

AN INTRODUCTION TO THE UNDERGROUND ECONOMY OF ROMANIA

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Abstract: *Shadow economy affected for a long time Romania, even since the old regime. During the period 1995-1996, the expansion of this phenomenon has become more serious. Along with Bulgaria, Romania is the second most affected country in the Eastern part of Europe, the shadow economy reaching around 28% of national GDP. This process is boosted by a high level of tax evasion, black labor and overregulation. With the ascension into EU, Romania made considerable efforts to combat the underground economy through a increase of electronic payments, credit card and deposit use.*

Keywords: shadow economy; overregulation; black labor; tax evasion.

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INTRODUCTION

The underground economy represents a vast section especially in economic literature, the most interesting points being focused on the main causes of the shadow market and the most efficient combating measures. Crime and shadow economic activities are a fact of life around the world, and almost all societies engage in trying to control these activities through education, punishment, or prosecution (Schneider and Enste, 2000, p. 3). The European Union is an economic and political centre with concerns and strong systems that acts against the causes of the informal economy. The EU member states made efforts to slow down this phenomenon, that in time it showed a significant increase.

The true fact is that there are hidden economies in our society, but what are the reasons why politicians and the other sectors, should be worried about the continuous growth of this phenomenon? Generally, the increase of the underground economy is caused mainly by a rise in the overall tax and social security burden, in other words it can be described as a reaction of individuals to over taxation managed through the state activities. Likewise, with a growing shadow economy the state faces several issues in terms of economic indicators, such as unemployment, income, consumption, labor force and so on, fact which can provide an unreliable economic situation of the respective country. Overall, the shadow economic activity have negative implications which strongly affect the macro-economic

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objectives, leading to a decrease in tax revenues, to distort the fair competition and also to cause productive inefficiencies. Along with this factors it must be mentioned that the state practice, such as over regulation can determine the rise of the informal economy, otherwise diminishing the trust of the firms in market mechanisms, to affect competition, the labor force, the gross domestic product etc.

The underground economy is influenced by:

- pressure of fiscality and benefit obligations;
- pressure of state-imposed regulations;
- public sector services (Manole, 2012, p.5).

The economic literature consider that the existence of underground economy can be seen as an indicator of an unhealthy state between citizens and government. The informal economy usually is associated with a large number of activities derived from illegal activities: monetary transaction (trade in stolen goods, prostitution, gambling, fraud or smuggling) and nonmonetary transactions (drugs, arms etc.) and from legal activities which can involve tax evasion (unreported income etc.) and tax avoidance.

Regarding Romania, the term *shadow economy* appeared for the first time in 1995-1996, being used on a large scale and describing illegal acts like tax evasion, corruption and some cases of fraudulent privatization.

Observing the international reality, the routes of informal economy are quite old, back in time of communism system, where activities like illegal distribution of several imported products (cigarettes, coffee, clothes etc.) were found very common in that period of time.

Generally it is difficult to estimate the real informal economy, due the fact that it is undetectable. Romania is known that the labor market is affected by the expansion of workers on the black labor market. In fact, statistics presents that approximately 1 third from the active population works on the black labor market.

1. THE ROMANIAN INFORMAL ECONOMY

Romania`s transition from a planned economy to a market economy has created a perfect environment for shadow economy expansion. The changing system has brought also wealth to the country, through liberalization, investments etc. After 1990, on the market were found different kind of

contraband especially in operations of exports and imports, speculations, and all sorts of pyramidal games, such as CARITAS, who brought in bankruptcy millions of people. The transition processes towards a market economy were accompanied by corruption and by the creation and development of informal economy. In Romania, ten years ago, almost 30% of the population lived in poverty. The Corruption Index placed this country in the group of the countries in the eastern part of the continent with the highest level of corruption (Pintilie, 2012, p.112). Also some recent studies point out that the rate of illegal economic practices is high (between 35% and 50%), Romanian being one of those country, along with Bulgaria, Ukraine, Russia, Moldova, Latvia, Georgia, Brazil, Columbia, Venezuela etc. (Pintilie, 2012, p.113).

Over time, the size of the Romanian underground economy compared with the other European countries has risen considerable, emphasized also by the effects brought by the economic crisis. The main causes that sustain the growth of Romanian shadow economy are found in taxes, changes in official output per capita, overregulation and bureaucracy and the unemployment rate. The mentioned indicators are the main worsening factors that boost the limits of shadow economy.

In this context, the evolution of unofficial economy can be highlighted by some changes on the market:

- The legacy of a parallel economy left by the centralized market and the old regime;
- Imbalances launched by the legislation adopted later in the market economy;
- The growth of corruption and decentralization;
- The presence of small business which led easily in gaps of tax evasion and undeclared work;
- Overtaxes imposed by the government and private sector which led to a weak system where the taxpayers have to bear every tax rising;
- A lack of public financial resources.

The non-observed economy of Romania has drawn attention of the specialists, being analyzed and evaluated by several state institutions such as The Ministry of Public Finances, Financial Guard, National Institute of Statistics, Romanian Intelligence and so on. Numerous studies emphasized that in Romania the underground economy is obviously a subsistence economy, the labor market representing 46.5% of it (Toader, 2007, p. 81). According to National Institute of Statistics, the non-observed economy of

Romania consist in black labor which is the main branch, followed by VAT evasion and unregistered household activities.

