

INFORMAL ECONOMY AND MONEY LAUNDERING IN ALBANIA

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Abstract

The purpose of this study is to show the problems of informality in the Albanian economy. The term informal sector has been used to describe an extremely wide spectrum of activities, which do not necessarily have much in common, such as tax evasion, corruption, money laundering, organized crime, bribery, subsistence farming, barter, petty trade, and the stealing of state property. This is a worldwide expanding problem especially in the under developing countries such as Albania. This paper try to show that the roots of the informality economy in Albania are deep in the society and government institutions, in fact so deep that we may call it a tradition now makes this a never ending fight between those which profit from it and the other side which suffers from it. Although there was done a lot to fight this by our government in past couple of years it was centered mostly around wide population rather than the real big problem. The real stinging part of informal economy is the money laundering which is the hard part. This study try to recommend how to reduce the informal economy and what is the importance policy that government must to do in order to reduce this problem.

Keywords: Informal sector, economy, poverty, unemployment, Albania

INTRODUCTION

The informal economy or informal sector is a broad term that refers to the many aspects of a country's economy that are not taxed or monitored tightly by any form of government and are not included in the GNP of that country. A few examples of the informal sector are farms markets, garage sales, street vendors, open air markets, and flea markets. Various collaborative or sharing economies can also be included within the informal economy sector, such as eBay or Craigslist. Other informal aspects can also include a wide variety of non-market activities such

as home projects, volunteer work or other nonprofit driven markets. Other labels for the informal sector vary greatly each carrying their own narrative, such as the illegal economy, hidden, unobserved, invisible, alternative, shadow, black market or unofficial. By looking at the terms describing the informal sector, one can see the varied opinions and aspects of the informal sector, from alternative economy to black market. In this paper, the informal sector will be referred to as one that is the opposite of the formal sector or one that is tightly controlled, monitored and quantified in the GNP. Not to be omitted, the informal sector can have negative and destructive divisions as well and these will be addressed later in this paper. The informal economy has been around since the beginning of civilization, not only as a “primary” economic form but in various alternate forms to avoid government regulations and laws. Titles such as the “black market” are indicators of this covert operation. Throughout history, governments have tried to control the economic aspects of their territories, though no policy has been able to maintain absolute control and the population has always found ways in which to sell goods and services without the need for governmental control and restrictions.

Some scholars have believed that the economic development in developing countries would cause the informal sector to disappear. The informal sector was merely a stepping-stone to a formal economy. Though with 1.6 billion people currently employed through the informal sector is it far from a mere stepping-stone to a formal economy. The informal economy can refer to various employment options in developing, transitory and developed countries. Many of these are the only form of employment in these areas. Unfortunately, the informal sector also includes the various negative aspects associated with it. Though this paper is intended to promote interest in future study of the informal sector, one cannot negate or omit the various negative aspects of the informal sector. Informal economy workers do not have the same commodities that their formal economy counterparts can enjoy, such as health care or possible job security. Despite this, every country, including those in the “first world”, have a significant portion of their economy stemming from the informal sector. Schneider’s study of 110 countries found U.S. tied with Switzerland with the informal economy making up only 8.8% of the GNP, Italy with 27%, Albania with around 50% and Georgia with 67.3%, to characterize the lowest to highest. Informal economy is divided in two main categories. First is the illegal sector such as tax evasion which is associated with grey money. And second is the criminal sector such as narcotics trade which is associated with dirty money.

INFORMALITY IN ALBANIA

The informal economy is considered an inevitable disease and as such, the focus of every government is not its elimination, but its reduction in appropriate levels not to hinder the

development of the country. The informal economy in Albania was first appeared during the transition phase of the centralized economy to the market economy, because in this period, the development of the regulatory, legal, institutional and fiscal framework remained far behind in comparison with the development of free enterprise, according to official statistics in Albania the informal economy currently accounts for about 33 percent of GDP. Given the features of Albania, the size of the current informal economy poses a serious threat to the fair competition, which is the main tool for development. Businesses that operate in the "gray" zone of the economic sector tend to avoid tax obligations (performing evasion) in order to reduce the costs of paying taxes and insurance. In these conditions they gain a considerable advantage compared with those businesses that conduct their activities according to the rules and regulations in power. Unfair competition has not only led to the bankruptcy of businesses that operate according to the rules, but has encouraged "leak" or "transfer" of businesses from the formal to the informal economy. Some key factors that influenced the growth of this sector in Albania are as follow:

The relatively large number of legal and administrative rules: the greater the number of rules, such as business registration, requirements for the license and permit for the exercise of activity, limitations of labor market, market entry barriers, etc., the more informal economy is stimulated.

