

THE GENERATING AND COMPLEMENTARY EFFECTS OF THE UNDERGROUND ECONOMY PHENOMENON

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Abstract:

For a comprehensive understanding of the informal sector, an analysis addressing the relationships and links between the morphology and etiology of the underground economy, on the one hand, and its effects on the economic, social or legal, on the other hand is required. The double identity, that of cause phenomenon and effect phenomenon, that the underground economy has, gives it a special status in explaining certain phenomena which vitiates the economic and social life. The generating and complementary effects of the underground area covered in this study are analyzed in terms of the following vectors of analysis: tax evasion, illegal work and money laundering. Tax evasion represents the central core of the underground economy and faithfully expresses the fiscal monetary policies, the fiscal mortality and the degree of compliance of the taxpayer. Undeclared work is an indicator of the labor market in the informal economy and is a good barometer for analyzing the demand and supply of labor in the visible economy. Money laundering defines the level of economic and financial crime and reflects the level of illegal use of capital on the black market. Tax evasion, money laundering and illegal work can only develop on a framework provided by illicit markets for goods, services and labor. Beyond the, unidirectional or bidirectional relationships between phenomena, the paper consists in a plea for an interdependent, multi-causal analysis of the phenomena and operating mechanisms of the relationships within and outside the underground economy.

Key words: underground economy, tax evasion, illegal work, money laundering, informal sector

JEL classification: O17, H26, J46, K34

1. INTRODUCTION

The names under which the underground economy was analyzed express the complexity and the intensity of the phenomenon, on the one hand and the inventiveness and originality of those focused on studying it, on the other hand. Van Eck has compiled even since 1987 a list of about 30 terms (ex. alternative, autonomous, black, dual, peripheral etc.) which are used synonymously or close in meaning and content to the underground economy. (Van Eck 1987). Therefore the definitions of the underground economy are also of the most diverse and reflect the views of the authors and researchers: "The underground economy represents all economic activities that are carried out at the borderline of the criminal, social or fiscal law, or are (massively) escaping the inventory of national accounts" (Pestiau, 1989); all economically undeclared activities to the institutions concerned with the assessment of taxes and social contributions, escaping from national accounting and statistical records" (Angelescu et.al., 2001).

In order to have an exhaustive understanding of the underground economy, a complex multifactorial approach is required, that includes in addition to the economic influencing factors, the noneconomic or quasi-economic factors such as institutions, direct democracy, religion, ethnicity or family (Baicu, Hapenciuc, 2016a, 2016b). Therefore the generating and complementary effects of the underground economy must also be understood in a multidimensional context. Addressing tax evasion along with money laundering and illegal work represents a prerequisite for a multi causal

approach to the underground phenomenon. In terms of methodology, the study combined the aspects of a deductive nature with the ones of an inductive nature, entering in the category of conceptual research. The paper is divided into the three major effects that are generating or complementary to the underground economy area: a. Tax evasion; b. Illegal work and employment in the informal sector; c. Money laundering.

2. TAX EVASION

Tax evasion has always existed and its quantification - due to the equivocal, questionable or too relative information - will never be performed accurately. According to some authors "Tax evasion is the avoidance by any means, in whole or in part from paying taxes, duties and other amounts owed to the state budget, local budgets, state social insurance and special funds off-budget by individuals and legal persons" (Câmpeanu et.al., 2003). In our opinion, tax evasion is a component of the underground economy which lies at the crossroads of the underground economy to the formal economy.

The perspectives on the causes of tax evasion also reflect a certain geographical specificity. Some authors understand and analyze this phenomenon through the socio-economic, fiscal and penal features and priorities of the analyzed countries or regions.

According to Obafemi the causes of tax evasion (ie. Nigeria, Africa) are: "corruption in public offices, inappropriate tax education, diversion of collected taxes, ignorance of the tax authorities, inadequate compulsory execution, proliferation of taxes, loopholes in tax laws, inequitable income distribution, lack of "Quid Pro Quo" - something of value given in return (by the government) for the paid taxes - the high level of illiteracy and the high tax rates " (Obafemi, 2014). In a study on the region (Asia-Pakistan), Khan Ahmad (2014) believes that there are several causes that influence tax evasion, namely: neglecting to explain and implement the concept of progressive taxation (system that can eliminate the inequality in the tax system); the high tax rate which discourages taxpayers to pay taxes and increases tax evasion; the corruption of government institutions made in order to avoid taxation for behaviors like "Go with the flow" - people follow the behavior of other people, if most people have an escapist behavior, the taxpayer reproduces this behavior and is motivated to not pay taxes (Khan, Ahmad, 2014).

