

## Informal economy in Romania- the main forms of manifestation

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**Abstract:** Nowadays, the informal economy can no longer be seen as a temporary, atypical and a marginal phenomenon, and besides, it has more than a fixed character in countries where incomes and assets are not distributed correctly. The informal economy will not experience a decline, if the economic development is not followed by an improvement at the level of employment and if income will remain at the same level. Informal economy cannot be measured accurately. Besides, without the certainty of success, trying to measure it would entail huge costs of information and creation of specific data bases. However, the opinion that the highest relevance cannot be given by the size, but by the dynamics of the informal economy, by its structure and the behavioral archetypes of the economic actors involved, it is widely accepted (the individual offering the job, the firm, the government). This paper tries to accurately present all the dangers and the consequences of an informal economy

**Keywords:** informal economy, economic actors, tax evasion, ghost companies, underground economy, black work market, clandestine labour.

**JEL Classification:** A1, B4, D00, E2, E26, H26, J21.

## 1.Introduction:

We find informal economy in all industrialized countries, but also in developing countries. Informal economy has adapted to its environment, by escaping economic and social regulations, and resisting to development and recessions. This capacity to adapt is found nowadays in Eastern European countries, through its so called secondary economy. Smuggling in the current system is represented by drug trafficking, weapon trafficking and other illegal or regulated acts.

The positive or negative influence of the informal economy is a widely studied phenomenon, mainly because of the view that the effects are mostly negative, however, there are also positive effects related to the revival of some economic branches, the elimination of rigidities or the increase of the stability of the state

## 2.Tax evasion

The term tax evasion, is currently used to define illicit operations, operations that cost the State Budget, unfortunately this term is not defined in Romanian law.

When the „Law against Tax evasion,, was developed in 1994, a certain interwar period tradition was considered; because in the interwar period the law that was used was called „repression law of tax evasion on direct contributions”; that is why this term was preferred against that of fiscal fraud [1]. In strictly practical terms, it is found that tax fraud is a real phenomenon in the Romanian economic landscape so that, as N. Hoanta argues, “it seems that no one is disturbed by its presence in all income activities” [2].

In the first years of the transition, tax evasion/fraud, manifested itself in direct

forms, without any coverage, the way some individuals acted could be considered “primitive” because all transactions were made in cash, sometimes directly in foreign currency, completely ignoring documents of fiscal and accounting nature, thus ignoring the payment of any tax obligations.

The state sector has been heavily used for masked lending to private firms or simply for transferring profitable activities to them, while negative externalities stayed in the Management of the State.

Due to the parasite activity carried out by these companies, mainly the records intermediation with collection of fees or unjustified commercial additions, these firms were called “tick companies”.

As a result of their knowledge expertise and know-how in the underground business, almost regardless of the field of activity, after 1994, they started to use tax avoidance techniques, creating a certain appearance of legality for the operations carried out. The purpose of these operations in the underground economy was purely economic, namely to infiltrate the market and to gain its most important segment.

The most used methods for avoiding tax obligations, justifying the provenance of goods introduced by smuggling or domestic clandestine production, and even for the reimbursement from the State Budget of particularly important amounts involved “phantom companies”.

Another example is that of an under evaluated import of goods, which means that the actual documents from the external supplier were substituted in customs by the importer, with counterfeited ones.

Subsequently, ghost companies will have to magnify the price from the under

evaluated one to the real one, thus gaining income without paying the fiscal obligations. At the same time, they will supply distributors counterfeited documents for goods destined for retailing.

The same principles are used for introducing smuggled goods into commercial circuit. In this case, the customs system is bypassed, there is no longer an importer, no fees are paid, smuggling is done, and the ghost company has the role of producing fictitious documents and fully assimilate the real value of the goods, including taxes, which theoretically are included in prices. In this case, unlike the complicated theoretical route followed by documents, the merchandise will be directed from the distributor to the retailers. On this short route: distributor - retailers, the goods circulate "on plain sight" and consequently they will be subject to tax obligations. Considering the example above, a commodity with a hypothetical value of 100 monetary units, reaching the retail area of 150 monetary units, will generate a loss of 36 monetary units out of a total of 37 monetary units that theoretically would be the level of budgetary obligations, thus more than 97% of the legal tax obligation - the same assessment principles were used as stated before.

