



“SOCIAL INSTITUTIONS SUPPORT PROGRAMME”

CONTRIBUTION COLLECTION SYSTEMS

AND

POSSIBLE MEASURES TO IMPROVE THEIR EFFECTIVENESS

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FOREWORD

It has to be noted that not all countries involved in the CARDS-Social Institution Support Programme (SISP) have decided to cooperate in the present regional project. Nevertheless, the **majority of the countries/territory** have acknowledged the importance of improving the organisation and operation of the social security contribution collection system and felt that further research, also within the CARDS-SISP programme, might prove to be helpful to achieve this goal. Thus, the main focus of this report is on the systems in operation in Bosnia and Herzegovina, Serbia, Macedonia, Albania and the territory of Kosovo (at present under the temporary governance of UNMIK).

This small regional project was selected **on the grounds of the following description:**

“Not only the grey and black work circuits constitute important problems for the social security systems in the region, but also the fact that (the employers of even) registered workers do not pay in the due contributions. These employers and employees are registered and operate legally, but for one reason or another, they do not fulfil their contributory duties. This may be linked to the fact that the concerned employers face major financial problems and e.g. prefer to pay out wages (if they are able to) than to conform with their social security contribution duties. Penal and other sanctions may be a response to an unwilling employer, but more often more ‘soft’ measures are more adequate if one tries to keep an eye to the overall social problem. On the other hand it is unacceptable that larger numbers of registered employers would come away with not paying in their social security due.

All the countries in the region are confronted with a problem of non payment of contribution and inefficient contribution collection. More innovative and effective ways of collecting social security contributions could be introduced. A study of best practices in and outside the region may show useful here.

Often many agencies are today responsible for collecting social security contributions. Expertise on the most efficient way of collecting contributions, also contributions/premiums for capitalised schemes, e.g. via the state tax administration or only one insurance fund could be conducted. Pros and cons of such a centralisation should be evaluated.”

The research was carried out between the end of November 2006 and March 2007. Due to very limited timeframe thorough analysis of the legislation and functioning of the contribution

collection system in each of the countries/territory involved could not be performed. Thus, the report contains no formal proposals to supplement or change the existing legislation. This was also not the intention of this project. The recommendations made should be seen merely as well intended **suggestions** for improvement of the contribution collection system.

The author wishes to express his appreciation to all actors involved in the CARDS-SISP programme, local program officers of the countries/territory involved, especially Ms. Tanja Kalovska and head of the project Mr. Sixto Molina. Gratitude goes to respected colleagues Prof. Dr. Danny Pieters, Prof. Dr. Paul Schoukens and Mr. Frédéric Sansier for their support.

I. OBJECTIVES OF THE REPORT

1. Social insurance relation as a starting point

It is worth noting that between the insured person and the social insurance carrier (e.g. pension and invalidity insurance fund, health insurance fund, employment agency) the **social insurance relation** is *ex lege* established. Legal subjects in this two-sided, sinalagmatic, public legal relation have certain rights and duties towards each other.

On one hand, the *fundamental right* of the insured person (and his/her family members in some cases) is the right to certain, legally determined benefits, of course, if the eligibility conditions are met. At the same time, provision of the benefits is the fundamental duty of the insurance carrier. They may be provided by the insurance carrier itself, e.g. by paying cash benefits, or by the third parties contracted by the insurance carrier, e.g. health care providers in mandatory health insurance.

On the other hand, the insured person's *fundamental duty* is to pay social insurance contribution. Fundamental right of the insurance carrier to receive the contribution corresponds to this duty.

It is important not to lose sight of the social insurance relation, since sometimes **third parties** are attracted to this, special legal relation as well, e.g. employer or the State and its agencies. Let us just focus on the financing (and not benefit) side of the social insurance relation. It is the employer who usually gathers both parts, i.e. employee's and employer's social insurance contribution and transfers it to the collecting agency/institution. Tasks of the collecting agency/institution may be performed by one or more social insurance carriers (funds) or the state tax authority.

It should be noted that not all social security schemes in the countries involved in the present project are of a **contributory nature**. Payment of contributions is a characteristic of social insurance schemes. Thus, the more precise term social insurance contribution(s) could be

used. Nevertheless, it was decided to use the term social security contribution(s), as this is the term mostly used in the literature as well.

2. Purpose of the report

Social security systems in many countries are constantly developing. The principle of the adjustment of the law to social relations is also one of the principles of a state governed by the rule of law, one of the cornerstone principles of the Council of Europe and the European Union. To this end social security **reforms** are planned or executed in many countries in and outside Europe. A discussion of social security reform in the countries/territory in the CARDS-SISP region usually includes mentioning of the problem of lost contribution revenues. This is especially true for pension reforms. Yet, efforts to find solutions have so far been limited. Most social security policy deliberations have been dominated by the public - private debate. Fundamental issues of social security governance, such as contribution collection have usually received only marginal attention.¹

It is vital for the operation of any social security system that due contributions are actually paid. If they are not, the proper functioning of the social security system may be **undermined** or in the worst case it may cause its collapse. Persons in need of social protection and recognised as such by the law, could remain without it. In some countries, they may acquire social insurance benefits even if the contribution is not paid, e.g. in mandatory health insurance (at least urgent medical treatment), or if the contribution is calculated, regardless if it was actually paid, e.g. in pension insurance. This may lead to raising the contribution level, which is reportedly already quite high in the involved countries/territory.² In addition, rising of contribution level may occur with a substantial time lag, causing a period of financing shortfall. It may also be that subsidies by the State are required, which at the end of the day has to guarantee the proper functioning of the social security system according to international legal standards and national constitutions.³

¹ For instance, *Gorbanyov et.al.* (2005), p. 20.

² *Sansier* (2006), p. 17.

³ C.f. for instance Serbian Constitution, especially Art. 68 (Health Protection), Art. 69 (Social Protection) and Art. 70 (Pension Insurance), which are placed under point 2 Human rights and freedoms in the chapter on

Thus, the **objective of this project** is to focus on the fundamental duty of the insured person (also his/her employer and other legal subjects), stemming from the social insurance relation. To this end a distinction between tax and social security contribution is stressed and various models of contribution collection presented. Also causes for not paying social security contributions are analysed and some possible solutions proposed. They relate to some of the (best) practices within and outside the CARDS-SISP region. Our hope is that the information provided could assist the countries/territory involved in improving the effectiveness of the contribution collection system, reduce or even prevent contribution evasion and ensure proper functioning of the social security system.

Although the available literature is mainly focusing on reforms to provide sufficient income and autonomy in old-age, other social security schemes, providing benefits at time of occurrence of other social risks should not be considered less important. According to this interest collection system for pension contribution is usually analysed. We, however, believe that contributions to other social security schemes are equally important.

3. Issues not tackled in the present report

Although, the **access of insured persons to the benefits** (in kind and in cash) in case social security contributions have not been paid is an interesting topic, it is outside the boundaries of this project. Thus, the question whether an insured person has any rights, when contributions have not been paid (in full) and who is to be held responsible is not subject of this report. Although, some argue, that a stronger link between contributions paid and entitlement to benefits may increase effectiveness of the contribution collection system.

Human and minority rights and freedoms; Macedonian Constitution, especially Art. 1 (social state principle), and articles enumerating social, economic and cultural rights, which are placed under chapter II. Fundamental Freedoms and Rights of a Person and a Citizen, i.e. Art. 32 (unemployment insurance), Art. 34 (social security and social insurance), Art. 35 (social assistance), Art. 39 (health protection), Art. 42 (protection of motherhood, children and youth), and Albanian Constitution, especially Art. 52 (the right to social security), Art. 55 (the right to health care), placed under chapter on Economic, social and cultural rights and freedoms.

In addition the **quantitative dimension** of not paying the due contribution will not be tackled. We believe that for the sustainability of the social security system, all social insurance contributions should be paid. If it is notable that some of the insured persons (or their employers) do not have to pay social security contribution for all the wrong reasons, this may undermine the credibility of the solidarity mechanism, distinctive for the social security system.

Another interesting topic, related to the collection of contributions is the **structure of social security contribution**. This issue could not be tackled in depth in this report, either. Investigation of the contribution structure, i.e. what is the contribution basis, its level, minimum and maximum contribution etc., was one of the proposals for the separate project. The countries/territory involved have decided not to select it. Nevertheless, the level of social security contribution may have some influence also on the amount of collected contributions.

4. Interrelation with other regional projects

A **clear delineation** between this and other regional projects of the CARDS-SISP programme has to be made. One of the other projects is dealing with possible ways of bringing to the surface **black and grey work**. That project is also (at least partially) concerned with the financing side of social security. However, it is tackling the problematic situation when social security contributions are not paid due to existence of black/grey/informal economy. This means, that contributions are not collected, because people are not registered (or registered in full scope) as insured persons. Hence, their (full) obligation of paying contributions is hidden.

The present project is dealing with the problem when employers and employees are registered and operate legally, but for one reason or another, they do not fulfil their contributory duties. Contrary to the black/grey/informal economy, they are visible to the social security authorities. Thus, our investigation is concerned with the collection of social security contributions, amount of which is already known. Although, the contribution due is established, contributions may not be paid in for various reasons.

Nevertheless, the two projects are interrelated as in some cases similar solutions might be proposed. It might also be discussed whether measures (sanctions or incentives) should be applied for each of the two steps separately or only if both steps are made. For instance, should one get some privileges only for (full) registration and then again for paying contributions or only if he registers and pays regularly social security contributions. Probably, it makes no or very little sense to provide incentives to register, without any effective measure to ensure the payment of contributions. One of the final goals to make black/grey/informal economy visible is to collect contributions and provide social protection to the people who would require it. Contributions have to be collected to enable provision of adequate social insurance benefits (and not rely solely on minimum social assistance).

Contributions might not be paid by the registered persons, who have to pay social security contributions themselves, like self-employed and farmers. Present report may thus be related to the separate CARDS-SISP regional project concerning the *adequate social protection for farmers*. Farmers may be given specific incentives to pay social security contribution or (part) of the contribution due could be covered directly from the (state) budget.

The present project may also be related to two other CARDS-SISP regional projects. One of them is investigating the possible outcomes of the *information centres and one stop shops*. They may contribute to the smoother information exchange between the agencies/institutions responsible for contribution collection and raise public awareness on importance of social security contribution payments.

The other is concerning the mandatory character of *2nd pillar pension schemes* and its consequences. It goes without saying that contributions have to be collected to enable the functioning of the mandatory 2nd pillar pension schemes as well. There might even be some distinctive solutions for collecting these contributions. Additionally, some (wrongly) believe that mandatory fully funded schemes may improve contribution collection.

II. DISTINCTION BETWEEN TAX AND SOCIAL SECURITY CONTRIBUTION

The relation between tax and social security contribution is quite complex. We shall not analyse in depth all the similarities and differences between them. Let us just mention some, probably most important common features and distinctions between a tax and a social security contribution.

1. Similarities of a tax and a social security contribution

Both, taxes and social security contributions are public levies and they may be felt similarly by persons who have to pay them. They are determined by an act of parliament in a form of a statute or a special decision.⁴ Thus, it is not the free will of the individual whether to act upon them or not (*ius dispositivum*). The individual is coerced (legal norms are part of *ius cogens*) to pay taxes and social security contributions.

Both, taxes and social security contributions reduce the salary or other disposable income and there might be a tendency (by some) to evade not only taxes, but also social security contributions. However, the purpose of levying taxes is distinct from the purpose of levying social security contributions.

