

# **INFORMAL ECONOMY: A SOURCE OF MONEY FOR THE ORGANIZED CRIME AND CORRUPTION IN SOUTHEAST EUROPEAN COUNTRIES**

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## **Abstract**

*In the early years of transition, the informal economy had a rampant growth; it was necessary, inevitable in an environment where the experience for the liberalization of the economy and the market economy lacked, and it had major economic, social, institutional and political consequences. Different researchers use different terms to define the complex informal activity, but in essence they have the same content. Informality is characterized by violating the laws and regulations of the country, but the sustainability of the informal economy in different countries depends on the relationship and attitude the country has towards this sector. One should not neglect the fact that informal economies in many cases survive due to high corruption charges, aggravating all the effects on regular businesses. The problem is that the informal economy is a source of money used for corruption and crime. By reducing the informal economy, are directly reduced the funds from the crime. In the end, we understand that the economic or political informality causes the economic and political instability, corruption, organized crime, completely disrupts the economy of a country.*

**Keywords:** *Informality, Corruption, Organized Crime, Tax Evasion, Black Economy*

## INTRODUCTION

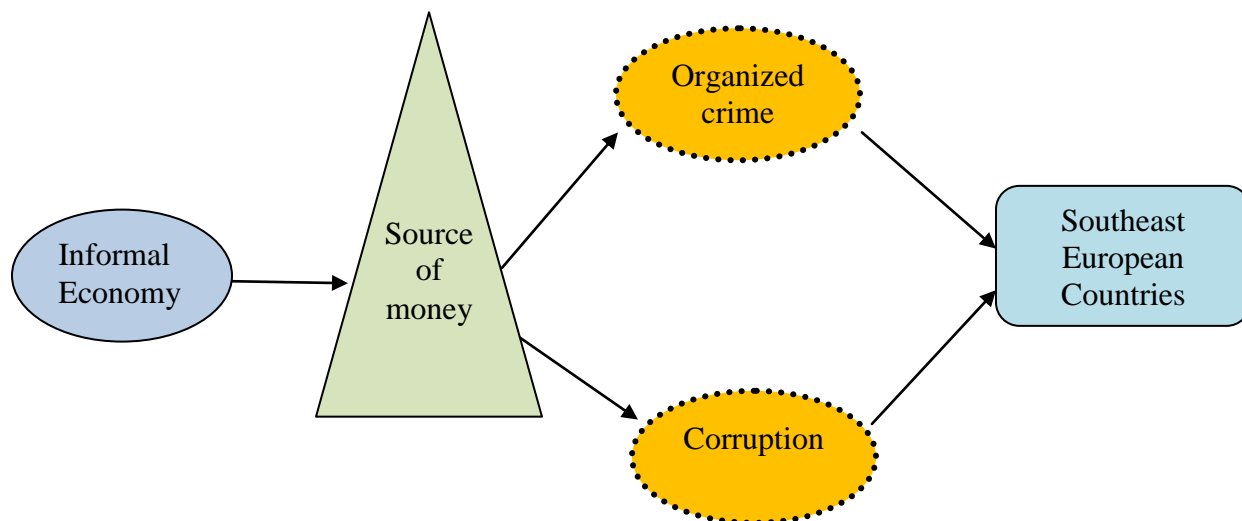
### Informal Economy, a Source of Money for the Organized Crime and Corruption in Southeast European Countries

Early studies on the informal sector in developing countries, consider the participants in informal activities as 'stand-by army' of labor, who mainly survive on a low level of existence. Swaminathan, (1991) says that the main reason to start the research on the formal sector in developing countries is related to the problems of mass poverty and unemployment, which has not always been a problem of the developed countries. With informality is described business activities or other transactions with are developed without other government institutions, or uncountable procedures (Tanzi, 1999; 1997).