Understanding the etiology of tax evasion for developing countries in terms of some analyzes carried out by certain Western European public bodies, highlights two categories of reasons (GIZ, 2010). The first category contains factors that adversely affect tax compliance by taxpayers and refers to the poor tax morality expressed by the absence of attraction for payment of fees or by high costs to comply with tax regulations. The second category, targeting the low capacity of the tax administration and tax contentious courts to enforce tax obligations, refers to dysfunctions in the administration and collection of taxes and poor ability to audit and monitor tax payments. We also believe that tax evasion is closely linked to the influence of indirect fiscal taxes and self-employment. The justification of these assumptions is the fact that, for example, direct taxes (ie. Personal income tax) are automatically deducted and the probability of fraud is limited.

Globally, between 1999 and 2010, studies have highlighted the trend of declining tax evasion for all countries; the average size of tax evasion was 3.2% of official GDP; the highest value was registered by Mexico with 6.8%, followed by Turkey with 6.7%; the lowest averages were recorded by the United States and Luxembourg with 0.5% and 1.3% (Büehn and Schneider, 2012). For the period 2010-2014, studies have shown, for some countries, the existence of a phenomenon of landing in the sense of relative stagnation (slight increases or slight decreases) around the values in 2010 (Schneider, 2015). For example (table 1), there were slight increases in the case of Bulgaria (from 4.8% to 5%) and Romania (from 5.2 to 5.5%), or decrease, in case of Germany (from 1.7% to 1.4%).

Table 1. The size and development of "pure" tax evasion (% of GDP) in 5 OECD countries

Country/an	2000	2005	2010	2011	2012	2013	2014	Medie
Bulgaria	6,4	5,9	4,8	4,9	5,0	5,1	5,0	5,5
Germania	2,1	2,1	1,7	1,6	1,5	1,5	1,4	1,8
Grecia	5,3	5,0	4,0	4,1	4,0	3,9	4,0	4,6
România	6,7	6,2	5,2	5,3	5,4	5,5	5,5	5,8
Turcia	7,3	6,8	5,7	5,8	5,9	6,0	5,9	6,5
Average on 5 countries	5,6	5,2	4,3	4,4	4,4	4,4	4,4	4,9

Source: (Friedrich Schneider, 2015a, p.20)

In terms of reporting of tax evasion to the underground economy as a share of GDP for 2014, some comparisons (concerning the order of magnitude) and considerations (concerning the definition of the concept of *pure tax evasion*) are due to be made.

Referring to the order of magnitude, for example, for 2014, Bulgaria, Romania and Germany had underground economies of 31.0%, 28.1% and 12.2% and tax evasion of 5.0%, 5, 5% and 1.8% respectively. We note the differences between Germany and Romania both for the size of the underground economy and tax evasion size. In other words, corruption, low tax morality or the deregulation of the tax system, among many other causes led to these discrepancies between Romania and Germany.

The conducted studies use the concept of *"pure" tax evasion*, a concept that does not consider illegal activities or household informal or voluntary activities; focusing on the unreported or underreported economic activities concerning capital and / or income from domestic or foreign labor. Given the small weights of tax evasion in GDP, even with its conceptual and statistical limitations, we express some reservations regarding the order of magnitude.

The explanations on the causes of tax evasion in the case of Romania aims according to Comaniciu, the following aspects "misunderstanding the tax authorities regarding the reasons for which the taxpayer evades the tax system; the existence of a tax legislation with loopholes, inconsistencies, ambiguities, weaknesses and repeated changes; the ineffectiveness and inefficient use of public funds; the existence of a precarious financial state among taxpayers; the inefficiency of guidance and assistance to taxpayers; the inefficiency of tax control; the existence of a low fiscal education "(Comaniciu, 2008, pp. 412-416).