⁴ For instance, in Albania the Law 9136 dated 11.9.2003 on the Collection of the Compulsory Social and Health Insurance Contributions in the Republic of Albania; in Serbia the Law on Compulsory Social Insurance Contributions (Official Gazette No. 84/04, 61/05, 62/06), in Bosnia and Herzegovina the Law on Contributions in the Republic of Srpska (Official Gazette of the RS, No. 51/01 and 96/03), as well as the Law on Contributions in the Federation of BIH (Official Gazette of the Federation BIH, No. 35/98, last amended in 2002).

For instance, a special Decision on the contribution basis and its level for mandatory health insurance (Official Gazette of the RM, no. 4/2001 and 50/2001) and the Decision on the level of employment contribution (Official Gazette of the RM, no. 50/2001) was passed by the Macedonian parliament. Decision on the contribution level for employment and Decision on contributions for mandatory health insurance in Bosnia and Herzegovina (Brčko District) was also passed. Answers to the Questionnaire, Bosnia and Herzegovina, p. 3.

2. Differences between a tax and a social security contribution

Social security **contributions** are collected with an exact purpose and have a multilayered meaning. *Subjective–individual* understanding of social security contribution corresponds to the social insurance relation as a public legal relation where social insurance carrier is a debtor. Contribution is paid in exchange to a benefit, which has to be provided by the recipient of the contribution, i.e. the insurance carrier.

Contribution may also be perceived in its *subjective-institutional* dimension. It emphasises the membership elements of the social insurance relation. An insured person is a member of the social insurance carrier and has membership rights, e.g. the right to participate in the self-government of the insurance carrier and membership duties, e.g. duty of paying the contribution. This right and a duty are not provided to the family members of an insured person, whose rights derive from the insurance of the insured person.

The third dimension of a contribution is *objectively-institutional* dimension. Recipient of the contribution is a specialised juridical person governed by public law, which exists for the sole, objective purpose to provide certain statutory defined rights.⁵

Such a purpose and a multilayered meaning are (generally) absent at **taxes**. They do not represent a payment for a specific benefit of a separate legal person.⁶ Their purpose is to gather income, which sometimes may be earmarked for a certain purpose and thus not completely freely disposable by the State. Social protection, fully financed out of general taxation can not be defined as social insurance. Also the fact that almost all inhabitants are included in (a certain) social (usually health) insurance scheme does not eliminate the necessity to distinguish between tax and social security contribution.

⁵ *Strban* (2005), p. 168.

⁶ There is no equivalency between the payment of taxes and benefits gained as it is in social insurance. Although, it is less expressed than in private insurances. *Jelčić* (2001), p. 431.

Of course, the possibility of engaging means collected by taxes to finance social insurance schemes is not excluded. We could still speak of social insurance if some benefits or benefits to certain groups of persons are financed out of taxes. For instance, some benefits within social insurance that have at least partial nature of social compensation or social assistance. These are payments of the State intended to equalise burdens, which are carried by the solidarity community of certain social insurance scheme, but should be carried by the whole (state) community. However, if such budgetary payments are permanent and disproportionate, social insurance may transform to a national protection system.

Legal expectations of socially insured persons may enjoy **more protection** than legal position of beneficiaries entitled to tax financed rights. Contributions are predominately paid by insured persons (and their employers) themselves. One of the interesting legal questions is could the right to property be interpreted in the sense to provide property protection also to social insurance contributions consequently to social security rights. Traditional concepts of private property usually afford the best legal protection.

The countries involved in the present project are Member States of the Council of Europe and thus bound by the European Convention of Human Rights (ECHR) and its interpretation by the European Court of Human Rights. It has confirmed that social security contributions are not solely of a public, but at least partially also of a private legal nature.⁷ The Court has already extended the notion of civil rights also to social security rights, in connection to the right to a fair trial (Art. 6 of the ECHR) and applied the property protection arguments (of Art. 1 Protocol 1 to the ECHR) to social security rights. It considered a social security right as pecuniary right without it being necessary to rely solely on the link between entitlement to social security right and the obligation to pay contributions.⁸ It appears that in the national context the German constitutional Court has gone the furthest in this interpretation.⁹

The term social security contribution is defined neither in international legal standards nor in national legislations. In the context of the European Community (EC) **social security co-**

⁷ E.g. the Court acknowledged that disputes concerning social security contributions are disputes on civil obligations and thus protected by Art. 6 of the European Convention on Human Rights (*Schouten and Meldrum v. the Netherlands*, 9.12.1994, A 304).

⁸ E.g. *Gaygusuz v. Austria* (16.9.1996, Reports 1996-IV).

⁹ *Pieters/Zaglmayer* (2006), p. 22.

ordination law there is a social security contribution when there is a direct and sufficiently relevant link between the levy and the legislation governing the social security branches to which the social security co-ordination Regulation 1408/71/EEC is applicable.¹⁰ It is not necessary that the levy is matched by a corresponding benefit, nor the way it is carried out. It is also no need that the levy has to be imposed upon the person benefiting from the social security system to be classified as a social security contribution.

However, there is no social security contribution when the levies are disconnected from the identity of the person paying, but are included in the price of goods and services available on the market. Crucial question is whether the revenue is going directly to social security or does it transit via the general means of the State.

According to what has been written above, we could try to **define** a social security contribution as a coercive (direct) payment to the social insurance carrier, intended to finance social insurance.

¹⁰ *Pieters* (2002), p. 527.

III. CONTRIBUTION COLLECTION SYSTEMS

Social security systems, including their part of contribution collection, have developed through time. They are conditioned by a number of structural and cultural elements and tradition in each country. Thus, social security systems vary from country to country and it is impossible to find two identical ones. The same goes for contribution collection systems as one of the vital parts of the larger social security system.

In general, a **distinction** between centralised and decentralised models of contribution collection can be made. Within the centralised model we could further distinguish between integrated collection system and parallel collection systems. Let us present some strengths and weaknesses of each of them.

1. Centralised collection system

Although classifications of different authors vary to a certain extent, we shall define a centralised system as a system where contribution collection is entrusted to one national (central) agency or institution. The collection of social security contribution may be the duty of the state tax agency or of a social security institution.

1.1. Integrated collection system

There is a clear **trend** in some European and other countries towards the integration of contribution collection with tax collection.

It is argued, that combining them may show some clear **advantages**. It could improve compliance and result in a more efficient use of resources. The collecting agency may achieve greater economies of scale, i.e. collect more revenue with less costs. In principle, common operations do not have to be duplicated and cause duplicative costs. In some countries,

building one modern, state of the art collection system is a challenge and the possibility of two or more is not within reach.

However, certain **conditions** have to be met. Joint collection of social security contributions and taxes is meaningful only in countries with well developed system of government administration and strong fiscal administration. Joint collection agency should also enjoy a high level of trust. The social security institution and the insured persons must be confident that a joint collection body (tax agency) will act solely as an agent who receives and transmits social security contributions to the social security institution without delay or diversion. The distinction between social security contribution and tax should not be blurred. Additionally, tax agency is a governmental body. Hence, in countries where governments face chronic budget deficits this trust can be difficult to build.¹¹

Some argue, that integration of collection activities will work best where both social insurance institution and tax agency are modernised. The task of integration can then be narrowly focused on the transfer of collection functions. For instance, such a set of circumstances was present in Sweden in 1999. The project to integrate collection worked extremely well and expeditiously.¹² However, these circumstances may not always be at hand. For example, integration in the United Kingdom, Ireland and Italy took place with a variety of problems, on both, the social security institution and tax agency sides.¹³

The advantages may appear as convincing. However, it is not easy to find empirical evidence of these advantages. Worldwide, many different models of contribution collection are in operation and it is impossible to demonstrate that one approach is inherently superior to others.

Integrated collection system may show its **drawbacks**, if there is no cooperation between tax agency and social insurance institutions. There should be cross-matching of data and regular and accurate exchange of information. The government-wide approach should be applied, involving all responsible agencies and institutions. Another problem may be in motivation of

¹¹ *McGillivray* (2001), p. 19.

¹²¹² *Ross* (2004), p. 9.

¹³ *Ibidem*.

the staff within tax agency, since its primary function is not to collect social security contribution, but taxes. Tax agency may be unaccustomed to crediting revenues anywhere other than to the State budget. In addition, shifting from one model to another always involves transitional costs and there is no guarantee that the new system will perform better than the old one.

Nevertheless, **examples** of integrated collection system, in addition to already mentioned countries, could be found in Norway, Estonia, Latvia, Hungary, Bulgaria, Slovakia, Slovenia, Croatia (except for the second pillar pension scheme)¹⁴ and Montenegro.¹⁵

1.2. Parallel collection system

When the collection of social security contribution is entrusted to one national social insurance institution, we could speak of a centralised **parallel collection system**. In addition to this collection system at least one other is in operation, i.e. the tax collection system. In this case some authors speak of a **full service social insurance institution**. It is responsible not only for providing the benefits, but also for collecting social security contributions.¹⁶ Others define this system as **semi-centralised**. They recognise centralised system only when the tax agency collects both, taxes and social security contributions.¹⁷

It is argued, that countries which have established their social security system much earlier had to introduce a parallel collection system mainly because the tax system was not well established. Another **reason** may be found in mistrust towards the government. In countries where people do not trust the government and its tax agency, there is a greater possibility that the social security institution is entrusted also with collection of contributions and collects them more efficiently than tax agency.

There are some **advantages** of the centralised parallel contribution collection system in comparison to others. This system might be more effective. It is argued by the Polish Social

¹⁴ More on Croatian collection system *Bejaković*, in *Fultz/Stanovnik* (2004), p. 59 ff.

¹⁵ *Ross* (2004), p. 15.

¹⁶ *Ibidem*, p.1.

¹⁷ *Watanabe* (2006), p.6.

Insurance Institution (ZUS) that the effectiveness of contribution collection by ZUS has been improving and is quite high. It is an example, that contribution collection by a social insurance institution could be more effective than if carried out by government agencies, e.g. tax agency, provided that proper regulations and techniques are applied.

Another advantage may be that the social insurance institution concentrates all its efforts and actions towards a single goal. Its functioning depends on efficient contribution collection, thus the motivation for collecting as much contribution as possible is very high.¹⁸

One of the **drawbacks** may be that such a system is still parallel. This means that at least two collection systems are in place, i.e. one for tax and the other for contribution collection, which may lead to certain inefficiencies in collection.

Examples of a centralised parallel system may be found not only in Poland, but in some other European countries as well. For instance, in *Belgium*, contributions are collected by the National Institute for Social Security. It takes a central position in the Belgian social security system. Practically all contributions paid by the employers and the workers of the private sector and the public services, are handled by it. Additionally, the National Institute for Social Insurance of the Self-Employed is entrusted with contribution collection for this group of insured persons.¹⁹ Thus, the system is parallel and centralised, as both institutes collect contributions for all branches of social insurance. It could also be argued that the system is in a way decentralised, as there are two institutes, not only one.

For example in the *Czech Republic*, the Czech Social Security Administration (ČSSZ) and its associated bodies, subordinated to the Ministry of Labour and Social Affairs, represent the principal administrative organs, responsible for collecting contributions for basic pension insurance, health insurance, maternity benefits, unemployment insurance and employment programmes. It is also responsible for the calculation and payment of benefits and keeping records of the insured persons.²⁰ In *Lithuania* the State Social Insurance Fund Board (SODRA) and its territorial departments collect contributions and distribute insurance

¹⁸ Wiktorow (2004), pp. 1 and 2.

