so in a regional context there is scope to extend it to other South-East European states to assess whether our findings hold true. There is also scope to compare our findings with other regions across Europe and globally.

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