The analysis of the phenomenon of tax evasion also regards and the interactions between creative accounting, management and tax fraud. Tax fraud can also be seen through the binomial light: creative accounting (to the extent that it violates tax laws) - the organization's management. According to some authors, creative accounting is generated by the management contract (Dinga, 2008, p. 33). Under the rule of fulfillment of the performance criteria (with influences on personal income and further professional development) the managers of some organizations resort to a series of alegal accounting procedures and techniques, located on the border between licit and illicit.

3. MOONLIGHTING - EMPLOYMENT IN THE INFORMAL SECTOR

Informal economy includes the illicit economic activities and the income derived thereof, through which tax legislation is partially or fully eluded or avoided with consequences on the fulfillment of the obligations of payment of taxes. A large part of the illegal economy is caused by the illicit work (meaning the undeclared salaries of the employees, the unreported income from self-employment or the underreported businesses and revenues due to the decline of turnover) in order

to avoid payment of fees or regulations (v. the legal relationship of employment, commercial or financial law).

The aspects of using the work force in the underground sector are of the most diverse. We can speak of the situation of a second job, simultaneous or not, with the official or the legal one; of the workers who participate exclusively only on the informal labor market, but without having any restriction in having a job in the formal sphere; the employment of people (illegal immigrants) who are not allowed to work in the formal economy. In general, the empirical research regarding an estimate of the impact of the undeclared work on the added value are more difficult to achieve due to the fact that the number of hours, the work norm, full or partial, or other items on labor costs are not known.

The influencing factors that contributed to the expansion of employment in the informal economy are of the most diverse and reflect the complexity of the phenomenon. Some analysis on the etiological factors of moonlighting highlighted the following aspects: the growing demand for household services - in the context of socio-demographic developments and lower working time; the tendency to hire, in smaller, less hierarchical organizational structures, flexible payment and working systems; self-employment or subcontracting labor in order to achieve flexible working contracts and avoid the partial or total, declaration of income; development of border enterprise groups that facilitate emigration and informal employment of manpower (European Commission).

According to Kucera and Roncolato (2008) addressing informal employment and labor market policy should follow two major directions, namely: a.) the analysis of the regulations of the formal labor market and b.) the so-called "voluntary" occupation of the informal workforce. The level of development, the social security systems, the unemployment benefits, the poverty, the low education level, the social values or the quality of the job are some of the elements of analysis used by researchers to highlight the role and importance of intensive regulations or to highlight "voluntary" occupation of the informal workers (Kucera and Roncolato, 2008).

Reducing the gray economy is not always followed by a reduction of informal labor. A study conducted by Schneider showed that although the size of the underground economy has been declining, the informal employment increased for most countries in the period 1999 - 2007 (Schneider 2015b).

Some studies highlight the existence of a positive relationship between the employment of the active elderly (55-64 years) and the informal sector. The analyzes performed showed a positive unidirectional causal relationship, starting from the employment rate of older people to the shadow economy (Davidescu, 2015). The possible explanations of this relation suggests: the poor capacity of the economy to generate adequate jobs, professional qualifications that are inconsistent with the official labor market, the involvement (also) in informal activities in order to supplement income.

Regarding the immigrants and the interaction between formal and informal sectors studies have shown that they are more interested in acquiring a legal status (right of residence, administrative acts, changing their status from an illegal migrant into a legal one) than entering the formal labor market (Magalhães, 2015). In other words, immigrants want a strengthening of social recognition, confidence and a favorable social position, rather than an entry into the labor force, either directly through employment within lawful or indirectly mediated through an intermediate stage of transition.

Further analysis identified a strong positive relationship between the presence of immigrants in a country and the underground economy; relationship which can be influenced, within the meaning of weakening it through the process of legalization of immigrants, ie, amnesty (Bracco and Onnis, 2015). The explanations of such a relationship are supported by the fact that illegal immigrants are forced to work in the underground sector or have a low level of professional qualification. However, amnesty programs tend to diminish this link between immigration and the underground sector, suggesting that the labor market is strongly affected by the number of illegal immigrants and a statutory regulation of labor relations is imposed.

Identifying undeclared work or employment in the informal economy can be achieved, indirectly, also depending on the ratio between the electronic payments and cash payments or the

business sectors with the highest share of the underground economy (Kearney, VISA, Schneider, 2013). The use of cash payments to the detriment of electronic payments suggests a lack of transparency of transactions and hide an unlawful relationship of collusion between the employee and the employer about fulfilling work tasks and rewarding the activities that have an underground character.