We could also present the case where the phantom company is used to justify the unregistered production of a legally established company and / or the production of a clandestine workshop.

The only difference from the previous example is that the commodity does not come from outside the borders, so tax fraud is not amplified by smuggling. The amount of the damage generated for the State Budget will be diminished, compared to the same example, with the amount of the customs duty.

A specific case refers to the role played by phantom companies to amplify the price of some products intended for export. The reason for this operation is the increase in value added tax that will be recovered as a result of export.

The exporter builds a commercial chain with the help of phantom companies, resulting in a higher theoretical cost of the commodity compared to the real one paid to the manufacturer. Formally justifying payment to the system of intermediaries, some of which being ghost companies (off-shore companies), the exporter will request the refund of value added tax. Using this chain, most of the reimbursed value will be stopped, so the manufacturer will get only the real value of the goods.

Another method commonly used in recent years to evade tax obligations involves the assignment of companies that previously worked and garnered debts.

### **3. Black labor market and clandestine labor**

Pre-1989 statistics did not register an unemployment rate, but a complex contradiction developed behind this official situation.

After 1990, the new conditions triggered a rapid process of unemployment or early retirement of a large number of individuals as a result of the closure of many economic units, the reduction of activity or, in some cases, the introduction of modern technologies that replaced the individuals.

After the end of the period of social benefits, most of the unemployed are registered, at least theoretically, without any source of income. This social category has become a favorable factor for recruiting clandestine

labor.

In turn, employees have become for the most part, a social category paid much less than the others.

In 2001 the real average wage reached 63,1% of the wage value from 1989, according to specialists from the Institute for Research on Life Quality, and 25% of the employees have had, between 1997 and 1999, a 50% less in salary than the average salary on economy.

Analyzing the labor market, the authors of „Romanian underground economy” have determined, based on data provided by the National Institute for Statistics, that in 1998 approximately 658 000 individuals,

representing 13% of the labor force and 15% of the labor demand have worked on the black labor market [3]. The distribution on sectors of activity is presented in Table no. 1.

In order to estimate exactly how the black labor market operated, the study used 1993 National Account System, that demands the comparison of the supply and demand of labor existent on the market.

Labor demand is estimated on the basis of the annual structural survey, which provides information on the average number of employees per economic branch.

Table no. 1 – Undeclared labor distribution on sectors of activity (thousands of people) [4],

<i>Sectors of activity</i>	<i>Supply of labor</i>	<i>Demand of labor</i>	<i>Black labor market</i>
<b>TOTAL</b>	<b>5.139</b>	<b>4.481</b>	<b>658</b>
Industry	2.706	2.360	346
- extractive	190	185	4
- manufacturing	2.279	1.976	304
- energy	237	199	38
Constructions	431	414	17
Trade	907	816	91
Hotels-Restaurants	146	107	38
Transportation	416	373	43
Communication	109	96	12
Other services	425	315	110

Source: Adrian Cucu, „Underground economy”, Bren Publishing House, 2003

The labor offer is estimated on the basis of the household labor force survey (AMIGO).

The structural survey applies to commercial companies in all branches of the economy but does not include family associations and independent natural persons. In the public administration there is no "black labor work" and for the activities carried out in agriculture, they use special statistics.

The household labor force survey – AMIGO, originally introduced to provide intermediate data between population censuses, provides information on the number of full-time, part-time or casual workers that received salaries during the analyzed period.

Comparing demand and supply of labor by sectors of activity, leads to the number of persons that have declared to work in the analyzed period in a specific economic branch; the number of individuals recognized by the economic units as employees during the same period, and, in the end, the difference representing the black labor force used by the underground economy.