However, although the economic regime is very different from that of the developed economies, the informal sector acts as a safety valve for political discontent in transition countries. The existence of the informal sector can be used as a safety valve for social tensions and public needs (Gërkhani, 2002)

If the corruption is present, how we could fight tax evasion, which has its roots in corruption. So they enter the goods, pay the ransom, otherwise the goods cannot enter inside the border, where the state border exists.

Figure 1: Theoretical Model of Informal Economy



Informal economy is one of the main obstacles to economic development of the country, increase of budget and it weakens the government's ability to provide social benefit for citizens. The bigger the informal sector, the greater the negative impact on the pace of development and economic growth will be. There is a lot of space for country's institutions to combat the informal

economy which undermines regular businesses, competition and it also aggravates the country's business climate a lot. We cannot expect foreign investments, if the informal economy dominates the country.

The problem is that the informal economy is the source of the money that is used for corruption and crime. By reducing the size of the informal economy, we directly reduce the financial resources from crime. We cannot eradicate it, but we should try to restrict it. If corruption is present, how should we fight the tax evasion, which has its roots in corruption? So they bring the goods in, pay tribute, otherwise the goods cannot enter inside the border, where there is a state border. Countries with high corruption have higher informal economy.

Measures for reducing the informal economy are a priority and very important for the growth of the national security of a country in economic terms and they are (Azfar, O and Tugrul G., 2004a):

- Reduction of cash payments, payments of salaries and other payments through bank accounts.
- use of electronic trade, or transactions via the Internet or other electronic networks without direct contact between economic entities.
- use credit cards that replaces cash payments.
- use of cash registers in retail trade that impedes the cash payment as a source of informality
- wide spread practice when natural and legal persons (companies) declare a minimum income and the same time repay large loans, they cannot offer high salaries and consequently the state imposes additional taxes and insurances to compensate the lack of money from the informal sector, so the firms that are correct they cannot compete with firms in informal economy.
- economic development of the region is of crucial importance. Nothing can be achieved out of the serious investment for the creation of strong institutions, increase of transparency and accountability. Thus creating a favorable business environment to attract foreigner investors, to develop economies and increase the competition.

Corruption appears as a phenomenon where an official exercises influence or has been implicated completely within the power, or the public sector and abuses the public service. This ugly phenomenon tacitly undermines the state apparatus, not allowing it to normally develop towards a stable and sustainable economy. This phenomenon is the key tool that damages the economy and the domestic market tacitly, presented and implemented by public irresponsible persons who fail to enforce ethical labor standards and thus damage the state budget. Corruption and organized crime to individuals realize fiscal evasion, fiscal evasion means escape from paying taxes, respectively fake real situation (Tupcaneski, 2002)

Reasons that lead to the promotion and growth of corruption and organized crime are many; Extreme poverty, changes of political system, globalization, country's non-integration in Euro-Atlantic structures. Corruption and organized crime is more expressed in post-communist societies and societies of Western Balkan countries in transition especially through the privatization of property, tax evasion, public procurement, failure of market reforms and many other factors (Bexheti, 2007)

All these are more or less a set of policies that have been pursued by governments in transition countries in the past and in the present.

When informality is combined with corruption and crime, then from wound it turns into a gangrene, and thus seriously undermines the economy. Corruption denies the growth and development, representing an additional cost to the economy, an aggressive tax for the poorest citizens and small companies, distorts market competition and generates monopoly, discourages innovations and allows wrong decision-making for the allocation of natural and financial resources, diverting them from vital sectors such as education and health. Organized crime and corruption cause social instability, public distrust, economic problems and inequality between people. (Azfar, O, Satu, K., and Patrick, M, 2001)

But even a good regional cooperation is an imperative to combat these phenomena, as “networks to fight networks” are required. “Attractive” factor that makes a country “hospitable” for criminal activities are (Selmani, 2010) :

- corruption,
- weak or incomplete legislation,
- dysfunctional markets,
- lack of a functional state, weak rule of law, non-transparent financial institutions, unfavorable economic conditions, and lack of respect for law in society as well as the geographical position plays its role (e.g. Italy, Turkey, cannot be controlled by the state because of the coastline thousands of km long and bordering with countries that face these problems –the informal economy, corruption and organized crime.
- The effects from the economic crisis, education and the increase of unemployment across Europe, makes individuals and organizations more vulnerable and risking the increase of social tolerance towards these activities.
- Without exception, the specter of threats to security of former south-east European communist countries is formed by networks of organized crime, money laundering, and human trafficking, together with other immediate challenges such as: poverty, corruption, economic instability, poor governance, thus creating a perfect environment with legal vacuums, which are used for criminal activity.