¹⁹ Pieters et.al. (2002), pp. 24 and 26, www.onssrszls.fgov.be, www.rsvz-inasti.fgov.be.

²⁰ C.f. the web page of the Czech Social Security Administration: www.cssz.cz/default_en.asp.

payments. The State Patients' Fund receives its funding from a portion of the social insurance contributions made to the State Social Insurance Fund and a portion of personal income taxes collected by the State Tax Inspectorate.²¹

In *France* special national fund, the Central Agency for Social Security Bodies (ACOSS) and its local offices, the 105 Local Unions for Social Security and Family Allowances (URSSAF) are responsible for collecting social security contribution and special social taxes for the funds which provide benefits. It is the experience of the French system that an institution for collecting contribution, separated from the funds providing benefits is the best solution. When both tasks are performed within the same institution, the slightest problem caused by absent personnel or staff cuts, could have negative effects on the collection function, although benefits always continue to be paid.²² This is the collection system for the French general social security scheme. And it could be argued that it is a centralised (parallel) contribution collection system with deconcentrated local offices.

It is also possible that centralised parallel collection system exists for the **second pillar** pension scheme. For instance, in Croatia, special public agency (REGOS) was established in 1999. Its task is, among others, to collect contributions for mandatory (or for some insured persons voluntary) second pension pillar contribution, control the payment and allocate them to the responsible second pillar pension fund. It is one, central agency, monitored by special agency responsible for monitoring and regulation of second pillar pension funds (HAGENA). REGOS exists parallel to tax agency and social insurance institutes. Tax agency is responsible for on-site control of the second pillar contributions. Social insurance carriers retained some control over first pillar contributions, but they do not collect them. It is a task of the tax agency. Within such institutional structure it is important that data sharing works flawlessly. Reportedly, in Croatia, this segment would still require some improvement.²³

²¹ *Pieters et.al.* (2003), p. 96 and www.sodra.lt.

²² *Lion* (2004), pp. 2, 9.

²³ *Bejaković*, in *Fultz/Stanovnik* (2004), p. 70 ff.

2. Decentralised collection system

In a decentralised system, the collection of social security contributions is the responsibility of **more than one social insurance carrier**. If there is a trend towards a centralised, especially integrated contribution collection system, there is hardly any move towards a decentralised system of contribution collection. Nevertheless, there are countries where the decentralised system of contribution collection is in operation.²⁴

For example, in the **German system**, the entire social security contribution is collected by the decentralised mandatory health insurance funds (they are so called *Einzugstellen*). They also decide on the mandatory insurance, duty to pay social security contribution and its level. The collected amount is then split, according to the law, and transferred to other social insurance schemes (i.e. pension and unemployment insurance scheme). The collection costs are reimbursed to mandatory health insurance funds by other social insurance carriers, which may conduct on-site supervision to determine whether the contributions are correctly collected. It is argued that paying pensions is tomorrow's problem but health care is today's problem. Thus, this kind of contribution collection system may promote higher levels of compliance.²⁵ Similar situation exist in Austrian contribution collection system.²⁶

This kind of a system is centralised (and parallel to tax collection system) in the sense that only health insurance funds collect the entire social security contribution. At the same time the system is decentralised, since not only one health insurance fund, but each of them is responsible for collecting contributions.

The German legislator introduced (another) health insurance reform in the beginning of February 2007, when the Law on Enhancing the Competition in Mandatory Health Insurance, i.e. *Gesetz zur Stärkung des Wettbewerbs in der gesetzlichen Krankenversicherung (GKV-WSG)* was passed.²⁷ Analysing this reform, more elements of centralisation of contribution collection system (but not its integration with tax collection) could be detected. Mandatory

²⁴ Watanabe (2006), p. 6 ff.

²⁵ *Ibidem*, Schuljin/Igl (2002), p. 120 ff and p.278 ff.

²⁶ Tomandl (2002), p. 65.

²⁷ Bundesrat approved the new law on 16 February 2007.

health insurance funds will retain the obligation to collect social security contribution. However, from the year 2009 they will not retain a part and dispense the remaining parts to other social insurance carriers. They will transfer (thus they will be called *Weiterleitungsstellen*) collected contributions to a special, newly established health fund (i.e. *Gesundheitsfonds*), which will be financed from contributions and taxes (for services provided to the entire population, not only to insured persons). Mandatory health insurance funds will afterwards receive mandatory health insurance contribution back as a lump-sum payment and an addition to equalise the age and risk structure.

The level of contributions will be raised and from 2009 prescribed equally for all health insurance funds (which today is not the case). Thus, employers will be relieved the duty to calculate and pay distinctive contributions for their employees. From the year 2011 they will have an option to pay all social security contributions to one health insurance fund of their choice. It is expected that this will lead to simplification of contribution collection system as well as concentration and tighter links between the institutions in charge of contribution collection (health insurance funds).²⁸ Some argue that this reform will lead to enhanced administration and financing of poorer health insurance funds by wealthier ones.

In **France**, a clearly decentralised system applies for compulsory complementary pension scheme. Here the same bodies, administered by social partners, collect contributions and provide compulsory complementary pension.²⁹

It is also possible that **each social insurance fund** collects its own contributions, which may give raise to number of inefficiencies. Such is the example of the Romanian contribution collection system, which is moving to a centralised integrated collection system on a piecemeal basis.³⁰

It is also possible that each of the **private pension funds** collects contributions/premiums for the individual account funded pension plan. This is the case e.g. in Chile, Peru, Singapore.

²⁸ *Die neue Gesundheitsversicherung* (2007), pp. 4-6, 14-15.

²⁹ *Lion* (2004), p. 3, *Watanabe* (2006), p. 7.

³⁰ *Watanabe* (2006), p. 7.

Also in Slovenia, premiums for the voluntary second pillar pension scheme are collected by private pension funds themselves.

3. Contribution collection systems of countries/territory involved in the project

Systems of collecting social security contributions of the countries/territory involved in the present project are **distinct** to a certain extent. In all of the countries/territory involved, reforms of contribution collection system have been conducted recently (e.g. Albania), are in the middle of the reform process or are preparing (new) reforms (e.g. Serbia and Macedonia).

3.1. Centralised integrated collection systems

It could be argued, that in Serbia, Bosnia and Herzegovina and Albania a **centralised integrated** collection system is in operation. Tax agency is responsible not only for collecting taxes, but also for collecting social security contributions.

In ***Serbia***, the tax administration, as part of the Ministry of Finance is responsible for collection of contributions as well as for the monitoring of their calculation and payment according to the law of tax procedure and tax administration. The process is supervised by the Ministry of Finance, part of which is also the tax administration.

Contributions are paid monthly to the tax agency, which transfers them (according to the percentage key between the insurance carriers) to the Treasury department. The latter actually distributes the amount to the accounts of each of the insurance carrier, i.e. three pension and invalidity funds (for employees, self-employed and farmers), health insurance institute and national employment agency.³¹

Tax administration is responsible for collecting social security contributions also in ***Bosnia and Herzegovina***. That goes for the Federation of BIH (calculation and collection of

³¹ Answers to the Questionnaire, Serbia, p. 1.

contributions is the responsibility of the tax agency according to the rules on taxation of income from farming and forestry)³² as well as for the Republic of Srpska (at least for pension and invalidity insurance and for unemployment insurance).³³ In Brčko District the inspectors of the tax agency seem to be responsible for supervising the calculation and collection of taxes and contributions.³⁴

In *Albania* the transfer of the responsibility to collect social security contribution from the Social Insurance Institute (SII) to the tax agency has been fully completed only recently.³⁵ Reportedly, the tax agency collects contributions on behalf of the SII and the Health Care Insurance Institute (HCII), although, the SII has no right to supervise the collection of contribution.

Contributions have to be paid to one of the 16 second level banks on the account of the tax agency, under the voice “social and health care contributions”. At the end of the day, these banks transfer the money to the central bank, i.e. the Bank of Albania on a Treasure Special Account. The funds are then used to provide social security benefits.

Special agreement between the tax agency (i.e. Directorate General of the Tax Office) and insurance carriers (i.e. SII and HCII) on data exchange was concluded mid 2004.

There is somewhat different situation in the **territory of Kosovo**. Social security system appears not to rely on contributory, social insurance schemes, but seems to be based on national protection scheme, financed by the Kosovo Consolidated Budget. The tax authority collects taxes, which is its primarily duty, and the taxes are also used to finance social security system. Thus, we could not speak of an integrated collection system, but of the only one, i.e. tax collection system.

³² Answers to the Questionnaire, Bosnia and Herzegovina, p. 4.

³³ Answers to the Questionnaire, Bosnia and Herzegovina – Republic of Srpska, p. 1.

³⁴ Answers to the Questionnaire, Bosnia and Herzegovina, p. 4.

³⁵ In September 2003 the Law 9136 on Collection of the Compulsory Social and Health Insurance Contribution entered into force. According to the Council of Minister’s decision the VIP contributors (i.e. big enterprises) started the process of transference in November 2003, subjects with a VAT in May 2004, small businesses on January 2005 and budget institutions in June 2005. Answers to the Questionnaire - Albania, p. 1.

The only difference appears to be the financing of the second pillar pension scheme. It is financed by employer's contributions. Special institution, i.e. the Kosovo Pensions Savings Trust, which is managed by an independent managing board, where one seat is reserved for a representative of Kosovo Tax Authority, seems to be responsible for collecting second pillar pension savings.³⁶ Thus, it could be argued that in this part a centralized parallel collection system is in operation.

3.2. Decentralised system

Contrary to the social security collection system of Serbia, Bosnia and Herzegovina and Albania, there is no centralised integrated collection system in **Macedonia**. It is in fact *parallel* to the tax collection system and at the same time *decentralised*, since all social insurance funds collect their own contribution.

Analysing only legislative acts one could (wrongly) argue, that contribution collection system is partly centralised and integrated with the tax collection system. According to the Employment and Insurance in case of Unemployment Act (Art. 96) the employer has to pay employment contribution to the Ministry of Finance – Public Revenue Office, which then has to transfer it to the Employment Agency's account. Thus in this part it could be argued that the contribution collection system is centralised and integrated with the tax collection system.³⁷

However, actual situation is somewhat distinct. Employment contribution (actually unemployment insurance contribution, 5% of which is used to finance active policy measures, which might not be uncontested) is collected directly by the Employment Agency of the Republic of Macedonia.³⁸ It appears that until 2004 the Public Revenue Office was competent to issue a decision on the contributory duty and the contributions were paid directly to the insurance funds. From 2004 onwards, insurance carriers issue their own decisions and

³⁶ Answers to the Questionnaire, Kosovo, p. 3.

³⁷ The legislative text was repeated also in the Answers to the Questionnaire, Macedonia-Employment Agency, p. 1.

³⁸ Discussions with the representatives of the Macedonian Employment Agency and Ministry of Finance-Public Revenue Office, March 2007, also Answers to the Questionnaire, Macedonia-Public Revenue Office, p. 3.

contributions are paid directly to them. It seems that only the Employment and Insurance in case of Unemployment Act was “forgotten” to be changed. Today the contribution collection system in part of collecting employment contribution is operating contrary to the legislative norms. Thus, the question of legality might be raised. The rule of law principle should be respected. It is one of the Macedonian Constitutional values (preamble and Art. 8 of the Macedonian Constitution) and a cornerstone principle of international organisations like the European Union and the Council of Europe. Therefore, either the law or the practice should change.