Understanding the dynamics of the underground economy can not be done without understanding the labor market and informal employment. Indirect taxation and the tax burden on personal income can be influenced by the government through a set of fiscal policy measures. The government can also affect unemployment (even through measures of economic policy of Keynesian essence) can try to improve the country's competitiveness, increasing external demand. All these measures plead for a more active involvement of the government in order to stimulate the formal economy, entrepreneurship development, reducing unemployment and, not least, to reduce the size of the underground economy by reducing undeclared work.

It is true that individuals seek ways (legitimate or not) to improve their economic situation, but equally true is that, they should contribute productively to the total income of a country; they can not succeed in anything by themselves it requires the cooperation and involvement of the government and society as a whole.

4. MONEY LAUNDERING

The studies that have proposed to quantify the economic scale of the money laundering phenomenon have identified a variety of criminal, illegal and socially or economically unethical activities. The precariousness of these criminal activities generated a question mark on the integrity and functioning of the financial and banking systems, good governance, financial stability and economic development. It raises the legitimate question (if) understanding the mechanism of money laundering and fighting against corruption can contribute to economic development, poverty reduction and, consequently, reducing the underground economy. The concept of money laundering is a rather vague and imprecise concept, having multiple semantic meanings, being used in the common vocabulary in the field of analyzes and economic studies or in the field of economic crime and criminal law.

The money laundering mechanism can be represented by a multi-phase process by which illegal profits (of the underground economy) are inserted through various means and fraudulent representation in the financial system, after that, the reintroduction of funds in the formal economy is operated. Money laundering does not exclude simple ways to transfer cash from the criminal economy through the banking sector to the formal economy.

The definitions that are commonly used by international organizations (FATF -The Financial Action Task Force, the World Bank, International Monetary Fund), emphasize the fact that money laundering is not only achieved through and with the mediation of the financial system, but also with money that already existed within the financial system. The preconditions to be met in order to speak about money laundering refers to the way of acquiring gains (proceeds of crime or as a result of breaches) and to the hiding and concealing the illegal income source. According to Stuart Yikona et. al. (2011), in order to avoid misunderstandings about the sources and to give an economic relevance, the definition of money laundering should be made taking into account "assets obtained through illicit means" and "transfers of illicit means" (table 2).

Table 2. Economic definitions of Money Laundering

Legal Definition	Economic Definition	Models
Use of.....	Transfers of money obtained fraudulently (flows)	Transfers into the legal economy, informal or underground and cross-border transfers

Possession of.....	Ill-gotten asset (stocks)	Cash, bank accounts, investment portfolio, real estate, cars and other goods, business investment etc.
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Source: (Stuart Yikona et. al., 2011, p.3)

Table 1.1. Economic Definitions of Money Laundering

Legal definition	Economic definition	Patterns
"Use of..."	Transfers of ill-gotten money (flows)	Transfers in the legitimate, informal, or criminal economy, and cross-border transfers
"Possession of..."	Assets of ill-gotten money (stocks)	Cash, bank accounts, portfolio investments, real estate, cars, other possessions, business investments, and so forth

Source: Author's formulation.

It is obvious that the circulation of money obtained through illicit means have a negative influence on the economic development of a country fully contributing to the erosion of values and relations between citizens or between citizens and institutions. The possible economic consequences of money laundering have been analyzed in a study coordinated by Unger through the produced direct and indirect effects on long or short term (Unger et al., 2006). The economic effects of money laundering are the most diverse, from distorting consumption, the artificial increase in prices incorrect competition, risk for the financial sector, solvency, liquidity and ending with terrorism.

According to the UNODC data, globally, the estimated value of the laundered money in one year is 2-5% of the global GDP, respectively, between 800 billion and 2 trillion USA \$ (UNODC, 2016). The estimated value size, expresses the importance of this phenomenon and the imperative need of the involvement of the international governments and institutions in combating the phenomenon and limit its effects.

The illegal activities that are most susceptible to money laundering are covered by tax fraud and financial crime, drug production and trafficking, prostitution, moonlighting and gambling; the percentage of money laundering derived from these activities is 80%, except for unlawful labor, whose values are lower, of 10% (Unger et al., 2006, p.48).

