

UNDERGROUND ECONOMY – A GROWING CHALLENGE FOR ECONOMY AND GOVERNMENTS

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Abstract

This article outlines some of aspects characterizing the underground economy in general and some of the concerns and measures that may be taken at the level of governments for diminishing the effects of black economy. The main tool and the most economic one is stimulating voluntary compliance of taxpayers.

Keywords: underground economy, public finance, taxation, tax administration, taxpayers, voluntary compliance.

The informal economy includes all economic activities that contribute to the welfare of citizens and not included in the official data (activities that escape official records), because they are deliberately hidden from public authorities.

The term informal economy has no clear accepted definition but it is synonymous with parallel/underground or hidden economy, depending from country to country.

The classic definition, as adopted in 1993, recognized as belonging to the informal sector all activities producing goods and services, whose purpose is to provide primary jobs and incomes of those involved, running businesses or households. This means that units engaged in producing goods and services cannot be separated as independent legal units, separate household, where generally there is no division between labor and capital as factors of production. In addition to household-enterprise can be entered here the small production units, which "commits" the long term for one or more workers without contracts in this regard.

Also, accounting for production work cannot be separated by that of their household expenses, even as capital goods (buildings, vehicles, machinery, etc.) cannot determine from the household owned. If the division of capital - labor exists the working relationships is developed through casual employment based on personal relationships or social type. Therefore, the international definition of underground economy includes tax fraud and "black" labor, where tax evasion is the result of undervaluation of income (avoiding imposing a larger or smaller parts of matter taxable), and black work is performed without legal forms prepared (lack of individual contract or payment on payroll). If we add to this the activities of smuggling, drug production and trafficking, will have the so-called underground economy, to the largest extent.

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International definition is far from establishing the line between formal and informal. The primary debate is related to agricultural activity, especially the subsistence activity, but the activities of domestic workers are to be considered as well (those employed by a household to do different jobs for which they are paid).

An important role in clarifying the activities has the adopted legislation of each country, and depending on how broad is it reported to the variety of labor relations that may exist at some point in the economy, informal sector activities may be an increasing or decreasing trend.

However, the system of accounting and financial tracking can control the size of the informal sector. In addition, the accuracy of reporting and data recording is a defining process for estimating the size of the sector.

The definitions used present underground economy as "economic activity not recorded in official records" or "any unregistered economic activity that currently contribute to obtaining (calculating) GDP" or "the demand for the sale of goods and services (regardless if it was legal or illegal), the official estimates beyond the control of gross national product".

A Romanian dictionary of economics emerged in 1995, defines the underground economy as "all undeclared economic activities of institutions involved in the assessment of taxes and social contributions are beyond national accounting and statistical records". Also, the shadow economy, known as hidden or informal economy includes "black", illegal or clandestine activities of production, design, etc. sparing, informal and undeclared.

The informal economy is a dynamic process that includes social and economic aspects of development theory, statutory regulations and their application, which creates difficulties for those interested in studying this phenomenon, given that:

- the informal economy has a temporary character;
- the law changes frequently;
- activities are diverse;
- there is no unified methodology for evaluation.

As shown by Hussmanns R., in order to describe the essential aspects related to informal economy a Matrix for the informal economy can be used. For each component of the informal economy considered an actor, the table below defines a methodology for measuring the size and characteristics of the informal economy. The areas that are not numbered in the table have no direct interest to assess the informal economy, in this context. Informal sector enterprises are defined as private units that are not established companies and have a number of employees which are not legally hired.

	Independent Employees	Employers	Unpaid family	Employees	Workers in productive
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					members			associations	
	informal	formal	informal	formal	informal	informal	formal	informal	formal
Enterprise from the formal sector					1	2			
Enterprise from the informal sector	3		4		5	6	7	8	
Households	9					10			

Figure no. 1: Matrix of informal economy – adapted after Hussmanns

The elements of the informal economy in the above matrix are held as follows:

- 1,5 - unpaid household workers (with no legal contract of employment and legal protection);
- 2, 6,10 - engaged informal or performing activity in a formal company (2) or informal (6) or in households that paid domestic work, but without being registered in official documents;
- 3, 4 - workers (3) and employees (4) having their own independent informal enterprise; the informal character stems directly from the business characteristics which owns or works;
- 7 - employees working in informal enterprises, but perform a formal activity (if the unit is defined informally on the number of employees);
- 8 - members of informal associations of production;
- 9 - production of household goods or end users level (applicable here, for example, to end users).

Taking into account these issues, literature, several methods have been developed to estimate the size of the informal economy.

