

WILL THE PRESENT ECONOMIC-FINANCIAL CRISIS CAUSE THE EXPANSION OF THE UNDERGROUND ECONOMY?

Lecturer, Dr. Adrian Ducu MATEI¹

Abstract: *This paper highlights the main features of the underground economy at the European level, laying the stress on Romania.*

The underground economy seems to have a major significance because important resources of the budget are “missed” by the state, with consequences for a decent standard of living and social peace.

The data on such phenomena are recent and reveal Romania’s features in relation to the other EU member states. The present economic context, determined by the economic-financial crisis, worsens these phenomena, which, in turn, worsens the crisis.

Key words: crisis, underground economy, corruption, sustainable economy

JEL Classification: P0, F0, D0, P35, P5.

1. Introduction

Frequently approached by scientific and academic circles and mass media in the last time, the underground economy makes us understand that strong measures should be taken urgently. At least in the last two years, this phenomenon has taken on proportions and consistency even in developed countries, as internationally recognized economists say. Black labour and tax evasion by non-payment of duties and taxes on wages, procurement of goods and services at very high prices and useless investments are quite usual even in developed countries.

¹ The Athenaeum University of Bucharest, ducumatei@yahoo.com

Tens of billions of euro, often undeclared and untaxed, are under offshore jurisdiction and thus diminish the national revenue from taxes. Due to the extent of this phenomenon, the intensification of the fight against fraud and tax evasion is not only a matter of revenues but one of equity.

According to estimates, only the recent initiatives taken to voluntarily comply with rules in accordance with the G 20 Initiative have enabled the mobilisation of ten billion euro in two years in the EU member states in question to combat evasion. By diminishing fraud and tax evasion, the member states may increase revenues from taxes, which would enable them to take stronger action for restructuring the fiscal systems in order to promote growth in accordance with the 2012 annual growth analysis.

Friedrich Schneider¹, an Austrian economist who studies the underground economy, says that “Because of the economic crisis, the underground economy will grow in 2010 in the developed countries, as it, anyhow, grew in 2009” (*Le Figaro*). According to his calculations, the share of the black economy in the GDP of the OECD countries increased from 13.3%, in 2008, to 14%, in 2010. In France, this share increased from 11.1% to 11.7%.

In Romania, the underground economy and corruption are two major shortcomings, as revealed by all statistics provided by international organisations. Therefore, we have to show great concern about our economy.

The underground economy is often accompanied by expanding corruption, which has serious consequences for the economic growth and causes a severer general consolidated deficit and further the worsening of the public debt.

2. A few conceptual clarifications

2.1. Underground economy

The underground economy is present in all countries, in various proportions to the GDP. The term *underground economy* is found in literature under different names such hidden, dissimulated, parallel, annex, dangerous, phantom, invisible, non-official, dual, cash, informal, secondary,

¹ Professor, Dr., Dr. H.C. mult. Friedrich Schneider, Department of Economics, Johannes Kepler University, Altenbergerst. 69, A-4040 Linz, Austria.

illegal, grey, shadow, unmeasured economy, counter economy. Pierre Pestieau's definition, according to which the underground economy is "a set of economic activities carried out outside the criminal, social or fiscal laws or outside the national account inventory" is considered by specialists to be one of the most comprehensive (Rădulescu, 2007).

There is a comprehensive literature dealing with possible causes of the underground economy, of which we selected the following:

- Increasing pressure caused by taxation (Caballé, Panadés, 2007).
- Pressure exerted by regulations enforced by the state (low regulation or overregulation) (Levaggi, 2007).
- Fiscal awareness or ethics: citizens' attitude towards the state (McGee, 2005; Torgler, Valev, 2007).

An oversized underground economy has two main effects: decline and diminishing rate of growth of the official economy.

Among the forms of underground economy, the most common ones are the following:

- the extension to speculative activities to financial markets, especially to financial stock exchanges;
- the internationalisation of the drug production, transport and distribution networks, the creation of new zones included in the category called "tax haven";
- the expansion of illegal international trade or international smuggling and the quick development of cross-border organized crime.

