

HIDDEN ECONOMY

A BARRIER FOR A SUSTAINABLE DEVELOPMENT

by:

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The issue of hidden economy is a major problem, though in practical terms it is a natural and spontaneous reaction towards the impossibility of formal economy to meet the necessities of a part of the members of the society. We should acknowledge that the contribution provided by the hidden economy in both the developing and transitional countries, is considerable for the economic growth; however, it is associated with a number of problems deserving to be treated carefully from the compilers and executors of economic policies.

Indeed, it's difficult to give a definition of hidden economy. It so happens not due to the lack of knowledge on how to measure and assess the size and spread of this sector; but because different experts view the problem from different viewpoints, thus giving similar definitions, yet different from each other.

Thus, the hidden economy (differently considered as grey economy, parallel economy, underground economy, informal economy) comprises small units engaged in the production of goods and services which are not registered as formal units; units that contribute to the production of goods and services, registered as formal units, but which declare only partly the capacity of their activity; production units or service units created on the basis of family business, which are not registered. The hidden economy often comprises individual persons who exert their activity unlicensed and some others who perform criminal economic activities and activities banished by law. It would have been more clear-cut to say that hidden economy is that part of "lawful" economy (neither banished, nor criminal) which doesn't respect the enacted legal framework and which would be rateable in case of report to fiscal authorities. Depending on the development of the countries, the hidden economy usually occupies 10-50% of PBB; i.e. it is lower in developed countries and higher in developing countries and countries in transition.

A flourishing hidden economy makes the official statistics on unemployment, labour forces, income, consumption etc., sound incredible; consequently, the compiled programs

and policies based on these statistics may be inappropriate for implementation. This is not the case of jumping to hasty conclusions, however, we might launch the hypothesis that **the modest achievements with regard to the implementation of poverty reduction and economic development strategy noticed in the impossibility of converting the well known macro-economic achievements in regional and sectional development, among others, are also conditioned by the considerable weight of the hidden sector and the lack of instruments enabling its formalization without damaging it, which means trying to “lighten” it in favour to the sustainable development of our country.**

Some elements of hidden activities such as:

- some public home services: TV and washing machine repair;
- human services: making medical visits and injections;
- foreign language courses;
- street retail-trading of agricultural products from villagers of nearby areas;
- day-labourers (members of cooperatives and agricultural enterprises departments) obtaining agricultural, farming products and different raw materials for family needs;

have existed even during centralized economy. The larger scale of hidden activities in Albania, primarily, came as a result of the collapse of the institutions of centralized economy, legal and institutional vacuum emerging soon after and of the initial weakness of the state to establish adequate legal and fiscal institutions for the market economy. We shouldn't be neglectful towards the destructive effects of the crises our country has faced in the meantime, as well as the high and constant economic and social polarisation during the entire transitional period up to date. Here we must stress that this polarisation in some cases achieved through a doubtful manner, has brought the long debate regarding fiscal amnesty.

We are of the opinion that the major factors leading to the strengthening of hidden economy in this period are:

- the massive close-out of jobs in the first period of transition;
- the huge demographic displacements towards field areas, big cities and particularly towards Tirana;
- the high politicization of public administration and frequent interventions of politics in economic decision-making;
- the compilation of a new and improved legislation, yet, leaving room for a high level of hidden economy.

The main effects of hidden economy are on:

1. Monetary indicators: Hidden activities tend to be carried out in cash, thus increasing the need of money circulation.
2. Participation in the labour market and duration of working hours: If the number of employees and working hours in the hidden economy increase, the rate of employees and working hours in formal economy will decrease.
3. Official statistics of production: Growth of informal economy is associated with less credible statistics and lower figures compared to the official rate of the economic growth.

4. There are two opposite streamlines concerning the effect of informal economy on economic growth: 1. the decrease of hidden economy influences on the economic growth; it means an increase of income from taxes by leading to an increase of the public expenditures. 2. the hidden economy is more competing and efficient than the formal economy; in this way it stimulates the economic growth.
5. The need for public expenditure on the conditions of high-rate hidden economy leads to an increase of the hidden economy itself, and in a vicious circle, to an increase of taxes to meet the public expenditure needs.
6. Potential possibilities to transfer a part of hidden economy to criminal economy and in financial support of crime, especially organized economic crime.
7. Increase of corruption through bribing civil servants dealing with tax control and collection, by bringing as a consequence the corruption and deformation of the activity in the public administration operations. There are plenty of pressures in the Albanian official bodies for employment in tax and customs administration.

Hidden economy can be measured by:

A. Direct methods, through:

1. Questionnaires;
2. Tax-control by means of expenditure and income statistics of companies and individuals.

B. Indirect methods through:

1. Statistics of national accounts (incongruity between the income and expenditure statistics in national and individual accounts);
2. Statistics of employment rate (decrease of employment in formal economy by assuming that participation in work has a relatively constant rate of participation);
3. Transactions (the data of the quantity of monetary economic transaction to calculate the total and official PBB);
4. Money demand (increase of cash demand because the transactions of hidden economy are performed in cash);
5. Consumption of electrical power as it is the best physical indicator of the overall economic activity (the difference between the growth of PBB and the growth of the power consumption).

Keeping it under control and enabling the gradual formalization of the hidden economy, we should look into:

1. Its role in the country economy, the weight in employment and the dynamics in different sectors, and in the relaxation of the social consequences of transition, etc;
2. The legal framework which leaves room for the hidden economy;
3. Problems in the taxing system, state bureaucracy and social insurance;
4. Employment of minors in the hidden sector.

We also highlight that, though a lot of partial studies have been made by different researchers, primarily foreign ones, by the state institutions and media publications, a higher priority, with regard to the study of hidden economy, should be given to Albanian

researchers, not for the mere fact that we have nowadays sufficient intellectual capacity graduated in the country or abroad, but also because of the features represented by the Albanian economy in this transitional period; this hinders its acknowledgment and consequently the implementation of given models for the assessment of the level and spread of the hidden economy. The most efficient way for complete studies that offer executable policy recommendations for this sector, would be the undertaking of common studies with the involvement of Albanian researchers, state institutions dealing with fiscal and employment matters as well as international institutions for expertise in this area.

In conclusion, here are some recommendations to reduce the hidden economy rate:

1. The low-tax countries tend to have a lower level of hidden economy, but we highlight that the reduction of taxes doesn't often reduce the rate of hidden economy; we, therefore, think that there is room for adjustments of the taxing system by making them simpler in content, logical for the citizens and executable in the conditions of Albanian economy. Establishing bridges between the contributions and profits from the fiscal system is viewed as the main way, which encourages the citizens and businesses to orient themselves towards the formal sector of economy.
2. The complicated state rules for licensing, market-labour and bureaucratic barriers increase the hidden economy. We, therefore, think that there are many cases, which require a relaxation of bureaucratic and exceeding barriers in the licensing documentation, etc.. A number of studies have been made in this area; what remains to do is their implementation in relevant fiscal packages.
3. Hidden economy is lower in countries where the state institutions are more powerful and efficient. The continuous strengthening of these institutions, the growth of public trust toward them remain the safest ways to enhance the formalization of economy and reduce its hidden sector.
4. The countries with a high corruption level have high-rate hidden economy. The fight against corruption, in term of the strengthening of institutions and state, the growth of civic consciousness and individual responsibility, as well as the strengthening and modernization of public administration remain premises for the reduction of this sector.

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