For other social insurance schemes it is clear that tax authority is not responsible for collecting social security contribution. This has remained in the domain of the social security institutions. Thus, contribution collection system in Macedonia is parallel in the sense that it exists parallel to tax collection system. At the same time it is decentralised in the sense that not only one, but more social insurance carriers are entrusted with the task of collecting contributions. Each for the scheme it manages. Hence, the Fund for Health Insurance of Macedonia collects the contribution for the mandatory health insurance and the Pension and Invalidity Insurance Fund of Macedonia collects the contribution for the pension and invalidity insurance.

There is a detailed procedure on collection and supervision of contribution payment by each of the Funds in the Pension and Invalidity Insurance Act (Art. 182 ff.) and Health Insurance Act (Art. 47 ff.).

Nevertheless, Public Revenue Office may be included in the contribution collection procedure. For instance, if the pension and invalidity insurance contribution is not paid in due time, the Fund for Pension and Invalidity Insurance is entitled to deduct contribution form the non-payer’s account. If the Fund does not succeed in this action, it has to submit a request to the Public Revenue Office for enforced collection from the property of non-payer according to the rules on determination and payment of public revenues.³⁹

Also the Fund for Health Insurance may lodge a request to the Public Revenue Office or other competent institution to monitor the calculation and payment of the contribution for

³⁹ Art. 185-i of the Macedonian Pension and Invalidity insurance Act.

mandatory health insurance. The relation between the two is regulated by a special agreement.⁴⁰

Macedonia is the only country involved in this project, where the *mandatory fully funded* (second/first plus pillar) pension insurance scheme is in operation. Contributions for this scheme are neither collected by a separate agency or institution, nor by tax agency. It is done by the Pension and Invalidity Insurance Fond, which is responsible primarily for the pension insurance scheme based on intergenerational solidarity (first pillar). Collected contribution is divided and transferred in five working days at the latest to bank accounts of private pension funds.⁴¹ This might prove to be a good solution. If private pension funds would be responsible for contribution collection it could be unlikely that they would take legal action against clients that are not in (full) compliance, due to the competition for clients.⁴²

Also in Macedonia a trend towards centralisation may be detected. An Office for Larger Payers (KGPP) has been established at the Fond for Pension and Invalidity Insurance. At the moment it is responsible for a bit over 100 juridical persons and only for collecting pension and invalidity contribution. It appears that from 1.7.2007 it will be responsible for collecting all social security contribution, but still only for larger payers. As of 2008 it should be responsible for both larger and smaller contribution payers. Thus, one institution will be responsible for social security contribution collection. Although, it may still face some problems, since the procedures of enforcement of due contributions and interests for due, but not paid contribution, are distinct in social insurance schemes and pension system has a second (first plus) mandatory fully funded pension scheme.

According to some projections the Office for Larger Payers should be only an intermediate step from centralised parallel to centralised integrated contribution collection system.⁴³ According to some projections, as of 1.1.2009 the Public Revenue Office should be responsible not only for tax but also for contribution collection. Integrated collection system appears to be advocated by the international financial institutions. Although it has to be noted

⁴⁰ Answers to the Questionnaire, Macedonia-Public Revenue Office, p. 4 and Art. 51 of the Macedonian Health Insurance Act.

⁴¹ Art. 60 of the Macedonian Mandatory Fully Funded Pension Insurance Act.

⁴² *Baily/Turner* (1997), p. 12.

⁴³ Answers to the Questionnaire, Macedonia-Public Revenue Office, pp. 4 and 6.

that integration seems not to be in the interest neither by the social insurance carriers, nor the tax authority. It is argued, that on one hand social insurance institutions, especially the Fund for Pension and Invalidity Insurance, are better equipped, and could easier enforce contribution payment. On the other hand tax agency has already enough work with the collection of taxes. Hence, one could reasonably doubt that all conditions for an integrated collection system are met. Additionally, as already mentioned above, there is no evidence that this solution is superior to others.

IV. CAUSES FOR CONTRIBUTION EVASION

Some contribution collection systems of the countries/territory involved are marked by high ineffectiveness. For instance, several years ago only 20 percent of the economically active rural self-employed in Albania were paying contributions and the revenue from contributions covered only about 40 percent of the expenditure.⁴⁴ In Serbia, it is estimated that around 40 percent of present labour force currently does not fulfil the fundamental duty from the social insurance relation, i.e. pay social security contribution.⁴⁵

Especially, the Serbian Fund for Pension and Invalidation Insurance of Farmers appears to be characterised by extremely poor collection. In 2005 the revenues from contributions made up only 15 percent of the total Fund's revenues. And only 44 percent of originally projected revenues from contributions were collected in 2005, despite the fact that the projections already took into account the inability to collect certain percentage of contributions.⁴⁶

Causes for contribution evasion may originate from the employer, worker or agency/institution responsible for the collection. Its prevalence depends on the attitudes of each and on the cost and reward structure they face.

1. Institutional arrangements

In integrated collection systems, excellent administrative cooperation is required between social insurance carrier and tax agency. There should be accurate and timely information transfer between collecting (tax) agency and social insurance carrier, responsible for providing the benefits (like in Serbia, Albania, Bosnia and Herzegovina). The same goes for parallel collection systems, where responsible social insurance carrier may ask tax agency's

⁴⁴ *Meca/Xhumari/Shehi/Poci* (2000), pp. 5, 10.

⁴⁵ Answers to the Questionnaire, Serbia, pp. 5, 8.

⁴⁶ Information – Current Status of the Republic Fund for Pension and Disability Insurance of Farmers, p. 4.

support in contribution collection activity (like in Macedonia). However, different agencies/institutions often **fail to share information**.

One of the major problems of the contribution collection system in Serbia appears to be lack of cooperation between the tax administration and social insurance carriers. Despite the legal obligation to share all relevant official data on contribution collection, there is actually no systematic linkage (and data flow) between tax administration and social insurance carriers. The electronic exchange of information is not satisfactory developed and causes important obstacles in implementing the legislation in force. Also databases of pension and invalidity insurance funds (of employees, self-employed and farmers) are not systematically linked.⁴⁷

It is the fundamental right of a social insurance carrier, stemming from the social insurance relation, to receive contributions in order to fulfil its basic duty, i.e. provision of benefits. The insurance carrier is entitled to contributions and thus very much interested to receive the necessary information and to conduct supervision. For instance, in Albania there is a special agreement between the tax agency and social insurance carriers. Tax agency provides certain data to the insurance carriers.⁴⁸

However, there is no right to conduct (external) **supervision** by the insurance carriers.⁴⁹ The same goes for the systems that operate in Bosnia and Herzegovina (in the Federation of BIH,

⁴⁷ Answers to the Questionnaire, Serbia, pp. 1, 5, 6. *Gorbanyov et.al.* (2005) pp. 20 and 21 ascertained that neither the tax authorities nor the pension funds have reliable records on individual contributors and that the lack of an individual database of contributors is generating problems for adequate enforcement. Also the Fund for pension and invalidity insurance of Farmers ascertained that legal obligation of co-operation between the tax agency and the Fund is not fulfilled in practise. It is not satisfactory, complete and continued. *Republički fond za penzijsko i invalidsko osiguranje poljoprivrednika* (2006) p. 3.

⁴⁸ The tax agency is obliged to send the social insurance institutions (i.e. Social Insurance Institute-SII and Health Care Insurance Institute-HCII) original list of payments; detailed data of the contributions, benefits and interests paid by each subject and each contributor in an electronic format; data of each individual contributor every 3 months; monthly information and data of those who do not respect the deadlines for payments; statistical data on the number of registered subjects and the number of contributors, according to the activities they carry out. The social insurance institutions (SII and HCII) are obliged to cooperate with the tax agency when designing the annual programme of income deriving from the contributions. Answers to the Questionnaire, Albania, p.2.

⁴⁹ *Ibidem*, p. 4.

the Republic of Srpska and Brčko District).⁵⁰ Internal supervision might be provided, e.g. by the Ministry of finance when tax agency collects the contributions. Problems concerning the supervision are also reported in the Serbian and Macedonian collection system.⁵¹

Where integrated collection system is in force, there might be cases of lack of **motivation** to collect social security contributions by the tax agency, as it also performs other tasks. Administration of social insurance carrier might be more motivated to collect contributions, since it is oriented towards a single goal, i.e. to have enough funds for provision of benefits. For instance the Fund for Health Insurance of Macedonia appears to be very much interested in collection of contributions. Its administration is aware, that if they would not be able to collect the contribution (using also enforcement procedures) they would not be able to function at all.⁵²

On the other hand, when social security contributions are collected by the social insurance carrier, the evasion might not be taken seriously. The administration might perceive as their objective as helping people rather than being law enforcers. They prefer to act through education, persuasion and incentives, rather than through enforcement, inspections and penalties. They may be reluctant to collect contributions from the employers in bad financial situation or may feel that it is unfair to penalise a few, while most evaders go unsanctioned.

Problems with certain tolerance for contribution evasion and not commencement of enforcement procedures are also reported from Serbia and Albania.⁵³ If there is low probability of contributions being levied by using also enforcement and other measures, then it is more likely that contributions are not going to be paid. Sometimes, the collecting agency/institution may face too many expenses to enforce compliance and rather does not start the procedure.⁵⁴

⁵⁰ Answers to the Questionnaire, Bosnia and Herzegovina, p. 4 and Bosnia and Herzegovina – Republic of Srpska, p. 1,

⁵¹ *Radovanović et.al.* (2006), p. 102. Answers to the Questionnaire, Macedonia – Pension and invalidity insurance fund, p. 3.

⁵² Answers to the Questionnaire, Macedonia-Health Insurance Fund, p. 3.

⁵³ *Radovanović et.al.* (2006), p. 102. Answers to the Questionnaire, Serbia, p. 1, 2; Albania, p. 3.

⁵⁴ Reportedly, in the territory of Kosovo, lack of resources is definitely one of the reasons (although not the only one) for relatively low contribution collection. Answers to the Questionnaire, Kosovo, p 4.

Administrative complexity of compliance procedures may stimulate contribution evasion. Separate contribution assessment and collection arrangements for different social insurance schemes (and income tax) and multiple collection agencies to which contributions must be allocated and remitted (e.g. like in Macedonia) make compliance more difficult and evasion more attractive and practicable.⁵⁵

Additionally, employees in the collecting agency/institution are often relatively poorly paid. This can result in recruitment and retention of **staff** problems, poor qualification and motivation.⁵⁶ These are also circumstances that increase the potential for corruption. It goes without saying, whatever the cause for contribution evasion, ineffective enforcement makes evasion more likely.⁵⁷

2. Causes lying within an employer

One of the main causes for contribution evasion by employers appears to be cost savings. Financially weak employers might place a low priority on paying social security contributions. Paying salaries would be a higher priority than paying contributions.

Also in Serbia, Albania, Macedonia, Bosnia and Herzegovina **bad financial situation** appears to be the number one reason why employers do not pay due contributions. In some cases they only pay net salaries, without paying social security contribution at all or they pay it from the lower bases as they are obliged to.⁵⁸ Where contributions are collected separately, like in Macedonia, employers might set higher priority on certain contribution (e.g. for health insurance) than on others.

⁵⁵ *McGillivray* (2001), p. 5.

⁵⁶ In the territory of Kosovo the staff seems to lack experience. *Ibidem*, p. 4.