A. **Direct methods**, based on the following four tools developed to investigate the informal economy:

- Questioning agents affected;
- Random response method - Martín Reyes and others (1982)²;
- Consulting experts;
- Methods of fiscal approximation.

B. **Indirect methods** have been developed mainly by applying econometric methods:

1. Indirect monetary methods:
 - Gutman (1977)³ – cash deposit-ratio;
 - Feige (1979)⁴ – transactional method;

2 Martín G., Ladoux M., García A., La economía oculta y el método de respuesta aleatorizada. Boletín de Estudios Económicos de la Universidad de Deusto, 1982, nr. 117, p.551-567.

3 Gutmann, P.M., The subterranean economy. Financial Analyst Journal. 1977, nov-dec.;

- Tanzi (1980, 1983)⁵ – econometric method.
2. Nonmonetary indirect methods:
- The method of difference between income and expenses -Dilnot and Morris (1981)⁶;
 - The analysis of determining factors – Frey and Weck-Hannemann (1982, 1983 and 1984)⁷.

An OECD (Organisation for Economic Cooperation and Development) study on informal employment places Romania among countries with a worrying development of undeclared work. OECD experts have found that informal employment accounts for between 20% to 50% of total employment of labor in our country and identified two groups:

- among those who evade paying taxes and social contributions, including a wider range of participants from companies that do not employ workers with work contracts and sales companies who declares as true value to people who do not declare all income or receive payments "in envelopes";
- among those for which informal work is a survival strategy, including those working in agriculture and unpaid family workers.

Thus, the true extent of undeclared work gives the distinction between these two categories, employed and informal employment. It was also found that most penetrating by the "black" are usually active people, the segment between 25 and 45. They earn the most money (and) of undeclared work, because they have access to the market. Illustrate the situation of an employee of a large company that has "formalized salary" in the sense that there are significant differences between the actual amount of money received by way of salary and declared.

Also in Romania, there were a number of studies on specific components of the informal economy, with the support of World Bank and the European Union through assistance programs. In terms of scientific research level of the informal economy, corruption and environmental economic impact stands the activity of the Academy of Economic Studies and Institute for Economic Forecasting.

For general needs of society for the establishment of major financial funds available to public authorities. Thus, public finances are there to serve the achievement of specific objectives determined, the performance of tasks that could not be accomplished by another means or other means, for which, the Constitution governs citizens obligation to contribute, through taxes, taxes and contributions to public expenditure.

4 Feige E .L., How big is the irregular economy? Challenge, 1979, nov-dec.;

5 Tanzi V., L. 'Economie occulte est fice a des activités illicites qui son difficilement quantifiables, Bulletin du F.M.I., 1980, feb.

6 Dilnot A., Morris C. N., What do we know about the black economy?, Fiscal Studies, 1981;

7Frey B., Weck-Hanneman H., What produces a hidden economy? An international cross section analysis, Southern Economic Journal, 1983, p. 49.

Distribution function of two distinct phases known public finances closely linked:

- establishment of funds and
- their distribution.

Participation in the public funds takes different forms, namely:

- taxes, social security contributions, fines;
- payments from profits of state-owned companies;
- payments from the income of public institutions
- royalties and rents from concessions and rental of state-owned assets;
- income from asset ownership state etc.

The establishment of public funds involved with resources in different proportions in relation to financial capacity, all social sectors: public, private, mixed. The state, through its institutions, acting on the one hand, public authority, and on the other, as the producer and consumer of goods and services, organized and financed insurance and social protection, banker and contractor loans.

State intervenes in the distribution of national income by taking a large part of its public finance funds. Money to support from social services initiated by the Government, in particular, taxes and social contributions. Their management is provided by the National Agency for Fiscal Administration (NAFA), which has both the power to determine, collect, control and enforcement of taxes and social contributions.

To the extent that the tax burden is not excessive, it may call into question the need for "modeling citizenship tax" determinant of fiscal performance, but the taxed (taxpayers) must clearly know their rights and obligations:

Administration of taxes, social contributions and other amounts owed to the general consolidated budget is provided by the National Agency for Fiscal Administration (NAFA), which has both the power to determine, collect, control and enforcement thereof. Generally, the taxpayer is any person or entity required by law to pay tax.

To substantiate income figures included in the performance management and performance in terms of their collection is necessary to correct record of all budget debts, together with their collection. Thus, at the level of financial records by paying nominal take, or separately on each taxpayer separately. Simultaneously, this information is managed and centralized, including on higher level.

To achieve paying nominal records, the management function is used record revenues payer (taxpayer), which is analytical tool and opens out separately on each tax, fee, and contribution. Thus, the recorded documents setting out the budget obligations and those that goes out these obligations.