Lack of trust in public institutions / state corruption: here we can mention the corruption in the judicial system, unclear legislation and bureaucracy.

Restricted (limited) accesses in the formal property system: it refers to the absence of clarity about property rights or property title and the inability to collateralize these assets becoming an entry barrier for firms and individuals in financial institutions as credit lines, insurance companies and financial and capital markets.

Decrease of the individuals' awareness, expressed as a reduction in loyalty to public institutions combined with the reduction of discipline in payment of fees and taxes.

Acceptance of illegal labor often approved or tolerated by the state.

If we refer to the nature of the informal economy in Albania it is noticed that, after the 1990 there has been a significant increase up to today's levels. This relates to the fact that during the period of the centralized economy, the private economic activity was forbidden by law.

Economic crisis of the '90-'92, very critical regarding problems of high unemployment, poverty and social insecurity, gave people a powerful impulse to respond creatively to their difficulties by becoming part of the informal economy. The most disturbing problem of informality in Albania is mainly in the fields (tax and customs) related to different business activities, which,

though being registered, they do not accurately declare annual turnover, profit, number of employees and real wages. Businesses that own the majority of economic activity have the greatest impact in this economy. Another important factor regarding the informal economy is the structure of business and number of employees. According to studies conducted, it results that the largest enterprises in the Albanian private sector have the largest number of employees. The collapse of the communist system brought about the increase of the emigrants number, a phenomenon that in the short term had a significant impact on remittance growth, stabilization of macroeconomic indicators as well as on the increased investment, thus improving the welfare of individuals. The negative effect of remittances is seen in the fact that they encouraged informality through the flow of "cash" out of the banking system channels, making it impossible to identify and measure their impact on the real economy. So, the fierce market competition, the difficulties and entry barriers, as well as the lack of legal capital led many firms in this period to operate in the informal economy. From the analysis of the main problems and those most influential in this sector during the transition period in Albania, it results as follows:

POVERTY

Poverty is the result of economic, social, political and cultural factors, which affect each other, exacerbating and worsening further the situation. Poverty is associated not only with insufficient income and consumption, but also with the inadequacy of health services, food, education services, lack of social relations, insecurity, and lack of power and lack of reliability. A person is considered poor if the level of income or consumption drops under the necessary level to meet its basic needs.³ The private sector may reduce poverty by contributing to economic growth, creating new jobs and increasing incomes of poor people. It can also help the poor by providing a wide range of products and services with lower prices. Poverty in Albania appears multidimensional in the following aspects: - Low or very low income level; - High vulnerability of disease and inability to access appropriate medical services; - Illiteracy or low level of education; - High level of exposure to risks and weak voice in governmental decision-making institutions. According to various studies and statistics about 12.4% of Albanians are poor, while 1.2% of this category lives in extreme poverty. Consequently, the response of this layer of population to this phenomenon is the hidden employment. When people are unemployed and cannot generate enough money for their living, then they rely on alternative sources of informal economy.

The unemployment rate is the ratio of unemployed to the labor force. The labor force includes all persons employed and unemployed. Unemployment can be considered as one of the most difficult "diseases" (problems) today and is generally a result of the economic

recession. The unemployment level in Albania remains still high. Unemployment economic losses are estimated to be greater than the losses sustained by the society due to the inefficiency of monopolies or tariffs and quotas. In these conditions, the unemployment rate becomes a measure of a country's economic health. In situations of unemployment, the production gap takes negative values. The unemployment rate in Albania registered in the fourth quarter of 2013 results to be 13.5%.

