

ON THE DEVELOPMENT OF THE ALBANIAN INFORMAL ECONOMY

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Abstract :

The purpose of the paper is to analyze the informal economy in Albania. The measurement of informal economy may be realized through direct and indirect methods. The collection of data about informal economic activities, the frequency and the volume of the underground activities present a challenge, because of the data limitations. Therefore, to measure it used more indirect methods. Albanian governments have always adopted a philosophy that aims to formalize the economy through legal and institutional improvements, reducing taxes, fighting corruption and tax evasion; improvement in revenue collection from customs and taxes in general, improving governance and increasing efficiency of public institutions. Albania is on the way of the integration in the EU. The integration perspective should be supported by concrete politics on the improvement of government functioning and decrease of the informal sector, so that the people think that their country is on the right way toward modernization and prosperity

Keywords: informal economy, taxes, tax evasion, corruption.

Introduction

It is hard to give a clear definition of the informal economy. This is not only because there are a number of drawbacks in the measurement and assessment criteria of this sector volume, but because despite similarities, the definitions provided by different authors are various.

The informal economy includes:

- small units engaged in the production of goods and services which may not be recorded;
- registered units which declare only part of their income;

- units based on family business and which are not licensed and do not pay taxes.

According to Hussmanns (2005) these units operate at a low level of organization, with little or no division between labour and capital as factors of production and on a small scale. Labour relations - where they exist - are based mostly on casual employment, kinship or personal and social relations rather than contractual arrangements with formal guarantees.

Various authors consider as part of the informal economy, even economic crime activities, such as arms drug and

human trafficking. However, this is not the focus of this paper.

In general terms, the informal economy refers to “all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements” (ILO 2002, p. 53). On the other hand refers to “the production, distribution, and consumption of goods and services that have economic value, but are neither protected by a formal code of law nor recorded for use by government-backed regulatory agencies” (Reimer, 2006, p.2). According to Reimer (2000) this includes illegal activities, but it also includes a large number of legal economic activities such as self provisioning, barter, volunteer work, unpaid labour, care-giving, subsistence production, and a wide range of sharing activities that make up human relations.

As part of previous studies in Albania the informal economy may be defined as “that part of the ‘lawful’ economy which doesn’t respect the enacted legal framework and which would be rate able in case of report to fiscal authorities” (Mema and Preçi, 2003, p. 64).

In spite of the fact that the informal economy definitions are different in a number of points of view, in most cases they have two things in common, the fiscal evasion phenomena and the illegal work.

Informal work is actually a concept that even the most advanced societies, there is more time using it. Even in these kinds of economies it hasn’t been, and it still isn’t easy to define in a scientific way the exact meaning of the concepts, informal sector, informal jobs, illegal work, since they involve a number of contexts and actions of complex non-official activities.

1. The Measurement of Informal Economy

The activities performed by the informal sector, frequently on co-operative basis, create new forms of the product - customer relationship. In reality it consists of non-accounting, immeasurable and unlicensed activities, which very often are based on collaborative patterns, mutual assistance invisible to competent organs.

The measurement of informal economy may be realized through:

- Direct estimation methods by means of:
 - Surveys of households or labour forces; and,
 - Monitoring expenditure and income statistics of the business and individual enterprises.

The collection of data about informal economic activities, the frequency and the volume of the underground activities present a challenge, because of the data limitations and hardship in getting information, since the people involved would not like to be identified. In that respect the assessment of the informal economy, may be considered a scientific commitment to know “the unknown”.

Indirect estimation methods by means of:

- National account statistics (incompatibility between the income and expenditures statistics of national and individual accounts).
- Labour and employment statistics (decrease in the employment figures of the formal economy, by supposing that its rates constitute a relatively constant membership).
- Transactions (data about the transaction quantity in the economy so as to calculate the total formal GDP).
- Money request (increase in cash request, since the dealings of the

informal economy are mostly carried out in cash).

- The electricity consumption for the reason that it is the best physical indicator of the general economic activity (there is disparity between the increase of GDP and the increase of the electricity consumption).

Because of the above mentioned difficulties, in Albania the measurement of the informal economy may be performed mostly by indirect methods. There are no precise figures about the size of the informal economy but according to different assessments it varies from 30 to 45 per cent of total GDP (ETF, 2010). Approximately 27 per cent of non-agricultural workers are wage employees in the informal economy, mostly in the construction sector (ILO, 2008). The economy sectors which witness the high rates of the illegal employment are construction and services enterprises.

2. Factors of the Informal Economy

Even though some sporadic elements of the informal activities existed even during the centralized economy, it witnessed the greatest expansion after the 1990s, during the initial phase of the transition toward a market economy; time when the designing of a legal, institutional, fiscal and regulating framework did not cope with the development of private enterprises. There was an institutional and legal gap, while the government was too weak to constitute appropriate legal financial institutions of a market economy.

The Albanian labour market has varied greatly since 1991. The economic transformations were accompanied by essential changes in the structure of the production and employment sectors. All of the transition societies go through this labour market phenomenon when, in certain periods of times, the legal and illegal, the formal

and informal economy change their proportion rates.