A problem with sensitive implications, somewhere on the border between black labor market and criminal activities, is represented by clandestine migration. Thus, on August 30th 2002, the main Romanian newspapers provided information according to Media fax data, that more than 220,000 Romanian citizens were returned from the border in an attempt to leave the country in the first 7 months of 2002, and during that same 6 200 illegal emigrants were sent back to Romania from European countries.

Considering that the reason these citizens were not allowed to leave the country was the lack of a minimum amount for living in the states they were supposedly visiting,

it follows that the touristic purpose of those journeys is also excluded on the basis of the presumption of good faith. It is likely that those emigrants have searched for a possibly seasonal, clandestine job in the European countries.

The figures presented are alarming because they account for about 5% of the existing workforce in Romania or about 33% of the underground labor determined according to statistical methods. These data supports our opinion that the individuals involved in underground economy is much higher, approximately with 500 000 people more.

Currently, it is estimated that there are 2-3 million Romanian citizens working abroad, which represents over 10% of the total population of the country, 20-30% of the employed population and 40-50% of the number of employees in 2007 according to Romanian statistics.

At the same time, according to official statistics, 30% of the population is involved in agriculture. In our opinion, the villages are practically abandoned by the individuals between 20 to 40 year olds, most of whom are abroad. Those who remain to work in agriculture perform an unregistered and non-taxed work, they do not pay social and health contributions, and they do not receive a salary. The work performed in agriculture or constructions is mainly paid by the hour or per day, and is generally illegal.

#### 4. Criminal activities

The most destructive segment of the informal economy has developed in Romania, according to the opinion of the specialists, on the "nuclei" of criminality, that made their presence known especially in the eighth decade, because of the social and economic crisis that took place during that period [5]. From the relatively succinct data available

to us today, we notice that most of the criminal activities specific to informal economy have made their presence felt, because of certain contact points in the Romanian space and in some cases the involvement is more pronounced.

Thus, the problem of international networks of human trafficking and prostitution, is probably the most pressing reality regarding the involvement of some Romanian networks in organized criminal activities.

A press study by Rompres Agency aimed at human trafficking reveals that a number of Western specialists believe that "Romania has moved from the status of transit country to the source country for organized networks." The same article quotes an article in the French Daily Le Monde, according to which "Romania has become a turning plate for the region for human trafficking[6].

These signals from outside our borders are not random, they demonstrate the emphasis of the phenomenon of organized crime and viewed from the point of view of globalization is a bitter "victory" of the Romanian criminal groups that have succeeded in infiltrating the existing system in the West by specific methods.

Regarding this kind of activity, the White Book on Organized Crime and Corruption explains the working methods of the individuals involved [7].

Another type of criminal activity, component of the informal economy that has emerged on Romanian territory, tenaciously strengthening its positions, is drug trafficking.

Due to its geographical position, due to the conflict in the former Yugoslavia, Romania became in the early years of the last decade an increasingly used variant, a segment of the Balkan drug route. Subsequently "from a former transit country, Romania has

also become storage space, where drugs are introduced. Especially through the southern border, drugs are stored for different periods of time and ultimately redistributed to high consumption countries."

Beyond these issues, the confirmation of the phenomenon implies that over the last decade the Romanian authorities confiscated over 20 tons of drugs and about one third of the individuals proved to be directly involved in these transactions were Romanian citizens.

## 5. Conclusions:

We can conclude that the balance of the world economy is relative in nature, trying to balance the factors of opposite action but with a dynamic character, gives a relative stability. It constitutes the most complex form of manifestation of general economic balance, including the national economic balances and all the sub region economic balances as well.

Governments have the interest of limiting the informal economy due to losses to the State Budget, even if it is known that some taxpayers disagree with the restriction in this sector.

The attempt of some States to reduce the informal economy as quickly as possible, on the grounds that its effects are predominantly negative, could have long-term positive consequences but will certainly affect those who are not favored by a competitive environment and who otherwise found refuge in the informal sector. We believe that the reduction of underground phenomena should be accompanied by a cogent analysis of the development and absorption possibilities existing in the legal economy.

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