It is a realistic assessment that it would be very difficult without corruption, perhaps even impossible to develop the organized crime. Organized crime and corruption are not unnoticed; however it is very little processed, investigated, and prosecuted, because the first is "saved" by the second, because the organized crime procession is made impossible with the help of corruption, while corruption prosecution failure is a result of "super-corruption" which means a mutual relation.

According to Latifi (2004) organized crime is itself an organization whose economy is based on the informal economy, tax evasion, on the persons who launder their drug and human trafficking money through illegally licensed businesses, on smuggling etc. Clans' drug and human trafficking money generate huge income, attracting the organized criminals and support them for their own purposes. Cash generated by smugglers, coming as a result of legal businesses, for quick enrichment occasionally create ties with criminals, since this group is continuously fighting with the state.

While the money deriving from tax evasion and from those working in the informal sector are areas where organized crime feels safe and is not considered an evil. In certain moments, when the state reinforces its fight against these phenomena, the organized crime responds by imposing fines on legal businesses. The organized crime itself creates businesses that are based on funds from fraud and violence, pyramid schemes etc.

Organized crime and corruption are the main obstacles to the development of Southeast Europe identified by B.E. According to the World Economic Forum, the amount of dirty money from criminal activities, which annually circulates in the world, exceeds 11.7 trillion dollars, which is supposed to comprise 15-20% of global GDP. According to the index of democracy "Economist Intelligence" states that dirty money from crime, corruption and tax evasion totaling 111 billion dollars in the period from 2001 to 2010, with Serbia ranked the worst, with about 5 billion dollars (2012).

A recent report by GLOBAL FINANCIAL INTEGRITY on the Balkans, which theory is proved, by using data from the World Bank, Albania with the highest level of corruption has the lowest GDP, with only 4023 dollars per capita and Croatia the highest with 14549 dollars per capita.

To understand the impact of crime and corruption, it is UNDP's indicator of social and human development. This index measured in 186 countries is an indicator that combines:

- life expectancy,
- level of education and
- income per capita;

The data show, confirming the previous findings that the country that ranks the best is Croatia, in the 47th place, becoming part of a group of countries with a very high index of development, then Montenegro in the 52th place, Albania in the 70th place, Macedonia ranks 78th. Very dangerous factor for the economic security of the state-owned enterprises are the debts of companies, which in many cases are provoked by delayed state payments to private firms.

The service is made, but there is no payment by the state in due time as agreed in advance. These delays are very dangerous for the economy as they reduce opportunities for greater growth. For this reason it is important for the state to settle all overdue payments to public procurement. So firms will settle financial obligations towards suppliers, employees, government, banks etc. These side payments last longer than 1 year, so the state itself generates debts to suppliers.

An econometric study on the region (2012) confirms a strong correlation between high quality institutions and IDH. Croatia and Montenegro have the highest I.D.H stock in the region, with 7026 and 9178 dollars per capita, Albania has the lowest, with only 1462 dollars. Foreign investments work legally, so it is necessary to reduce the informal economy. Starting from the fact that the informal economy greatly hampers the foreign investments, as is well known that investors act only in accordance with strict standards of accounting report, in a society where the rule of law governs and a society with a high level of transparency. Corruption, organized crime and weak institutions have kept away the IDH, which is an important indicator of economic health and stability.