⁵⁷ *Baily/Turner* (1997), p. 7.

⁵⁸ Answers to the Questionnaire, Macedonia – Public Revenue Office, p. 4. Macedonia – Pension and Invalidation Insurance Fund, p. 3. Macedonia – Employment Agency, p. 1, Macedonia – Health Insurance Fund, p. 3; Bosnia and Herzegovina – Republic of Srpska, p. 2; Serbia, p.1.

Also financially healthy employers may evade contribution, just to **reduce their expenses**. Costs may be saved by not paying social security contribution and by avoiding the costs of compliance (they do not have to keep additional records, make additional calculations and spend the time for obtaining and completing necessary forms). This way they may gain an unfair advantage in the market competition.

Employers may also collect social security contributions, but they do **not transfer** the money to the competent agency/institution. Some argue that this is the worst form of contribution evasion.⁵⁹ Employer defrauds not only collecting agency/institution, but its own workers and solidarity community of each of the insurance schemes. Fraud might also occur in a more subtle form, when employer **delays** transmitting the contribution to the competent agency/institution, because he profits from interests gained. This is even more likely in times of higher inflation. At that time the real value of contribution decreases quickly.

Sometimes employers may save costs by bribing the responsible person instead of paying contributions. Such practice may occur in the **environment** where corruption is tolerated. And the environment is extremely important, since the subjects adapt to it. Thus, if contribution evasion is widespread, considered an acceptable business practice, tolerated by the competent agencies/institutions, or if government agencies and State owned companies do it themselves, then individual employers are more likely to evade contributions.

Insufficient control that leads to the perception that paying social security contributions is not a legal obligation, and that non-compliance will not trigger any sanctions or not even enforcement procedures, may be detected in the countries/territory involved in the project as well.⁶⁰ For instance, in the territory of Kosovo the controlling mechanism is too slow and not functioning very well.⁶¹

Contribution evasion is more easily accomplished when **production** is mainly done by small employers and by employers without fixed location of production. In many circumstances it is not easy for large employer to evade contributions. However, if evasion is due to

⁵⁹ *Baily/Turner* (1997), p. 8.

⁶⁰ Answers to the Questionnaire, Serbia, p. 5; Albania, p. 3.

⁶¹ Answers to the Questionnaire, Kosovo, p. 3.

macroeconomic causes, there is no difference between small and large employers in evading social security contributions.

3. Causes lying within a worker

The employer is usually obliged to deduct social security contributions at source before paying its employees salaries. It has to calculate and pay the sum which corresponds to its own part of the contribution and deduct the sum to be paid by the employee. The employer alone is in legal relation with the collecting agency/institution and the later is not allowed to demand the payment directly from an employee. Thus, opportunities to evade for employees wishing to do so are **limited**. And it is indeed reported from the countries involved in this research that employees can not influence the (non-) payment of social security contribution.⁶²

The employee wishing to evade social security contribution may **collude** with his/her employer or may **change his/her status** to become self-employed, casual or contract worker, where contributions may not be required or are more easily evaded. For instance, it seems that in Macedonia civil law contracts are extensively used also to evade regular employment contracts and hence paying of social security contributions.

Self-employed usually have to pay social security contributions themselves, as they act as employers and employees at the same time. Thus, most of the findings related to the contribution evasion by the employer may be applied in the case of self-employed as well.

It is emphasised in some reports from the countries/territory involved, that causes for not paying social security contribution also lay within the self-employed. Urban self-employed as well as farmers mostly evade contributions because of bad financial situation.⁶³ They pay

⁶² Answers to the Questionnaire, Bosnia and Herzegovina – Republic of Srpska, p. 2; Macedonia – Pension and Invalidity Insurance Fund, p. 3. In the territory of Kosovo the employers are the most responsible for not paying contributions. Answers to the Questionnaire, Kosovo, p. 3.

⁶³ Answers to the Questionnaire, Serbia, p. 1.

social security contribution irregularly or do not pay it at all.⁶⁴ As already mentioned, separate regional project is analysing possible measures to provide decent social security to farmers.

4. Legislative framework

Non-compliance with the contributory duty by employers and workers as well as the non-collection of the contribution by the competent agency/institution increases with the **complexity** of the laws, rules and regulations and the **frequency** with which they are changed.

In the countries/territory involved in this project, contribution collection is regulated by an act of parliament. Usually, a special law dealing with social insurance contributions is in force or a special decision is taken by the parliament. However, also other laws have to be taken into account. These range from laws regulating a specific social insurance scheme, to the laws regulating personal income tax and the law on tax procedure and tax administration.⁶⁵ And the laws are more or less often changed and amended.

Additionally, the decisions and regulations passed by the government or a responsible minister have to be taken into account. Hence, one can come up with quite a vast amount of legal norms that have to be respected.

When legal norms are complex and often changed or supplemented, legal subject may not be (fully) aware of their (new) duties, which may lead to **legal uncertainty**. We already mentioned that e.g. the Macedonian Employment and Insurance in case of Unemployment Act was “forgotten” to be changed and it is not applied.⁶⁶ In such cases the need to inform the subjects responsible for paying contributions on the exact scope of their duty and procedures to fulfil it, increases. They should also be fully aware of the consequences of not paying contributions. For instance, in Serbia it appears that only small part of self employed insured

⁶⁴ Answers to the Questionnaire, Macedonia – Health Insurance Fund, p. 3.

⁶⁵ Answers to the questionnaire all countries/territory, p. 1 or p. 2.

⁶⁶ C.f. chapter III, point 3.2., above.

persons is acquainted with legislative changes, the structure of social insurance and consequences of not paying social security contribution.⁶⁷ It goes without saying that also the need to (re)train staff of the competent agency/institution is emphasised.

Not only complex and often changing legislation may contribute to evasion. In combat against contribution evasion, it is important that the legislation provides for the appropriate set of sanctions and incentives to comply with the contributory duty.

⁶⁷ *Radovanović et.al.* (2006), p. 108.

V. POSSIBLE MEASURES TO ENSURE

MORE EFFECTIVE CONTRIBUTION COLLECTION

There is still quite some space for improvement of social security contribution collection systems in all of the countries/territory involved in this project. They could be made more effective in the sense that legal subjects responsible for payment of social security contributions would actually do so in timely and accurate manner.

1. Good contribution collection governance

Although governance is a broad notion, we believe that a first step in improving compliance is modernising the institutional arrangements.

1.1. Detection of non-payers

In order for agencies/institutions responsible for collecting social security contributions to be effective, they have to be able to **identify** the legal subjects who have to pay contributions. Among them they have to identify those who have to, but do not pay contributions (in full). To this end modern information technology could be made useful. Enforcement could be improved by a program of audits to determine compliance.⁶⁸

First, there should be a **registry** of contribution payers, i.e. employers and insured persons. To do this most efficiently, there could be a single, unique identifying number for all social security schemes. The same number could also be used for tax purposes and other government affairs (so called government-wide approach) to allow cross-checks. It goes without saying that this number should be protected against official or other misuse to ensure the right to privacy.

⁶⁸ *Baily/Turner* (1997), p. 12.

Some countries involved in the project are developing central registry of insured persons. For instance in Serbia, a Project of consolidation of payment and reform of the pension administration in Serbia is in progress. It envisages the establishment of the Central Registry of Insured Persons in order to ensure efficient and continuous coordination of activities related to the new system of collection of contributions and creation of a central base of insured persons.⁶⁹ Some of the countries already have a central registry. It appears to be the case in Bosnia and Herzegovina.⁷⁰

Lack of cooperation seems to be one of the major obstacles in effective contributions collection. Thus, **information flow** is vital. All the involved agencies/institutions have to share relevant information. For instance, tax agency, social security institutions and customs service could share information that would facilitate comparison of records and lead to identification of delinquent employers and others who should pay contributions.⁷¹ This could be achieved with more extensive use of information technology.⁷² It could improve not only contribution collection but tax collection as well.⁷³

1.2. Accountability and external supervision

Collection agencies should become more efficient, with higher **accountability** and greater **trust** of participants.⁷⁴ Good contribution collection governance has to be based on

⁶⁹ Answers to the Questionnaire, Serbia, p. 6.

⁷⁰ In the Federation of BIH there is a Law on Central Register of Insured Persons and Beneficiaries of the Pension and Invalidity insurance. In the Republic of Srpska there is a Law on Central Register of RS. Answers to the Questionnaire, Bosnia and Herzegovina, p. 2.

⁷¹ *Ljubljana Note*, p. 2.

⁷² For instance, in Macedonian pension and invalidity insurance scheme, contribution is paid exclusively electronically (as of 1.1.2006). Answers to the Questionnaire, Macedonia – Pension and Invalidity Insurance Fund, p. 3.

⁷³ For instance, for Macedonian residents employed by non-residential employers or diplomatic and consular posts, employers pay contributions, but employees have to pay personal income tax if the employer fails to do so. In many cases such employees do not declare income for tax purposes. Answers to the Questionnaire, Macedonia – Public Revenue Office, p. 4.

⁷⁴ *Watanabe* (2006), p. 7.

transparency as well as adequate checks and balances.⁷⁵ Thus, there should be strong supervision over collection of social security contribution, also by the on-field inspection. The supervision should be not only internal, but external as well. Where contribution collection is performed by the tax agency supervision should be conducted by the social insurance carrier responsible for management of a certain social insurance scheme. The fundamental right of the insurance carrier from the social insurance relation is to receive contributions, regardless whether it actually collects them itself or is this responsibility ceded to some other (usually tax) agency.

The same applies vice versa. Hence, when contributions are collected by the social insurance carrier, the government should play an important supervisory role. Its interest is to prevent engaging more budgetary means than necessary (e.g. for covering losses of social insurance carrier or for providing more social assistance in case an insured person can not exercise social insurance rights because the contributions were not paid).

High level bodies, involving also representatives of insured persons and employers could oversee the correct collection of contributions, regardless it this function is entrusted to tax agency or social security institution.⁷⁶

The **external supervision** on contribution collection could also be performed by other legal subjects interested in the matter. For instance, employers in the same branch might be interested to know that all of them are paying contributions (in time) and no one gets an unfair advantage in the market race. If that would be the case, they could report it to the responsible agency/institution. Also trade unions representing the workers might be interested that contributions are paid for the workers, especially when benefits depend on contributions actually being paid.

The same goes for employees themselves. The law could also prescribe an obligation of the collecting agency/institution to send periodically to each of the insured persons information on the amount of contributions actually paid. This would enable the insured persons to know the state of their contributions and to pinpoint any abnormality. Employers that do not pay

⁷⁵ Compare with *Ross* (2004), p. 7.

⁷⁶ Compare with *Fultz/Stanovnik* (2004), p. 16.

contributions at all or in the full amount could be exposed. It goes without saying, workers anonymity should be safeguarded. Otherwise he/she could face retaliation (dismissal of an employment contract). And if enforcement is weak, reporting the employer may be futile. A special system could be established, enabling the insured persons easy and accurate access to information regarding the records of contributions paid. Such access, e.g. via the mobile phone, home computer or in information centres, could be even more important for checking the accounts of mandatory second pillar pension schemes, like the one in Macedonia.⁷⁷

1.3. Staff

It should not be invested only in the use of modern information technology, but in capable and competent staff of the collecting agency. First, there should be **enough** staff, also to enable field inspections. Reportedly, the Macedonian Fund for health insurance is monitoring the payment of contributions within the limits of disposable human resources.⁷⁸ It seems that Macedonian Employment Agency, responsible for managing the unemployment insurance scheme, has not even one person employed to monitor the contribution collection, because this is the function of the public revenue office.⁷⁹

The staff should also be **well trained**, especially when the law is changed, or one collected system is substituted by another one. It should be knowledgeable about the legal requirements so it can provide accurate and reliable advice to employers and insured persons. The staff should be **well paid**, also to avoid the environment for possible corruption.