So many organisations are interested in researching the "hidden face" of the world economy, followed the diversification and the internationalisation of the fight against the underground economy.

The statistics concerning this phenomenon in Romania are alarming, and the effects of the extensive underground economy are harmful both to the GDP and to the tax collection.

An indirect participant in "the black economy" is the European Union itself. The investigations among foreign builders working in Germany show that about 20% receive unemployment allowance in their country of origin.

To expose this kind of fraud, multilateral agreements of the EU states are required. Even the EU legislation should be changed to allow for data transfer from social services to a country or other. On the other hand, these changes should be consistent with EU directives ensuring the secrecy concerning the individuals.

In the last decade we have witnessed a diversification of underground activities as well as their internationalisation.

The underground or informal economy is harmful to the whole national economy because of:

- the state 's failure to collect taxes, representing huge amounts;
- losses taken during the marketing stage (indirect duties);
- the diminishing foreign currency reserve of the country.

All of them endanger the security of the impoverished state. In these circumstances, an urgent goal is the maximisation of direct or indirect tax collection, which accompanies the security goal whatever it might be: “gendarme” or “providence”.

Some people consider that developed countries tend now to formalize the underground economy and restrain the area of informal activities, which often have perverse effects: for example, the category of people who are able to work but have no job and, moreover, do not receive unemployment allowances (the so-called exclusion).

Contrary to this trend, some developing countries consider the informal economy as a main factor of development, such as the Maghreb.

Romania cannot avoid the effects of the underground economy; it accounts for 29.1% of the GDP in 2012, as estimated by Prof. Dr. Friedrich Schneider¹ (*Annex 1 - Size and Development of the Shadow Economy of 31 European and 5 other OECD Countries from 2003 to 2012: Some New Facts* by Friedrich Schneider), being surpassed only by Bulgaria (32.3%) in this respect. The EU 27 average is 18.4% of the GDP, so Romania has 11.2 pp above this average, and within this range it could obtain considerable amounts for the national public budget, provided that the fiscal discipline improves.

A share of the underground economy below 15% is found in the northern countries, in Austria, Germany, France, Ireland, the United Kingdom, Luxembourg and the Netherlands. Even if this value is low in the above-mentioned countries, the weight of the underground economy should be taken into account, because the smallest value is still significant, i.e. 7.9% (in Austria and Switzerland).

¹ Prof. Dr. Friedrich Schneider, *Size and Development of the Shadow Economy of 31 European and 5 other OECD Countries from 2003 to 2012: Some New Facts* (ShadEcEurope31_March2012.doc).

2.2. Corruption

Being complex, multistructural and multidimensional, corruption is an economic, social and political phenomenon and has several causes that can be grouped as follows: economic, institutional, legal, political, social and moral.

The *economic causes* are: high cost of living, on a steady rise; deterioration of the economy and, consequently, pauperisation; low wages for public servants, not paid in due time; non-viable state budget; overregulation of the private sector.

There is one comment on overregulation, because regulations in excess do only justify actions taken by those who generate corruption; there are regulations that hinder competition, free access to the market for all competitors or even generate corruption, and the beneficiaries of such regulations justify their actions by those legal provisions.

The *institutional causes* include the following: unwise personnel policy; promotion of incompetent and corrupt persons to high positions; lack of transparency of the central and local public administration, of the judicial bodies; too much freedom for decision-makers; a small capacity to expose corrupt people; poor technical means for judicial bodies; poor human and logistical resources and lack of effective tactics.

The *legal causes* are related to faulty legislation, the lack of effective mechanisms.

The *political causes* consist in: lack of will and political responsibility; internal and external factors that foist group interests on decision makers; erroneous ways of economic and social reform; unfair political competition; traffic of influence in mass media and judicial bodies; funding of press trusts for an unfair presentation of facts.

The *social and moral causes* are related to culture, mentality, tradition, corrupt behaviour of the government and legal bodies and consists in: society disintegration and demoralisation; erosion of the ethical values; improper information of the civil society; civic non-action; public tolerance; social polarisation; dependent mass information means.