In terms of flows of dirty money, few relevant studies, included Romania in the top 10 destination laundered money respectively 6th position, with 3.1% of the world total, and 7th position in the worldwide list of the origin of laundered money, with 4.1% of world total (Walker, 1999).

The underground economy is structurally closely related to money laundering through the apparently legal and illegal types and categories of activities which will finally end up as offending, with the aim of circumventing the law, in order to avoid non-declaration of income to tax authorities. In other words, behind the binomial underground economy - money laundering we can find crime in its various forms.

Some authors, such as Walker and Unger (2009) uses the concept of "hidden economy excess " in order to explain and measure the potential of proceeds of crime (Walker and Unger, 2009). The study suggests some interesting aspects (Figure 1): poorer countries have a larger underground economy than the rich ones (note the J curve – on the graphic); countries bounded by the blue line (on the left of curve J) have a smaller underground economy (eg. China, Iran, Mongolia etc), it is assumed that the economies of type "command" suppress the underground sector; countries on the right (delimited by the red line), Russia, Colombia, etc., are characterized by a significant transnational crime, money laundering, drug trafficking, corruption and tax and financial fraud.

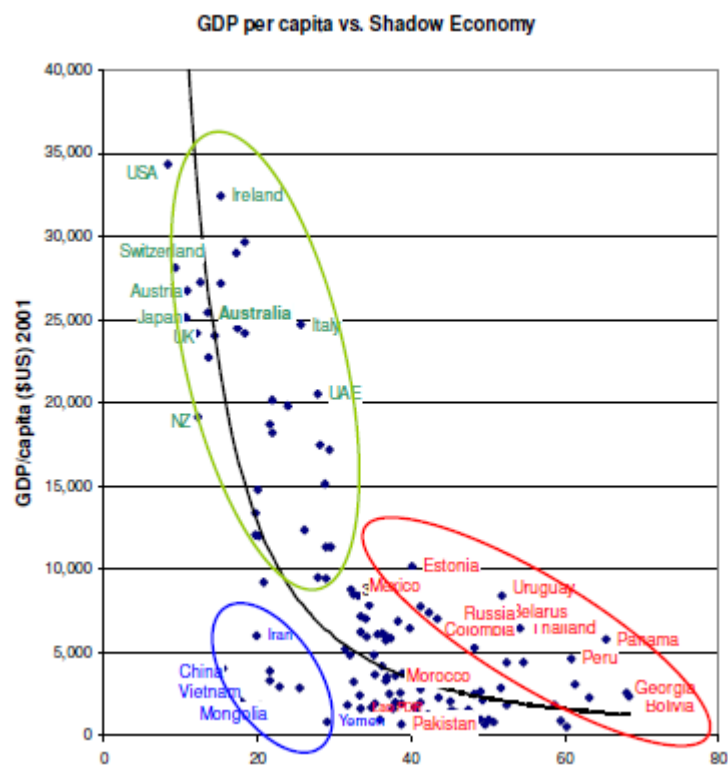


Figure 1. The concept of " Excess shadow economy "
as a potential measure of the proceeds of crime

Source (Walker and Unger (2009), p. 845)

5. CONCLUSIONS

A comprehensive evaluation of the underground economy phenomenon is not possible without the interdisciplinary study and interpretation of some generating and complementary effects such as tax evasion, money laundering or illegal work.

The etiology of tax evasion largely overlaps with that of the underground economy. Therefore, through its size and forms of manifestation, tax evasion is the most important barometer of quantification and combat of underground economy. We believe that a more efficient "pure" tax evasion estimate, supplemented by a more relevant manner of highlighting the domestic or voluntary illegal and informal activities, would contribute to a more accurate dimensioning of the informal or invisible economy. The dynamics of underground economy is also dependent on moonlighting. Moonlighting or the employment in the underground sector can not be reduced only by administrative sanctions imposed by labor inspection or other institutions with responsibilities in the area. We believe that the main priority should be represented by investments and thus the creation of new jobs. In this way the premises for a good part of workers to escape from the informal sphere to the formal one would be created.

Money laundering defines the means by which capital is used for illicit purposes. In our view combating money laundering regarded as an end in itself would generate unsatisfactory and inconclusive results. Given the scale of the underground phenomenon we appreciate that a comprehensive, integrative approach of the economic and financial criminality, covering a wide spectrum of the informal economy, would be a more viable and efficient alternative.

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