The research data also show a direct negative relation between the level of corruption and income per capita. Consequently, the poorly ranked countries on the list of "Transparency International" with high corruption have also lower income. The countries of the region are also considered countries with the lack of democracy where Croatia is in the 50<sup>th</sup> place, Montenegro in the 76<sup>th</sup> place, Albania and Bosnia and Herzegovina are considered hybrid countries, ranked in the 90<sup>th</sup> and 98<sup>th</sup> place respectively. All these problems have created a negative image for the region for foreign businesses, political partners and international institutions, creating major obstacles to Euro-Atlantic integration process.

The main challenge of the governments of the countries in transition has to do with the implementation of the final reforms in the administration and coordination of specialized bodies at local and regional level and beyond to prevent the informal sector and tax evasion that are the basis of corruption, organized crime and money laundering. If are not made radical steps regarding this situation, not only that the roads to Euro-Atlantic integration will be closed, but there is also a threat to bury all hopes for an acceleration of economic and social development in general and the development of democracy and the rule of law.

Especially in countries in transition, especially in the early years of transition, when the country is fragile and easily manipulated, the informal economy becomes very quickly a victim of criminal activities that created new overnight billionaires. In the early years of transition the Russian mafia was the biggest guarantee of any businesses transaction, security in transport of goods than the law enforcement and accession-penetration in these facilities was very difficult and a privilege, ex. 50% of the shares of Gazprom multinational company in Russia evaporated and the shares passed into the hands of managers and Russian oligarchic structures.

Countries with more corruption have higher informal economy. The fight against corruption, understood as strengthening and consolidation of state institutions, as an increased awareness of civic and individual responsibility, and the strengthening and modernization of public administration and consistent policy, remain a premise that this sector is gradually reduced.

We believe that the ongoing consolidation of these institutions, increase of political confidence, remain the safest ways for the expansion of economic formalization and constant reduction of its informal sector.

The process of Euro-Atlantic integrations is an advantage to harmonize the legislations and to strengthen the effective cooperation in the region, by learning from the experiences of countries that are ahead in this process.

## **CONCLUSION**

One of the major problems in transition economies and developing countries is the presence of very large informal economy. The high level of informality narrows the base of taxpayers, which means increasing the tax base for regular companies, by artificially increasing the abuse of tax administration toward the formal economy, unable to extend the tax burden on the informal economy.

Favored companies are being paid out of standards and fines for these companies do not exist. From this, entire public officials make a fortune which does not comply with the real legal income and as a result, the material benefit circulates in a vicious circle involving citizens and businessmen. Today, there is almost no country that has "organized crime" in which, directly or indirectly, is not involved any political authority with powerful influence on the people in power. For this reason, this phenomenon is everywhere fought with difficulty and in this regard it requires a long-term permanent mobilization of the whole society.

Misuse of official duty, the politicized administration and other politicizing options, make the political parties to consider the power as a key tool to ensure the tangible and intangible benefits for their members and supporters. The informal economy is lower in countries where

state institutions are more powerful and more efficient. In countries with fragile democracies corruption is more and more present and it's growing.

In a democracy, the institutions are considered as conscious and aware of protecting the state against corruption and informal economy. Countries with more corruption have higher informal economy. War against corruption, understood as a strengthening and consolidation of state institutions, as an increased awareness of civic and individual responsibility, and a strengthening and modernization of public administration and consistent policy, remains a premise that this sector will gradually be reduced.

The problem is that the informal economy is the source of the money that they use for corruption and crime. By reducing the size of the informal economy, we directly reduce the financial resources of the crime. We cannot eradicate it but we should try to inhibit it.

We believe that the ongoing consolidation of these institutions, increasing of political confidence, remain the safest routes for an extension of the formalization of the economy and constant reduction the informal sector.

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## SUGGESTIONS FOR FURTHER RESEARCH

This topic of study is very complicated and as we as is very complex issue. There are plenty of research and paper that shred light in corruption dimension in the local, regional and world are. We are going to continue to research in this topic in the Republic of Macedonia and do give to the readers, academics and institution relevant information in the same are but in the different way.

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