According to the Fiscal Procedure Code, tax claims settled by collection, compensation, enforcement, exemption, cancellation, prescription and other means provided by law (e.g: giving in payment, assignment of claims, payment facilities, submission

of corrective statements with easing, etc.). Information provided by the documents referred to above (document date, the amounts assessed, the amounts settled and how they were off major revenue with tax claims made in the account) are correlated with the legal terms payment and the number of days of delay in payment of tax obligations can be calculated accessories.

Operations must be registered to the appropriate payer system nominal balances constant, ie after each cutting / decrease and after each collection / off is determined remaining balance payment obligation, which provides some evidence on individual taxpayers / legal, and on the other hand, enrollment in the same position (on grounds of unique registration code / PIN) of all debts owed by the same taxpayer.

Centralized record revenues carried out on each category of income (based on budget classification) and requires the preparation of cases, such as:

- summary statement of outstanding obligations at a given date, which shall be made at the territorial fiscal body;
- summary sheet of the taxpayer's remaining obligations on a specific date, which reflects synthetic debt situation and accessories for each source of income;
- summary statement of revenues, at a given date each territorial fiscal body, a situation that is made for budgetary obligations with payment terms in the current fiscal year and, separately, on budgetary obligations outstanding from previous years.

Statements that make up central register shall be prepared and supplemented with information from data processing of regular (monthly, quarterly, annually or occasionally, if applicable). National Tax Administration Agency should encourage taxpayers to fulfill tax compliance incumbent, established itself in this regard and continuously improve the relationship and tax payer. The level of compliance is a key indicator for any tax administration, in turn, the National Tax Administration Agency being able to perform detailed analysis of compliance to highlight weaknesses, that the categories of taxpayers, industries or categories of taxes where compliance is low. Based on these data, one can identify and implement measures to reduce the number of taxpayers who fail to comply.

Compared with the level of voluntary compliance of taxpayers registered in other EU member states, whose value is generally around 95%, in Romania it has been low in the period 2007-2010, as can seen from the table below:

The degree of voluntary compliance of taxpayers in Romania during 2007 - 2010

Nr. crt.	Voluntary compliance	Fiscal year			
		2007	2008	2009	2010
1.	- to declare	81%	83,2%	83,9 %	84,6 %
2.	- payment (value)	71%	79,4%	77,4 %	78,9 %

Source: National Agency for Fiscal Administration: <http://www.anaf.ro>

For a good collection of budget revenues, to increase the taxpayer's fiscal citizenship and improve their relationship with tax, the National Tax Administration Agency continues to work for:

- operational services to taxpayers;
- improving management procedures;
- Services in providing quality care, operatively (electronically or telephone), development and diversification;
- develop materials to inform taxpayers about their tax obligations and rights;
- expansion of the electronic filing of tax returns;
- possibility of payment by electronic means, in addition to other traditional instruments of payment etc.

All administrations have as main objective to increase voluntary compliance, but to the extent that tax obligations are not met, they have specific means to achieve their achievement means more or less coercive. Thus, implementation of adequate procedures, when the maximum yield opportune and expected, European practice is to develop tools based on fiscal risk analysis models. As common features found among the Member concerned with the development of fiscal risk analysis, we find the following:

- desire for renewal of arrears management mode, moving from a logical analysis of indiscriminate profiling files to the files;
- taking into account the constraints related to costs of collection, in a context of reduced employment and financial resources allocated;
- reorganize the mission of collecting and / or enforcement by the implementation of specialized structures (eg poles collection in France, call center in England) or outsourcing (such as Italy);
- developing a strong and centralized system, and expanded access to various data on debtors etc.

In particular, models of risk analysis are intended population segmentation (debtors) on relatively homogeneous groups (using the individual scores, calculated separately for each taxpayer), and the proposed collection strategy motivated (directed and adapted to value and age of the claim).

The analysis allows, in principle, an optimal allocation of resources to achieve expected yields. The method used is to examine the debtor accounts and various features thereof (collectively, risk factors) are then combined to obtain a share of risk, the latter being used to determine the most effective methods of collection. The analysis involves examining the taxpayer as a whole, history, behavior and its heritage. Differentiation of cases, that prioritization is done based on the approach of the tax: as the amount of the claim after claim age, combining several criteria.

In general, the means put in practice for groups identified as low risk, consist of simple and automated procedures, such as:

- transmission of notices;
- transmission of summons;
- establishment of attachment of wages or bank accounts held.

Years of tax arrears and failure to recover within a reasonable claim, are important risk factors for non-recovery.

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