CORRUPTION

Corruption is perceived as the most disturbing problem in Albanian society, because doing someone a favor, due to its non-monetary character and its role in the redistribution of income and power, is considered as more acceptable by the society. While bribery is perceived less acceptable, as seen as a mechanism that produces social inequality. Corruption hinders economic growth, destroys democracy, degrades society and destroys the chances of putting the rule of law. In post-communist Albania, corruption is of clientelistic nature and is closely connected with the formation of political parties and redistribution of state property. In Albania corruption is widespread, becoming an integral part of the institutional system. Individuals perceive that, in order to set in motion their rights practices, they should expect the abnormal bureaucracy imposed by the state administration employees. On the other hand, the key to put things in motion is the "promise" for a possible reward. But, corruption is widespread in lack of business declaring their real activities, making secret deals with fiscal administration officials.

INFORMALITY IN TAX SYSTEM

Since year 1997 Albania is making significant efforts to establish a system of taxes and fees according to EU member countries model (for the VAT, personal income tax and profit tax). Although positive steps have been taken in implementing a number of programs to improve the fiscal system and to reduce the informal sector, Albania still has an informal sector at a high level. The situation inherited in this area is problematic. A considerable number of firms have developed for a long time economic activity out of the evidence and surveillance of fiscal authorities, i.e. in the informal sector of the economy or they have only partially declared their activity, hiding in this way a significant part of transactions performed and consequently the cash flow and corresponding profits. Fiscal environment in which the fiscal administration operates has drastically changed in the last two decades. Although the tax base is expanding and the number of taxpayers is increased, at the same time it is increased the tax authorities work to educate taxpayers and tax administration. Also, during these years there have been significant changes in the techniques used for the assessment and collection of taxes using new

technologies (IT) for the administration of taxes and fees. These improvements have created opportunities for improving the efficiency of tax administration. Main fiscal factors that encourage informality in the Albanian economy are:

- Non-declaration. Lack of economic information presentation related to the transactions carried out is considered a non-declaration. This is a widespread phenomenon in the economy. A part of businesses hide and don't declare the commercial operations they conduct affecting negatively the economy. Because of the non-declarations, the tax inspectors fail to make a fair assessment of real business situation. Many businesses choose not to declare the number of employees in their company, the different purchases and sales they make, or the selling prices of their products and services.
- Failure to keep a regular tax database. Another problematic factor is also the failure of keeping regular tax documentation. This is evident when we refer to the type of invoices issued by businesses, lack of cash registers usage by the businesses, non declaration of prices and cash transactions in the economy.
- Setting the wages below the reference level. One of the main problems of the albanian businesses is the declaration of the payroll expenses. The trend over the years has been to declare lower wages in order to reduce as much as possible the tax obligations as well as social security and health insurances. To reduce this level of informality, the government has occasionally set reference wages (the minimum and maximum) in order to approach business statements as much to the reality, but, despite the measures taken, still these businesses find room for fiscal evasion.

Tax evasion: Tax evasion is a disturbing problem, not only for transition countries like Albania, but also for countries that have a developed fiscal system. The presence of this phenomenon and the level of its extension lead to a reduction in tax revenue. Concealment of tax obligations, through the submission of false documents, false statements or unreal information, which consideration leads to inaccurate calculation of the amount of tax, creates tax evasion. This is the definition by law for this type of law violation. Considering it as the most serious violation for which the taxpayer might face not only severe administrative sanctions but even the relevant criminal sanctions.

A problem for Albania is that there are still no accurate statistics and standardized methods for determining tax evasion. There are no accurate reports of the responsible institutions for this phenomenon. Albanian businesses, experiencing a rapid growth, often are

tempted to gain privileges/benefits via the deliberate tax evasion. The poor tax infrastructure, lack of human resources in this area has so far made it easy to carry out such informal activities.

According to the report "Doing Business 2014", in order to start a business in Albania there should be applied 5 startup procedures which require on average 6 days to be fulfilled. But, how much does it cost to start up a new business in Albania? Based on the same studies, the results recorded in monetary value is of concern, since the average cost of setting up a business is 55.700 ALL and apart that, there is enough lost time and suffering from a series of bureaucracies. There are also required many forms and documents in the different steps of the registration process. Many entrepreneurs think that the theoretical process of registration and obtaining the license seems to be fast and cheap, but in practice it does not seem to be like that considering that they have to go through this process, deal with relevant institutions, try to obtain the licenses, sometimes have to pay informal fees, and all this makes the regulatory framework costly and problematic. A significant impact on informality has had the exercise of different activities by unlicensed entities, as shown in the figure below, where about 10% of the total entities do not have a license.