1.4. Reporting

Moreover, there should be straight forward **reporting** of earnings which fall under the contributory duty. Special, social-administrative procedure should be (more) developed. It has to ensure easy access to administration and not cause too many obstacles when fulfilling the

⁷⁷ Compare with *McGillivray* (2001), p. 7 and *Ortega* (2006), p. 4.

⁷⁸ Answers to the Questionnaire, Macedonia, Health Insurance Fund, p. 3.

⁷⁹ Answers to the Questionnaire, Macedonia Employment Agency, p. 1.

duty or claiming the right. To this end development of a single reporting form for all social security contributions is highly useful. Also filling of a form via a secure electronic program could be foreseen.

Contributions could also be paid to only one account. For small enterprises that do not have a computer or an accountant, a regular (monthly) flat-rate payment could be enabled. At the end of a year a final adjustment could be made.

To enable easier reporting one stop shops could prove to be useful. As already mentioned, there is a separate regional project dealing with pros and cons of information centres and one stop shops.

2. Enforcement and sanctions for non-compliance

When legal subjects have to pay social security contributions, but they for one reason or another fail to do so, they breach the law and have to face sanctions. Collecting tax agency or collecting social insurance carrier has to have the possibility to enforce compliance and payment of social security contribution. Additionally, higher interests, fines, or even criminal sanctions may be prescribed by law.

Indeed, this way of enforcement is most common also in countries/territory involved. Responsible agency/institution may start an enforcement procedure for the **basic debt**, i.e. the non-paid (part of) contribution, with certain **interest**. It could be done, in accordance with the civil law procedure,⁸⁰ special administrative procedure,⁸¹ or according to the tax procedure,⁸²

⁸⁰ For instance, this appears to be the case in Macedonian mandatory health insurance scheme, although the punitive interest is enforced according to the tax legislation. Without the possibility to enforce payment of due contribution Macedonian health insurance fund could not function properly. Answers to the Questionnaire, Macedonia – Health insurance fund, pp. 3, 4. Interests should also be paid for the delayed payment of unemployment insurance contribution as well as pension and invalidity contribution. Answers to the Questionnaire, Macedonia – Employment agency p. 1 and Art. 184 of Macedonian Pension and Invalidity Insurance Act.

Interest should be paid also in the contribution collection systems of Bosnia and Herzegovina.⁸³

The interest for non-paid contributions or for late payment has two functions. It should guaranty that the contribution retain certain value (the value of money decreases through time), and guaranty financial discipline (punitive part of this kind of interest). They have to be high enough so that legal subjects rather pay social security contributions than high interest. On the other hand, they should not be too high, not to discourage voluntary payment. It is important that the payment of due contributions with interest may be forced in a **court procedure**.⁸⁴

Additionally, legal subjects not complying with their contributory duty or not allowing the inspection may face **fin**es for misdemeanour. Fines may be different for employers, responsible persons of employers, self-employed and other natural persons. Fines are prescribed in all of the countries/territory involved in the present project.⁸⁵ Again, the penalties should not be too high, but high enough. The employer should not get more profit for paying contributions at a later date with interest and fines then paying them in due time. Fines are usually fixed in the law. Thus, they might become meaningless in periods of high inflation. In this case the law should be changed more often, or the fines could be determinable by law, using and indexation mechanism.

⁸¹ For instance, like in Macedonian pension and invalidity insurance scheme. According to Art. 185-g of Macedonian Pension and Invalidity Insurance Act, payment of the contribution debt with interest is required by a Fund's decision. Appeal is possible according to Art. 185-h of the same Act.

⁸² For instance, as in Albanian integrated collection system the amount of interests that has to be paid when contribution payment is delayed is set by the law 8560 dated from 22.12.1999 on the tax procedures in the Republic of Albania. Interest amount is 2 percent for the first month and 1 percent for the following months. Answers to the Questionnaire, Albania, p. 3. In Serbia interests according to tax legislation are enforced (Art. 2005 of the Pension and Invalidity Insurance Act, Official Gazette, No. 34/03).

⁸³ For instance, if in the Republic of Srpska contributions for pension and invalidity insurance are not paid until the 7th day in the month for the last month, the interest should be paid according to the Pension and Invalidity Insurance Act. Answers to the Questionnaire, Bosnia and Herzegovina – Republic of Srpska, p. 2.

⁸⁴ Answers to the Questionnaire, Macedonia – Health insurance fund, p. 4, Employment agency, p. 1 and Art. 185-h Macedonian Pension and Invalidity Insurance Act.

⁸⁵ Answers to the Questionnaire, Serbia, p. 2; Bosnia and Herzegovina, p. 5; Bosnia and Herzegovina – Republic of Srpska, p. 2; Macedonia – Public Revenue Office, p. 5; Albania, p. 3; Kosovo, p. 3.

In some cases the employer could be given a possibility to **request a waiver** of punitive interest and fines. For instance, in France, the URSSAF may show indulgence and propose staggered payments, depending on employers past record and good faith.⁸⁶ In Albania it appears that the law in 1999 provided the opportunity to agricultural self-employed to pay contributions for the previous years without fines.⁸⁷

In some cases the employer and the responsible person could face **criminal charges**. For instance, if the employer does not pay (in full) the mandatory health contribution in Macedonia for the purpose of increasing the profit, it and the responsible person will be punished for criminal act. The sanction is imprisonment form one to five years.⁸⁸ Criminal charges are foreseen also in other contribution collection systems.⁸⁹

All the enforcement actions should be performed in a **timely manner**. Compliance might be facilitated when legal subject liable for paying contributions know that they are being monitored and any delayed payment will be met with a quick response. Improving the timeliness of enforcement actions tends to improve their effectiveness.⁹⁰

If a company, an employer does not comply with its duties in the market, e.g. does not pay for the goods or services provided, than this payment may be claimed at the court of law. If certain conditions are met, e.g. illiquidity or insolvency of an employer, even a **bankruptcy procedure** may be initiated. One may rightfully wonder why an employer should be in a different position if the wages are not paid or social security contributions for its workers are not levied. Of course bankruptcy procedure should be an *ultima ratio* measure, when no other measure would guarantee compliance. For instance, in France the URSSAFs may initiate bankruptcy procedure on the employer, whose payments are too overdue or is considered unable to meet its obligations.⁹¹

⁸⁶ *Lion* (2004), p. 6.

⁸⁷ *Meca/Xhumari/Shehi/Poci* (2000), p. 9.

⁸⁸ Article 89 of the Macedonian Health Insurance Act.

⁸⁹ For instance, answers to the Questionnaire, Bosnia and Herzegovina, p. 5; Bosnia and Herzegovina – Republic of Srpska, p. 2.

⁹⁰ *Fultz/Stanovnik* (2004), p. 16. *Baily/Turner* (1997), p. 13.

⁹¹ *Lion* (2004), p. 9.

It is generally considered that it is better that the employer provides jobs without paying social security contributions than not to provide them at all. However, lack of financial discipline might be the cause and a consequence of such a condition.

In some cases, the collecting (tax) agency may **seal the premises** of the employer or a shop of non compliant contribution payer, like in the Brčko District of the Bosnia and Herzegovina.⁹²

However, not only sanctions may improve the effectiveness of contribution collection. Sometimes more “soft” measures and incentives might result in larger amount of collected social security contribution.

3. Lead by example

Sometimes, social security contributions are not paid by the government for its civil servants or employees of State-owned employers, regardless big or small. This practice is unacceptable. Government should lead by example, i.e. by paying all social security contributions in due time. Only this way **public trust** in social security governance may be re-established.

Widespread evasion, especially by the government or State-owned employers, fosters disrespect for law. Governmental example is essential in improving compliance, without which other initiatives could not be expected to succeed. Workers and employers as well as their organisations should insist that government leads by example to adhering to this standard.⁹³

⁹² Answers to the Questionnaire, Bosnia and Herzegovina, p. 5.

⁹³ *Fultz/Stanovnik* (2004), p. 15. *Ljubljana Note*, p. 2.

4. Deferment and write-off of the contribution debt

Sometimes, the **deferment** of contribution debt, i.e. make it possible that the debt is paid at a later date or in instalments, could improve compliance. For instance, in France, the URSSAFs can defer payments to fit in with the economic situation or cash flow of the enterprise. The later has to lodge a request for deferred payment.⁹⁴ In Poland, the ZUS may apply certain flexibility to improve collection effectiveness. In justified cases payment of due contributions may be split in instalments or their payment may be deferred.⁹⁵

Also in some countries involved in this project the possibility to defer payment of social security contribution is at hand, while in others there seems to be no such possibility. For instance, the managing board of Macedonian Fund for Health Insurance has issued a Decision on deferred payment. All legal persons in financial difficulties may conclude an agreement with the Fund on deferred payment or on payment of due contributions in instalments.⁹⁶ Similarly, in Macedonian pension and invalidity insurance scheme the possibility of deferred payment seems to exist. With a decision of the government or the managing board of the Fund for Pension and Invalidity Insurance contributions may be paid in instalments.⁹⁷

In Bosnia and Herzegovina, the government of the Republic of Srpska may adopt the decisions on the reschedule of the debts, with which it may also defer contribution debts. This has to be done in accordance with the conditions regulated by the Ministry of Finance and Ministry of the Economy and the assent of the respected fund or institute.⁹⁸ The law on tax administration in the Brčko District of the Bosnia and Herzegovina allows conclusion of the agreement on deferred payment between the tax agency and the contribution payer, who requested the agreement. Payment of social security contributions is usually deferred for 3 months.⁹⁹

⁹⁴ *Lion* (2004), p.7.

⁹⁵ *Wiktorow* (2004), p. 4.

⁹⁶ Answers to the Questionnaire, Macedonia – Health Insurance Fund, p. 4.

⁹⁷ Answers to the Questionnaire, Macedonia – Pension and Invalidity Insurance Fund, p. 2.

⁹⁸ Answers to the Questionnaire, Bosnia and Herzegovina – Republic Srpska, p. 2.

⁹⁹ Answers to the Questionnaire, Bosnia and Herzegovina, p. 6.

Deferment of the contribution debt appears not to be an option in the Serbian and Albanian collection system as well as in the Macedonian unemployment and pension and invalidity scheme.¹⁰⁰

Deferment of the contribution debt or allowing payment in instalments might be a better solution than immediate write-off of the contribution debt. The insurance carrier is still receiving the contributions, although with some delay, which is better than to start an expensive enforcement procedure and possibly get nothing at the end. However, the deferment should only be possible under certain conditions, prescribed by law. The social insurance carriers might otherwise at a certain point in time be left without liquid means to pay out benefits. Of course, it should be prevented that employers and other legal subjects misuse this option. Thus, once the contributions are not paid according to the agreement or decision on deferment, there should be no possibility to get a deferment in the (near) future.