The informal economy issue gets primary importance, even though "...in reality it is a natural and unprovoked reaction of the incapability of the formal economy to satisfy the needs of a part of its society members" (Mema and Preçi, 2003, p.63). The economic activity of the informal sector co-exists with well-structured ones; what is more, in some cases it may successfully compete with it. There are many cases when the informal sectors provide the raw material for the production activities and delivers ready-made products to the market.

The factors which enhanced the birth and increase of the informal economy in Albania are numerous; among the most important ones we can mention:

- massive job loss after the 1990s and huge demographic movements of the population;
- lack of trust on the competences of the official institutions;
- non-efficient and corruptive administration;
- insufficient implication of law and rule;
- high financial costs and heavy administrative burden for the private enterprises;
- non-efficient governmental politics on poverty reduction and absorption of the labour force;
- high taxes, complicated taxing patterns and administrative abuse;
- full trust over the illegal jobs and the ability of the informal economy to solve problems for the public in general;
- vast application of the financial transactions and payment outside the bank systems; etc.

Economic informality is a fast growing phenomenon in the Albanian economy. Its high rates constitute an

issue of concern not only for the Albanian government or the involved institutions, but also for the entire Albanian society.

3. Some of the Negative Outcomes of the Informal Economy

The most negative occurrence of the underground economic ties occurs in the case of economic decision-making. High rates of informal economy result in the creation of incorrect official aggregates, such as unemployment and income figures. The economic deciding policies, as well as the monetary measures of the Bank of Albania, which makes use of these macroeconomic formal data, may result inefficient. The increase of the formal unemployment may not indispensably notify a serious need for further fiscal politics; on the contrary, it encourages a further movement of the economic activities toward informality.

The informal economy brings about a decrease in the economic growth and consequently less trustworthy statistics. Yet there are two opposing tendencies of the effect of the informal economy on the economic growth. First, the decrease of the informal rates influences economic growth because there is an income increase due to the tax collection and rise in the public expenses. Secondly, the informal economy may be more efficient in terms of competitiveness with the formal sector; that is why its presence encourages the economic growth.

High rates of informal economy are result on huge sums of uncollected taxes (Loayza 1997) and this is reflected on the reduction of the state budget income, on the decline of the social and health insurance income; it encourages illegal jobs, makes the quality of goods and services worse, especially when it reaches a considerable size. High informality rates constitute a direct threat to the

economic stability. It can worsen the financial position of the social insurance institutions. What is more, by decreasing the tax income it restricts the social assistance rates for the people with low incomes. This is reflected directly on lower living standards for these people and it may introduce social tension in the community.

One of the informal sector features is "black" work, which has a very negative social impact, since it results in a social stratum of people completely out of the job legislation protection. Someone who is employed in the informal sector may sooner or later be victim of changes of the following kinds: salary decrease, loss of the working place, lack of lawful contracts, etc. He depends on the work welfare in general, more than a "formal" employer for whom the burden of economic changes is less heavy due to better contract safety. The more informal workers and working hours there are the less formal occurrence and formal working hours there will be.

On the macroeconomic point of view, informal economy encourages unfair competition among enterprises. The underground ones feel free of legal rules, and can therefore set more competitive prices than the licensed businesses. They are able to provide lower prices for their goods than the general market set prices and increase the quantity of their sales and their earnings. Informality distorts the rules of an economy and it can in that way infringe the enterprising equality. It damages the market competitiveness and reduces its transparency. The lack of fair competitiveness as well as normal rules of free market, are the two main reasons which inhibit the foreign investments in Albania.

There is a negative relation between the size of the informal economy and the public expenses. The higher the former, the less public benefits there will be. When the tax

income is not sufficient for budget finances, the government may be obliged to emit treasury notes or depend on inflator finances (by emitting new currency); actions that can both threaten the economy. The informal economy presence may make the macro politics less effective. On their behalf, these make the macroeconomic stability too difficult to be reached.

“Cash” economy is one of the important factors of the informal sectors. The cash proceedings are a negative occurrence for the present Albanian economy and finance, because they impact not just the state budget, but also legal businesses.

Another negative outcome of the “cash” economy, which is directly related with the Bank of Albania, refers to the fact that the huge amount of money in circulation influences negatively on the value of monetary politics.

Cash activities prevent the conveyance of a clear and full image of the economic developments within the country. The lack of detailed information over the quantity of money in circulation makes it difficult to keep the macro-fiscal parameters safe within the standards established by the government programs and it has become one of the main obstacles for the correct prediction of economic developments.

The existence of “cash” economy lays a potential ground to the movement of the informal economy into a criminal economy, by financial support it provides for the crime, especially the organized crime economy.

Businesses, whose sources are not very trustworthy, as well as the money clean processes grow in the countries with high level cash economies. With the cash which is kept under the counter within shops, the lawbreakers would not resist the temptation to get cleaned overnight. The hidden activities supply direct losses which increase the production

costs. This involves bribes, license and tax evasion, and selective alternatives of the private sector rather than the public one.

Bribe corruption of the state officials, directly related with tax gathering and monitoring, brings about corruptive and abusive tax and customs administration. In Albania they find themselves under huge pressure.