INFORMALITY IN THE CUSTOMS SYSTEM

Despite the advances made in this system, where so far have been taken a series of reforming steps, still the administrative barriers and especially the burden of customs procedures for business, remain a serious problem. The main fiscal factors that encourage informality in the customs system are: Lengthy and costly customs procedures. Lengthy and costly customs procedures as well as the unpredictable delays are not only serious obstacles for import and export, but also for foreign investment capital, especially in the manufacturing sector, which are of particularly importance in achieving the development objectives.

Although, in recent years, according to the report "Doing Business" there have been positive developments in terms of reducing the customs processing time, which shows that the average clearance time during 2015 was approximately 2 days compared to 5.3 days in the past years. The process of clearance, clearance cost, number of documents, and export and import time.

Table 1: Indicator and nature of export procedures

Indicator	Albania	Europe & Central Asia	OECD
Documents to export (number)	7	7	4
Time to export (days)	19.0	23.6	10.5
Cost to export (US\$ per container)	745.0	2,154.5	1,080.3
Cost to export (deflated US\$ per container)	745.0	2,154.5	1,080.3
Documents to import (number)	8	8	4
Time to import (days)	18.0	25.9	9.6
Cost to import (US\$ per container)	730.0	2,435.9	1,100.4
Cost to import (deflated US\$ per container)	730.0	2,435.9	1,100.4

Nature of Export Procedures	Duration (days)	US\$ Cost	Nature of Import Procedures	Duration (days)	US\$ Cost
Documents preparation	11	130	Documents preparation	12	115
Customs clearance and inspections	2	65	Customs clearance and inspections	2	65
Ports and terminal handling	3	350	Ports and terminal handling	2	350
Inland transportation and handling	3	200	Inland transportation and handling	2	200
Totals	19	745	Totals	18	730

Source: INSTAT

Customs system has shown significant progress moving gradually from a system based almost entirely on paper records and documents in automated information systems. But, still it is evident that, generally there are delays in the processing of information by the customs due to system faults, load on the network, uncompleted automated information system at all customs points, insufficient preparation of professional staff, etc. According to the report "Doing business", the cost of export is 745 US\$, cost of import 730 US\$, export documents number is 7, while those of import 8, export time is 19 days, while import time 18 days, which rank Albania the 68th. Despite the progress, the Albanian customs service quality still needs to be improved in terms of reducing the number of necessary documents, making the import and export procedures faster and cheaper, in order to increase competitiveness.

Ethic Issues

There are identified issues of poor ethics of customs administration in relation to the business. The issues are made evident in several reports that are published and occasionally there are given concrete recommendations. The regulation on ethics has been very poor in formulating the rights and obligations of customs employees, as well as of the private entities in their dealings with the customs administration.

Transaction costs

Costs of customs procedures that are necessary and efficient + cost of customs procedures that are unnecessary and inefficient + costs of corruption. Transaction costs are especially increased due to customs procedures that are unnecessary and inefficient, and the costs of corruption.

Transparency of customs administration

Increased transparency of customs administration in relation with the business is essential in the fight against corruption and abusive application of customs legislation that favors evasion. The institution of customs administration continues to rank as the institution with the highest level of corruption.

TOWARDS FORMALIZATION

Informality in Albania, as discussed above, appears in a multi-dimensional plan and is one of the most difficult reforms to be undertaken. There are many businesses that conduct their activities without being registered, although the necessary measures are taken to identify and register those businesses that operate illegally. The main factors that develop a suitable ground for informality in Albania are: over-power, secret negotiations and subjective interpretation.