Another possibility that is used also in the countries/territory involved is to **write-off** the contribution debt. Here the conditions should be stricter than by a deferral. Generally, write-off may be used in a form of a contribution amnesty, during which fines and contribution arrears are forgiven to encourage voluntary compliance by non-compliers. It may happen one time only when the system of contribution collection, where non-compliance was tolerated, is substituted with a new one where it is not tolerated. A pattern of periodic contribution amnesties is not recommendable. It may encourage evasion, because the employers and other legal subjects expect future amnesty period.

For instance, in Serbia, the State may not enforce compliance mainly from political reasons. It rather covers the losses from the state budget. With a special legislative act the State has taken over the contribution debt for pension and invalidity insurance for all insured persons, whose employers have not paid the contribution in the period from the beginning of 1991 until the end of 2003.¹⁰¹ It could be argued, that it was a form of contribution amnesty.

¹⁰⁰ Answers to the Questionnaire, Serbia, p.3. Answers to the Questionnaire, Macedonia – Employment Agency, p-1.

¹⁰¹ C.f. the Law on Payment of Pension and Invalidity Contribution for Certain Groups of Insured Persons – Employees (Official Gazette, No. 85/05) and Answers to the Questionnaire, Serbia, p. 2 and 3.

The government or the parliament might decide on the write-off of contribution debt. The Serbian government has already written-off due contributions for certain categories of insured persons. In Bosnia and Herzegovina, the government of the Republic of Srpska and the Ministry of finance may decide on the writing-off the contribution debt.¹⁰² In Albania, the contribution debt may be written-off by law.¹⁰³ In Macedonian collection system it appears that the contribution debt may be written-off according to the Ascertainment and Payment of Public Revenues Act.¹⁰⁴ Although in the territory of Kosovo, the write-off of contribution debt is not legally regulated, it is argued, that such decision could be taken by the tax administration.¹⁰⁵

The write-off should be a measure of the last resort (*ultimum remedium*), when there is clear that contributions could in no way be collected. The conditions under which this is possible should be clearly stated in the law and not left to the governmental discretion and possible arbitrariness, as it is also rightfully argued in the Serbian report.¹⁰⁶

The write-off of the contribution debt might not be uncontested. One of the questions is who will provide for the missing funds. Should that be the insurance carrier or the burden of the solidarity community of the social insurance scheme or should that be done by the State. In any way, it should not be done to the detriment of an employee. This is also one of the reasons that the write-off should be made by the State, preferably by an act of the parliament who should provide for the missing means. For instance, in Albania, the contribution debt may be written-off only, if there are sufficient means in the reserve fund of the Council of Ministers.¹⁰⁷

Additionally, not all forms of deferment and write-off of contribution debt are admissible under the European Community (EC) law. The Court of the European Communities (also called the European Court of Justice - ECJ) has decided that a deferment or write-off of the

¹⁰² Answers to the Questionnaire, Bosnia and Herzegovina – Republic Srpska, p. 2.

¹⁰³ Answers to the Questionnaire, Albania, p. 4.

¹⁰⁴ Answers to the Questionnaire, Macedonia – Health Insurance Fund, p. 4.

¹⁰⁵ Answers to the Questionnaire, Kosovo, p. 4.

¹⁰⁶ Answers to the Questionnaire, Serbia, p. 3.

¹⁰⁷ Answers to the Questionnaire, Albania, p. 4.

contribution debt may breach the EC law on inadmissible State aid.¹⁰⁸ When, for example, the health insurance carrier as a legal person under public law, established by the State, defers payment of contributions to a certain undertaking, the competition may be distorted. Inadmissible state aid and unfair competition occurs, when the employer gets financial benefit, which would not be the case under the normal market circumstances. The ECJ applies the test of a “reasonable investor”. State aid is not contested if it would be paid also by a private investor.¹⁰⁹ Similar rules apply when the contribution debt is decreased or written-off for certain branches of economy.¹¹⁰

5. Clearance certificate

Collection of social security contributions could become more effective, using also indirect methods, which require employers and other legal subjects to prove they are up to date on their contributory duty in order to **gain access** to certain government benefits.

¹⁰⁸ C.f. Article 87 of the Treaty establishing the European Community (the EC Treaty).

¹⁰⁹ For instance, in the case *DM Transport* (C-256/97, 29.6.1999) the ECJ argued, that the concept of State aid embraces not only positive benefits, such as subsidies, but also measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, accordingly, without being subsidies proper, are of the same nature and have identical effects. For instance, where a public body with responsibility for collecting social security contributions tolerates late payment of such contributions, its conduct undoubtedly gives the recipient undertaking a significant commercial advantage by mitigating, for that undertaking, the burden associated with normal application of the social security system. The ECJ ascertained that it follows from the wording of Article 87(1) of the EC Treaty that general measures which do not favour only certain undertakings or the production of only certain goods do not fall within that provision. By contrast, where the body granting financial assistance enjoys a degree of latitude which enables it to choose the beneficiaries or the conditions under which the financial assistance is provided, that assistance cannot be considered to be general in nature. Payment facilities in respect of social security contributions granted in a discretionary manner to an undertaking by the body responsible for collecting such contributions constitute State aid for the purposes of Article 87(1) of the EC Treaty if, having regard to the size of the economic advantage so conferred, the undertaking would manifestly have been unable to obtain comparable facilities from a private creditor in the same situation vis-à-vis that undertaking as the collecting body.

¹¹⁰ Latest cases on State aid by using the instrument of reduction of social security contributions could be found at http://ec.europa.eu/comm/competition/state_aid/register/ii/by_instrument_5.html

The law could oblige the social insurance carriers to issue a kind of clearance certificates, or even better one **clearance certificate** to employers, to confirm that the whole social security contribution has been regularly paid. Such certificate could be a requirement for engaging in business or receiving payments from government (including from the Ministry of Agriculture),¹¹¹ public institutions or international donors. For example, such a certificate could be required in order to obtain an import-export licence, to participate in a government tender, to obtain loans or subsidies for small and medium enterprises, or even to be listed on the stock market or to be able to renew a business licence. Clearance certificate might not be fully effective for those small businesses that do not tender for government contracts or public institutions or State-owned companies.¹¹²

Government and public institutions could *ex officio* **verify compliance** in each case separately, without issuing a certificate. This could be friendlier to employers and other legal subject, because they would not be under obligation to obtain the certificate and to deal with administration. However, the proceeding, e.g. tender for obtaining government loans, etc. should be transparent and subject to control to avoid misuse and preference for certain non-complying employer.

6. Public communication and education

Raising **public awareness** on the importance of paying pay social security contribution may be a crucial step towards more effective contribution collection. Social insurance carriers and the government should embark on various means of information dissemination.

Social insurance relation and fundamental duty of insured persons and their employers (if they have one) to pay contributions is governed by public law. Thus, it could be argued that information on employers failing to comply with their contributory duty is public information. Employers failing to pay contributions or part of them could be listed and **publicly exposed**

¹¹¹ In Serbia it is suggested that receiving money from the agricultural budget should be conditioned by the evidence of paid contributions. *Republički fond za penzijsko i invalidsko osiguranje poljoprivrednika* (2006) p. 6.

¹¹² *Ljubljana Note*, p. 2. *Fultz/Stanovnik* (2004), p. 17, *Ejuba* (2006), p. 9, *Ortega* (2006), p. 3.

(or at least a threat that it may happen should be maintained).¹¹³ On the other hand employers who regularly pay their contribution due could be publicly praised.

Additionally, public education campaigns on importance of social security system for the whole society and the vital part that is played by social insurance contribution could be organized. It should become an issue of the **whole society**. The essential duty of employers and other legal subjects to pay contributions accurately and in time should be emphasized.¹¹⁴ For instance, improving the public information on the pension system is one of the objectives of the pension reform in Serbia.¹¹⁵

Public education activities should be **tailored** to reach the different target groups, e.g. employers, self-employed, farmers. They should also be decentralized so that even those living in the remotest part of the country get the message. Mass media channels like radio, television, posters, and short documentary films could be used. The basic principles of social security should be taught in schools, stressing not only the benefit side, but the financing side of social security system as well. Also the information centres could play a decisive role in raising public awareness.

One should not forget the importance of trade unions and employer associations, as both are disadvantaged by competitors who gain an unfair advantage by evading contributions. Employers could make paying of contributions a measure of good corporate practice and trade unions could educate their members on the risk of failing to pay contributions and advantages that compliance brings.¹¹⁶

¹¹³ For instance, in Romania, the government is authorised to report employers' contribution arrears to the relevant trade unions. *Fultz/Stanovnik* (2004), p. 17.

¹¹⁴ On low awareness of agricultural self-employed in Albania *Meca/Xhumari/Shehi/Poci* (2000), p. 11.

¹¹⁵ Answers to the Questionnaire, Serbia, p. 6.

¹¹⁶ *Fultz/Stanovnik* (2004), p. 16

7. Contribution structure

Separate project proposal, which was not selected by the countries/territory involved in the CARDS-SISP project, was dealing with contribution structure. Related to the contribution collection, some argue that collection could be more efficient, if the contribution burden would be lower. This, however, is not uncontested. There is no guarantee that employers who do not comply with the contributory duty would comply with it, if the **contribution rate** would be lower. Therefore, if the decision should be made to lower the contribution rate it has to be accompanied with strict measures to increase contribution collection.

The trade-off between reducing contribution rate and maintaining or improving benefits is a sensitive one and should be resolved through social dialogue in each particular case. Some argue, that in the regional context where there are more unemployed persons than available jobs high contribution rates may deny workers pension coverage as surely as reducing benefits.¹¹⁷ On the other hand increasing the contribution rate in hope to collect more contribution is not realistic. For instance, Romania increased contribution rate several times in the last decade, but was confronted with the decrease of contribution revenue.¹¹⁸

Another option relating to contribution structure could be to broaden the **contribution base**. The historic presumption was that the only income of workers was their wage. This is not completely true any longer. Today also the general requirement of some international standards that financing must also take account of the capacity of persons protected to contribute should be respected. It is important that as much as possible contributions are levied on the total real income out of work of the socially insured.¹¹⁹

This may contribute also to reduction of contribution evasion by extensive use of civil law contracts, which seem to be widely used in Macedonia, but also elsewhere, to evade regular employment contracts. It is suggested to restrict very much the conditions under which

¹¹⁷ *Ibidem*, p. 17.

¹¹⁸ *Ibidem*, p. 54.

¹¹⁹ For instance, in Serbia, cadastral revenue, which is used as contribution bases for farmers, appears not to correspond to the economic capacity of (especially) commercial farmers to contribute. Hence, it is suggested that it should be revalorised. *Republički fond za penzijsko i invalidsko osiguranje poljoprivrednika* (2006) p. 6.

exemption of social contributions is allowed. Reportedly, in Macedonia the contribution base seems to be harmonised for all social insurance schemes,¹²⁰ however, it seems that it will not be enhanced. On the other hand, it was broadened in Serbia, at least for pension and invalidity insurance. Additionally, when minimum contribution base is used, the danger exists that most contributions will be paid from this base and not according to the actual economic capacity of the person responsible for paying them (most notably in the case of self-employed).¹²¹

8. Proper legal framework

In order to provide impeccable operations of various agencies/institutions involved in contribution collection it is vital to have a **proper legal framework**. It should ensure clear designation of responsibilities and precise accountability.¹²²

It is also important, that the legislation is clear and easily understandable, even if it is complex, and preferably not too often changed and amended. Thus, the legislation should be stable, but this does not mean that it should stand still.¹²³ It should be of a **good quality** to encourage responsible legal subjects to pay social security contributions. The legislation *per se* should not give a reason for the contribution evasion. If the contributory duties are not clear or the legislation unjustifiably discriminates against certain groups of contribution payers, than the chance that contributions will not be paid is much higher.