The informality rates are directly related with corruption. They both increase proportionally. In a way these elements have influenced and supported each other in reciprocal levels.

4. Some way-outs

The frequent occurrence and consequences of informal economies in Albania and the little awareness of the public opinion of this phenomenon, constitute a challenge which needs to be over-passed due to the very positive effect its reduction would have on the country economy. This requires more work on the behalf of the government, non-governmental organizations (NGOs), and national or international institutions that monitor the phenomenon. Special attention should be paid to the increase of public opinion awareness of the informality consequences.

Since the informal sector shares a significant part of the economic activities in Albania, its movement toward formality should be aimed gradually, without the complete destruction of the former and by allowing duality for a transitory period.

The main challenge for the government may be summarized as below “...in the adoption of measures aimed at improving governance. and strengthening of public institutions, including customs and tax administrations” (Olters, 2003, p. 53). That would facilitate the improvement of the public services, would offer better public goods and an improvement in the

relationships between the taxpayers and the tax monitoring institutions.

The informal economy is lower in countries where the state institutions are more powerful and more efficient. Therefore, their improvement accompanied by the increase of the people's trust may be a safe way toward increasing the rates of formal economies.

Warfare against fiscal evasion remains one the objectives of the Albania government. However it needs to get out of the election slogan framework, and be reflected on concrete undertaking of measures. In this respect the government has undertaken a number of actions culminating with the law about fines and the decision of referential salaries for the private sector. Neither of them was welcomed by the Albanian businesses, even though they both aim at the decrease of informality rates and the fiscal evasion. It would be very useful if, the government paid due attention to the opinion of all of the involved parts, which aim at the improvement of the situation.

Countries which apply lower taxes tend to have a lower level of informality (Mema and Preçi, 2003). That may also be the case of Albania. There is a 10 per cent level tax on duties from the income, and a tax on the big and small businesses; furthermore there is a total reduction of all the other taxes that have to do with custom duties aiming at enhancing business. These measurements have aimed at withdrawing the fiscal burden which keeps business away from formality. Yet, despite the low tax rate, there is still high informality in Albania. That is result of an ineffective way of the tax law application. There is need for better focus on the law application rules by avoiding all political abuse on their behalf, on unequivocal ownership rights and investments on the behalf of official institutions.

The cash economy and its reduction carry with themselves a complexity whose solution requires the engagement not only of the banking system, but also of other factors with important influence on the economic progress of the country. The impact of the banking system on the actual size of the cash economy is reflected in the insufficiency of the substitute products they offer for the cash economy. In this respect, improvement of the legal focus and of the infrastructure may decrease the rates of unfair business by increasing honest competition and by soothing the encouragement of the fiscal evasion.

The government should utterly fight corruption. High levels of the state intrusion and the corruption in its institutions have fundamental importance for the economic informality. If there is corruption, there is informal economy. If the government bans the informality source, i.e. the state corruption, and allows little interference of the state in business relations, it is on the right way to stop informal economies. Its decrease will only be due to corruption avoidance, state institution full function, increased awareness of the public opinion as well as updated and efficient the public administration.

Since currently Albania is hoping to be a country candidate for the EU, it has to strictly fulfill all the required standards (both politic and economic) of such a status. If the experience of the other countries in transition is analyzed, there is a tendency of less informality trends if a country aims at EU membership (Johnson et al, 1997). Reduction of informality in the economy is one of the three problems for which Albania should find an immediate solution. International reports written after concrete surveys carried out in Albania define informality as one of the most problematic features and one of the worst prevention for faster entrance rates. The fight against informality is not

just a strategy, or an objective in itself; it envisages the establishment of a pro-business atmosphere and the design of fair play rules in a competitive market. This means that there should be more space for each of the actors which in collaboration with each other aim at fast progress and integration of the country in the EU.

Conclusions

The informality should never be expected to disappear completely, because it is a phenomenon which depends on a number of economic, social, cultural, professional politics, whose full disintegration is impossible, since they are an integral part of the natural development of a country. "The experience of a number of OECD and transition countries shows that there is no magic formula or single major solution to transform informal economic activity into formal activity (OECD, 2005, p.11). The challenge consists on limiting its expand on acceptable levels for a healthy social and economic life of the country.

Lack of rules implementation is also an important factor for the existence of informal economy. Chaos occurs if people think that the law does

not work; it influences the occurrence of certain behavior which brings about informality. It is high time a new mentality is born, which respects the state, the law and its application, so as to diminish the various negative outcomes of an informal economy.

Competition is another focus of concern. It requires equal treatment of everyone by the same rules and laws of the market economy: free and fair competitiveness. The market economy needs powerful and efficient legal, politic and economic institutions.

The increase of the budget income should constitute the central focus of each development strategy in Albania. In order to face this challenge the government should be not tolerant of the corruption and the bureaucratic inefficiency. That would result in less informality and a softer fiscal evasion.

Albania is on the way of the integration in the EU. The integration perspective should be supported by concrete politics on the improvement of government functioning and decrease of the informal sector, so that the people think that their country is on the right way toward modernization and prosperity.

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