- Over-power is one of the diseases that should be cured as soon as possible in the Albanian administration. Code of ethics should be recognized well and every employee should have clearly defined tasks. An individual who holds a senior post in the administration level should not be able to take arbitrary decisions.
- Secret negotiations are another factor that develops informality in the Albanian economy. Fiscal employees have the opportunity to create "secret negotiations" with the control entities, distorting information and unfairly favoring some businesses. But, given the current law that requires the creation of electronic files, the opportunity for these "negotiations" reduces. Every taxpayer has the right to impartially, professionally, and ethically treat issues related to tax liabilities.
- Subjective interpretation is one of the most controversial issues that can find solutions due to the application of NAS (National Accounting Standards). They clearly present how an event is made evident, how is it assessed and how will it be reflected in the financial statements. Recognition and correct implementation of national accounting standards, updated and in line with the international accounting standards and financial reporting (IAS / IFRS), will lead to a significant improvement of the overall quality and scope of financial reporting, by the private and public

economically profitable entities. This will make possible the improvement of decision making, the management efficiency and will increase transparency and reduce the country's economic informality.

The efforts to reduce informality will require more work, time and financial support because this type of fight is multi-dimensional and complex. Government has taken measures to reform the tax administration and, what is most important, the support and goodwill of the business, are key tools to combat this phenomenon that threatens the very prospect of the Albanian economy. The government should undertake concrete and reliable actions to minimize the informal economy, coordinated with all market participants:

Identification of the real economic activity of market players. This activity should be controllable by state authorities (customs and tax);

Legal collection of the tax obligations to be paid to the state budget should be in compliance to rules and regulations and not using inefficient administrative methods.

Implementation of the law equally for all the market actors. This helps and encourages the country economic development in conditions of the fair competition.

The high degree of informality makes it difficult for the government to collect revenues for the budget, while the government itself should not allow informality. So it looks like we are in a vicious circle. In fact, the way to reducing informality is not in the form of a vicious circle, but in the form of a classical spiral, the perimeter of which is ever decreases, approaching the peak. This means that economic agents' efforts coordinated fairly by the government will constantly reduce the informal sector. Existing problems in revenue collection raise the question: under what conditions the government's ambitious objectives can be realized in the near future? The main lesson from the practice of countries in transition is that: "Improving governance to achieve social objectives means to pass from an economy without infrastructure and misleading network of social protection in a formal economy that pays taxes, with small but efficient social protection networks".

Anyway, many of these reforms cannot be successful without the reduction of corruption, bureaucratic inefficiency and of the other causes that create informal economy. In this period, great efforts are being made to reduce the cash economy. Identification of cash that is transferred through formal channels affects the reduction of corruption and evasion and will undoubtedly result in the reduction of informality. Banks, small and medium businesses, and individuals are among the main actors that affect the reduction of cash transactions in the economy. State institutions, such as state inspectorates, through inspections and enforcement

of legal frameworks that regulate this activity, play an important role in reducing the informal labor market.

Increasing transparency. Transparent information is a prerequisite for business development. This information will not only assist in developing local business, but it will also help the foreign investors. Given the new law for the tax procedures, the businesses are compelled to make their statements electronically, on-line. Electronic on line payment of taxes, defined by law, will significantly facilitate taxpayers meet tax obligations, reducing contacts with the tax administration and reducing opportunities for corruption.

CONCLUSIONS

Informality and money laundering are the bad bones of society. They ruin social integrity, democracy and fair competition. During this research we had an overview on the two most present phenomenon throughout the world. Informality has been around since there were set rules as it is going under the rules while money laundering though has been around for a while was introduced to the law only in the 1980s.

Informality is spread from the very low street dealers trying to make a living going on with the big formal companies and ending with the government officials who exploit it for their profit. Until three weeks ago we didn't use to get the tax voucher which is the pure visible tax evasion. As I mentioned on the paper before informality is categorized in four main types all of which generate informal income.

- The need to establish an inclusive growth strategy that would promote the expansion of the formal economy and promote the creation of decent and productive employment
- The promotion of a conducive business and investment environment
- The need to promote access to land and property rights
- The need to harness and develop the entrepreneurial spirit of informal economy operators
- The need to reduce barriers to the transition to the formal economy such as those related to registration, taxation and compliance with laws and regulations
- The need to promote micro-, small- and medium-sized enterprises and provide them with incentives to grow
- The need to promote access to education, life-long learning and skills development
- The need to provide access to financial services
- The need to provide access to business development services
- The need to provide access to markets
- The need to provide access to infrastructure and technology among others.

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