Rights and duties of all legal subjects involved in contribution payment/collection should be determined by an **act of parliament**. Administrative decisions of the government, ministries

¹²⁰ Answers to the Questionnaire, Macedonia, Health Insurance Fund, p. 5.

¹²¹ In Serbia it is argued that economic capacity of the self-employed is stronger and they should not pay contributions from the present minimum contribution base (from 1 February 2007 - 35% of the average wage in the last quarter of the year in Serbia). Due to minimum contribution paid, self employed are entitled to a minimum pension and may rely to budgetary financed social assistance. Hence the contribution base should equal at least the average wage in Serbia. *Radovanović et.al.* (2006), p. 101.

¹²² The desire for improving the legal framework is stressed also in the report from the territory of Kosovo. Answers to the Questionnaire, Kosovo, p. 4.

¹²³ Compare with *Anđelković/Jovašević* (2006), p. 114.

and other agencies should be issued in accordance with the legality principle. Also the procedures should be regulated in the legislative act. Special administrative procedure should be client friendly, i.e. to the contribution payer and to the insured person.

Legal subjects should be able to foresee the behaviour that is required from them. Only this way the rule of law principle and its integral part **legal certainty** can be fully preserved and breach of law minimised or abolished.

9. Privatisation

Not (fully) effective contribution collection has many adverse effects on any social insurance scheme. National efforts to combat non-compliance may rely on reforms that **tighten the link** between the contributions paid and the benefit received.¹²⁴ In this way the financial incentive to pay contributions should be enhanced. The most radical approach involves scaling down the social insurance schemes and replacing them with privately managed schemes.

The more the contribution evasion is widespread and tolerated, the higher the probability of privatisation may become. The voices supporting privatisation may advocate privatisation of the social insurance scheme as such, e.g. privately managed mandatory second pillar pension scheme or private health insurance, or they could argue to privatise the scope of insured persons and to make the scheme voluntary.

We strongly believe that this is **not the right path to be followed**.

The studies provide no evidence that such linkages between contribution and benefit have had the intended impact.¹²⁵ Link between the contribution and cash benefits to a certain point already exists in social security system. The principle of equivalence between premium and future compensation (commutative justice-*iusiusticia commutativa*) is the characteristic of private insurance. One of the basic principles of social insurance is principle of solidarity

¹²⁴ *Ljubljana note*, p. 2.

¹²⁵ *Fultz/Stanovnik* (2004), p. 13.

(distributive or even redistributive justice – *iustitia (re)distributiva*), which could be diminished with tightening the contribution – benefit link.

Some analysts of the World Bank have over a decade ago considered that **defined contribution schemes** would solve the problem of contribution evasion. However, the experience from Latin America (e.g. in Chile, Uruguay, Columbia, Peru) indicated that switching to a defined contribution system does not solve the problem of contribution evasion.¹²⁶ It may even worsen it, since there are no benefits if the contributions are not paid. For instance, there are no contributions credited on the individual pension account and there is no possibility of capital gains (which insured persons all hope for). It could also make a deferment of contribution debt (no gains for the deferred period) or even its write-off more difficult.¹²⁷ Also the rights to health care (except urgent medical treatment) might not be provided until the whole contribution debt is settled, as it appears to be the case in Macedonian health insurance scheme already.¹²⁸ This might be contested, since it appears that worker's rights are not protected if the employer did not pay the contribution. And it is only the employer who can make the payment. Worker him/herself has no such possibility.

There are also some suggestions to make the access to the social insurance scheme **voluntary**. For instance, it was one on the alternatives for social insurance of farmers in Albania.¹²⁹ Switching to voluntary insurance is also an option considered by the Serbian government on the future status of the Republic Fund for Pension and Invalidity Insurance of Farmers. At the same time it was detected, that the changes of the law in 2003 allowing only one member of the agricultural household to be mandatory insured, while others may join on voluntary basis, have not resulted in any significant improvement of contribution collection.¹³⁰

One of the consequences of making a scheme voluntary could also be that people will not join the social insurance scheme. Such a solution may solve the problem only temporarily, as, logically enough, no benefits are provided, if no contributions are paid. But it may have some

¹²⁶ *Baily/Turner* (1997), p. 2. *McGillivray* (2001), p. 7.

¹²⁷ About the Polish example *Fultz/Stanovnik* (2004), p. 13 and *Chłoń-Domińczak*, *ibidem*, pp. 184 ff.

¹²⁸ Answers to the Questionnaire, Macedonia – Health Insurance Fund, p. 4.

¹²⁹ *Meca/Xhumari/Shehi/Poci* (2000), p. 15.

¹³⁰ Republic of Serbia, Information, Current Status of the Republic Fund for Pension and Disability Insurance of Farmers, pp. 1, 5-6.

serious long-term consequences, since these persons may depend on budgetary financed social (and medical) assistance in the future.

VI. CONCLUSIONS AND SUGGESTIONS DE LEGE FERENDA

Countries/territory in the region are reforming their social security systems. Weak compliance with the contributory duty is a regional problem and ineffective contribution collection might be one of the causes for reforms. On the other hand, contribution collection system, as one of the vital elements designed to ensure proper functioning of the social security system, is in desperate need of reform itself.

The problem of contribution collection is fuelling the public-private debate. However, it is our firm belief that privatising the existing social insurance schemes or making them voluntary is not the solution to the problem and will not improve the effectiveness of contribution collection. It may even cause serious adverse effects.

It is basic social choice in public-private mix and it is basic policy choice in the contribution collection system. In principle, there are strong arguments for centralisation of contribution collection system. Whether contribution collection system should be integrated with the collection of taxes or operate parallel to it is less clear. Centralised *integrated* system may perform well and increase the collected contribution amount, like in the case of Albania.¹³¹

However, we could not find any convincing evidence that the integrated collection system is the only solution, nor that it is the best one. For an integrated system to work well, modernised tax agency and modernised social insurance carriers as well as excellent cooperation between them is required. These conditions seem not to be fully met in all the countries/territory involved. Yet, in some of the countries involved in the present project the collection system has (recently) been centralised (Serbia, Albania, Bosnia and Herzegovina), in others it is a clear tendency in the same direction (Macedonia). Specific situation seems to exist in the territory of Kosovo, where majority of social security benefits are tax financed.

¹³¹ Answers to the Questionnaire, Albania, p. 3.

On the other hand, social insurance institutions might be more effective in contribution collection for various reasons. There is a clear distinction between tax and social security contribution and tax agency may already face some difficulties collecting taxes. There might be no motivation to deal also with social security contributions. Thus, a centralised *parallel* system might prove to be more effective, regardless whether the contributions are collected by the national health insurance fund or by the pension and invalidity insurance fund (as it seems to be the intermediate step in Macedonia). Although, health insurance fund may be more effective to ensure compliance, since health may be person's today problem and old-age a possible problem sometime in the future. Contribution collection could also be entrusted to a special social insurance institution. It is also possible that each social insurance fund collects its own contributions, but this may give raise to number of inefficiencies.

Some of the CARDS-SISP countries/territory have introduced a mandatory fully funded (second/first plus pillar) pension insurance scheme (Croatia and Macedonia) and others are at least considering this option. It is a clear advantage, if contributions for this scheme are collected centrally, possibly together with other social security contributions (not necessarily by tax agency), then by private pension funds themselves. There is little incentive for private pension funds to devote resources to improve contribution collection. Thus, a centralised collection agency /institution may pursue a more diligent enforcement of contribution due.

Before copying models of contribution collection from abroad, the countries/territory involved should invest more effort to find appropriate solutions that are best suited to their specific circumstances. The system has to be "homegrown".¹³² If they cannot make one system work, they might not be much more successful with another one. The surest way to improve contribution collection is to address the weaknesses of the existing system directly, then to make radical changes.

It goes without saying that the most important external measure for improvement of social security contribution collection is the macroeconomic one, i.e. the revitalisation of national economy. However, there is a kaleidoscopic menu of possible additional improvements, which are not mutually exclusive and could be applied cumulatively. First of all, the information systems should be developed to provide a registry of contribution payers and

¹³² Fultz/Stanovnik (2004), p. 19.

insured persons. It should enable information on who has paid how much contribution in what time and immediate identification of non-payers. With appropriate usage of information technology the monitoring costs could be reduced and internal as well as external cooperation, i.e. with other agencies and institutions improved. Also easier reporting could be enabled. Information should be delivered to a collecting agency/institution that may be held accountable by contribution payers and insured persons or their representatives, who may be given the right to (externally) supervise its operation. Thus, one of the top priorities should also be investment in staff and its training.

It is obvious that weak contribution collection presents not only a threat to a destabilisation of the social security system, but that non-payers are breaching the law. And the rule of law is a cornerstone principle of every democratic State, as well as the European Union and the Council of Europe. It is unacceptable that larger numbers of registered employers would come away with not paying in their social security due. Thus, the evaders should face sanctions. However, strict application of fines, punitive interests or criminal prosecution might not always be most effective in contribution collection.

Therefore also other, more “soft” measures and incentives should be considered and regulated by the law. Contribution evasion should be made a social issue, informing the public on the importance of social security system and its financing. Best or worst contribution payers could be exposed that would (positively or negatively) affect their public image. It is also possible to prescribe a clearance certificate when the contributor would want to compete for public (national or international) funds. Of course, clearance certificate makes sense only, if the government leads by example. The government should ensure timely and accurate contribution payment for civil servants. The same goes for State-own companies and public institutions.

Objective, non-arbitrary measures for deferral and write-off the contribution debt or only fines and/or interest should be clearly set by the law and in line with the EC rules on state aid. Deferral should be given preference over write-off. The contribution structure could also be fine-tuned, especially by enhancing the contribution base. It goes without saying that more efforts are expected mainly from the parliament. The legislative act should contain all possible sanctions and incentives for effective contribution collection. And the role of the

legislator cannot be overemphasised. Legislation should be changed before a distinctive practice is *de facto* introduced!

However in choosing proper sanctions and incentives, the causes for not paying social security contributions should be taken into account. The principle of proportionality and good faith of the employer and other legal subject responsible for paying social security contributions should be considered. Understanding the causes for ineffective contribution collection is important not only to improve contribution collection, but also for structuring social security reforms. The contribution collection system, also put in the broader perspective of economic and social climate in the State may play a vital role in enabling social security to achieve its purpose, i.e. provide effective security to the people on the occurrence of social risk or emergence of a specific situation of need.

SOURCES

The report is based mainly on the following **sources**:

Answers to the questionnaire prepared for the present project for the following countries/territory:

Bosnia and Herzegovina, prepared by the Ministry of Civil affairs of Bosnia and Herzegovina, and the Ministry of Labour and Combatant-Invalidity Protection of the Republic of Srpska;

Serbia;

Macedonia, prepared by the Fund for Health Insurance of Macedonia, Employment Agency of Macedonia, Fund for Pension and Invalidity Insurance of Macedonia and Public Revenue office;

Albania;

Kosovo.

It should be noted that the information was predominately gathered from the description of contribution collection systems, kindly provided by the Local project officers, who were sometimes confronted with not an easy task of gathering all the relevant information. Answers were provided either fully in English (Albania, territory of Kosovo), or in Bosnian and Serbian (Latin and Cyrillic), Macedonian (Latin and Cyrillic) with some or no parts in English language.

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