The multitude of causes of corruption determines the diversity of domains affected and the complexity of the actions taken to prevent and combat corruption.

The official statistics and those provided by specialized non-governmental organisations¹ (Annex 2), the results of scientific, socio-

¹ According to Transparency International, ANAF, NIS.

criminologic research, the information provided by judicial bodies, judicial statistical data and information provided by mass media show that corruption affected the following domains: political and institutional, economic, judicial and juridical, training and education, social and healthcare, investments and international trade, which seriously affect the state's authority and make citizens lose their trust in state institutions.

Transparency International shows that Romania is ranked the 66th by the Corruption Perception Index in 2012, below Lesotho, Kuwait and some EU countries like Poland, the 41st (score: 58), Hungary, the 46th (score: 55), and Croatia, the 62nd (score: 46).

The ranking by Transparency International is between zero (the highest level of corruption perceived) to 100 (the lowest level). This phenomenon causes also tax evasion, because an honest citizen or economic agent is no longer stimulated to pay duties and taxes when he/she sees that public money in the form of special funds or budget sources is spent ineffectively.

The economic impact of corruption takes various forms. **Bureaucratic delays** in preparing documents, state's incapacity to ensure the security of producers, lobbying, protectionism, traffic of influence, unfair competition, excessive regulation and control by the state - which affect the mechanisms of the market economy and free competition and discourage investors and entrepreneurs – cause an increase in the cost of public projects, a diminution in economic efficiency, the expansion of tax evasion, a diminution in payments from the budget and the expansion of the underground economy.

The social-political effects of corruption is **the functional, political and moral degradation** of the central and local public authorities, which is a result of the expansion of political corruption by diminishing the transparent and responsible political competence, by impoverishing the population and increasing social unrest.

As regards the Government's activity, the effects of corruption are: low quality of public administration, a system of unofficial decisions, close relationships between organized crime, public servants and corrupt politicians, etc.

The corruption effects extend to international relations under the form of incompetent, irresponsible, provocative and subjective-conventional behaviour of persons in executive positions, who first promote their

personal and corporative interests against national interests, thus undermining the image and credibility of the country as a partner within international relations.

3. Comments

Some of the measures to be taken for combating the underground economy, i.e. pushing it to a zone where it can be taxed, are the following:

- Reducing the fiscal pressure by diminishing some categories of taxes and duties, especially those related to the labour cost.
- Analysing the regulations enforced by the state in the fiscal policy field:
 - the size of the public financial collections;
 - the distribution and the utilisation of budget expenditures;
 - activities with a quasi-fiscal character (trading some of the state's assets).
- Taking measures for stimulating and promoting fiscal conscience or ethics: citizens' attitude toward the state.

The task of a possible fighter against the underground economy and corruption seems discouraging. History provides many examples of great promises but no results.

Sometimes, there were some reforming intentions: newly elected leaders, determined to resolve the problems, were quickly overwhelmed by the complexity of the problems or by the opposition of the political and administrative environment which had to be reformed from inside. Others, only for the sake of propaganda, delivered speeches, approved laws, but actually not intending to make any changes. Sometimes, optimistic voters re-elected governments determined to effectively combat corruption. Governments fell due to their inability to deal with it; others were elected with the hope that they could do more. Still, few of them could boast of any progress.

The multitude of works produced by economists and researchers may hinder us from seeing the wood for the trees. There are many theories slightly linked to reality.

Anyhow, the analysis of previous failures helped us to identify several common causes. The most obvious ones are the following:

1. **Limits of the top leadership.** A new leader might actually want to resolve the problems, but he inherits a corrupt government mechanism that hinders any action.
2. **Non-commitment of the leadership.** Second-ranked persons from the political and administrative system may wish to make changes, but their endeavours are hindered by the lack of determination of the leadership.
3. **Too ambitious promises leading to unreasonable expectations.** Those who make empty promises shake the confidence of those who expect effective measures.
4. **Slow reforms without a clear programme.** In this case, one cannot say who “manages” the reform, i.e. there is no person dedicated to it and, for personal reasons, that person does not want to implement and update it.
5. **Reforms too much based on the legislative system,** which is an ineffective instrument for changing behaviour, or **on constraint,** which may lead to repression, to an apparent abuse of power and to a corrupt regime (what could convince us that, while present laws are ineffective, the new ones would be more successful?).
6. **Reforms tend to omit the high-ranked ones,** the so-called “big fish”, and to focus only on “small fish”, implying that leaders do not “need” reforms or they openly reject changes. Therefore, the law is unjust, the leadership loses credibility, and soon the law is no longer enforced.
7. **The purposes of the reform are not clear and easy to achieve,** and reforms do not show real changes (in the absence of which the population’s confidence – essential for a successful reform – vanishes).
8. **Institutional mechanisms** are not provided – not even where the reform is real – so the process cannot go on after initiators have left the political stage.

This opinion is based on the belief that all aspects concerning the government – higher competence, channelling of results, public involvement and the promotion of national integrity – should be approached by means of a coordination programme covering all important fields. The general purpose might include the following:

- Provision of effective public services for a substantial development.
- Government decisions in accordance with the law to protect citizens against arbitrary decisions (including the denial of human rights).
- Development of strategies to the benefit of the society as a whole, including the poorest and most vulnerable members, not only the well-placed elite.

The dissemination of the idea of national integrity among the leadership is an essential stage of any reform. By implementing a system of national integrity, corruption can be diminished and this approach is vital unless we want the undermining of other efforts for a balanced development.

Bibliography

Aderinwale, Ayodele (ed). *Corruption, Democracy and Human Rights in East and Central Africa: Summary Report of a Seminar Organized by the Africa Leadership Forum, Entebbe, Uganda, 12-14 December 1994* (ALF Publications: Ibadan).

*** *Corruption, Democracy and Human Rights in West Africa: Summary Report of a Seminar organized by the Africa Leadership Forum in Cotonou, Benin, September 1994* (ALF Publications: Ibadan).

Agarwal, A. and S. Narain (1998). *Corruption and the Environment: The Method Behind the Madness*. In: *Down to Earth* Vol./Issue Date: 7/31 October 1998. P.: 01-04.

Berkman, Steve. "Corruption and its impact on contract management", 3 April 1995 (mimeograph, World Bank).

Bierich, M. (1997). *Ethische Aspekte wirtschaftlichen Handelns von Untemehmungen bei internationaler Tätigkeit* in: *Handbuch der Wirtschaftsethik.*, P.: 1-23.

Elliott, K. A. (1997). *Corruption and the Global Economy*. Washington, D.C., Institute for International Economics. P: 1-244.

Eser, A., M. Oberhofen, et al. (1997). *Korruptionsbekämpfung durch Strafrecht: Ein rechtsvergleichendes Gutachten zu den Bestechungsdelikten im Auftrag des Bayerischen Staatsministeriums der Justiz*. Freiburg im Breigau, edition iuscrim. P: v-xii, 1- 795.

- Feld, Werner J.** *Multinational Corporations and UN Politics: The Quest for Codes of Conduct*, (Pergamon Press: New York, 1980).
- Pop Napoleon and Ioan-Franc Valeriu**, *Credință și economie*, Editura Expert, București, 2012
- Transparency International (TI)** - *The Fight Against Corruption Is the Tide Now Turning? Report*, 1997. Editor(s): Jeremy Pope and Carel Mohn. Berlin, TI (Transparency International). P: 1-192.
- Finn, Paul.** *Abuse of Official Trust: Conflict of Interest and Related Matters* (Australian National University: 1993) p.5.
- Fleischer, David.** "Political Corruption and Campaign Financing in Brazil" (paper delivered to the Workshop on Political Corruption in Latin America, North-South Center, University of Miami, Coral Gables, Florida, 8 May 1995).
- *** (1997). *Political Corruption in Brazil*. In: *Crime, Law & Social Change* Vol./Issue Date: P.: 297-321.
- Frisch, Dieter.** "The Effects of Corruption on Development" a paper presented to the Africa Leadership Forum on "Corruption, Democracy and Human Rights in Africa," Cotonou, Benin, 19-21 September 1994.