2. THE MAIN CAUSES OF ROMANIAN NON-OBSERVED ECONOMY

The main causes which define the shadow economy at an international level can also be observed in Romania. According to Professor Mircea Cosea, the underground economy is a comprehensive concept, so the phenomenon causes are vast. Along with the causes the consequences are an important fact of the process ramification.

The consequences of non-observed economy are the following:

- diversion of resources to other purpose than the ones officially set (Pintilie, 2012, p.115);
- damaging the social assistance system;
- a growth trend regarding the budget deficit;
- possible reduction in the public investment process;
- the appearance of distrust in public authority and government programs;
- an increase recorded in social insecurity and crime rate.

Regarding *the main causes* of non-observed economy of Romania, can be mentioned:

- intensity of fiscal overregulation - fiscal practices are characterized by numerous modifications, bureaucracy and so on.
- fiscal pressure - a cause which affects seriously the taxpayers;
- corruption;
- poverty level and unemployment rate, which influence the hidden economy, due the fact that the labor force can use different activities found in the crime sphere or associated with the black labor;
- the desire of population enrichment;
- complex and cumbersome processes to strengthen domestic capital

3. DIMENSION OF ROMANIAN NON-OBSERVED - RECENT EVIDENCE

For years, the dimension of the underground economy in Romania has been an issue of concern for government. Today, this problem has become more seriously. In this order can be reminded the efforts of this country to be prepared for entering into EU at the beginning of 2007. Comparative with other EU countries, Romania continue to have a high level of shadow economy. The increase of the phenomenon is seriously felt in GDP and tax revenue. Financial Guard represents a specialized body in combating the illicit activities that define the shadow economy. In 2009, in order to achieve its objectives, the Financial Guard participated in collaboration with other specialized bodies of the ministries in detection of activities derived from non-observed economy (Mara, 2011, p.1118).

According to Institute of Economic Affairs, it seems that Romania is confronting with one of the worst cases of the EU, regarding underground economy. In the last 10 year, Romanian shadow economy registered about one third from GDP value. In the same context, recent studies highlighted that this situation is similar with other countries from Eastern Europe, like Bulgaria, Hungary, Poland or Baltic state, and even with Greece (IEA, 2013).

Recent evidence emphasized that in 2013, shadow economy reached 28% of national GDP (see Table no.1) and around 40 billion of euro, Romania being the second country with a worrying score after Bulgaria, Bulgaria remaining in top with a rate of 31% of GDP.

In contrast with the occidental part of Europe, Romania and other countries in the Eastern Europe come along with a great inheritance left by the old regimes and its quit difficult to adapt and to keep up with Western countries. In order to reduce the evolution of such phenomenon, the mentioned countries make considerable efforts. Accession to the EU and rapid expansion of electronic payment services, were the main factors which boosted seriously those efforts in the last period.

A solution to the growing shadow economies it seems to be electronic payments, credit card and deposit use. A study released by AT Kearney revealed that Nordic countries with a high level of electronic payments determine a very low level of shadow economy, while countries like Romania, Greece or Bulgaria, where electronic payments are minimal are dealing with a increase of shadow economy.

Table 1 - The shadow economy in relation to GDP in Eastern Europe (2013)

Countries	Shadow economy size (€ billion)	Official GDP (€ billion)	Shadow economy size (% of GDP)
Poland	95	400	24%
Romania	40	139	28%
Czech Republic	24	154	16%
Hungary	23	103	22%
Bulgaria	13	41	31%
Slovakia	11	74	15%
Slovenia	8	35	23%

Source: Schneider F. (2013), *The Shadow Economy in Europe 2013*, AT Kearney VISA Europe, accessed in November 2013, http://www.protisiviekonomiji.si/fileadmin/dokumenti/si/projekti/2013/siva_ekonomija/The_Shadow_Economy_in_Europe_2013.pdf

CONCLUSIONS

The Romanian underground economy is characterized by tax evasion, illegal employment, relationships with organized crime and terrorism, and involvement in almost all areas of economic crime (Manole, 2012, p.5). Despite the serious effects spread by underground economy, it is possible to mention that this phenomenon sustain in one way or another the Romanian real economy. The fact that the underground economy reaches around 30% of GDP is quite worrying. Although the country has experienced a slight decrease in the last five years, fact which helps the macroeconomic view. Yet, this country is still confronting with activities associated with crime and terrorism, such as drug, arms and cigarettes trafficking, car trafficking, prostitution etc. plus a weak government which is struggle to handle legislation, to take efficient measures to combat the underground economy. For Romanian government is it obvious that underground economy it is a big challenge, taking into consideration the fact that they to decrease the fiscal pressure, to create jobs, to implement new policies which can help the economy to move forward.

Some remedies against shadow economy are the electronic payments, online transactions which are minimal compared with Nordic countries. Although this are recommended solutions, Romania needs first quality of public services, state institutions, labor market regulation. However, is proved and it is logic that money earned in the cycle of underground economy are spent then in the real economy. Therefore, the market functions also with black money or dirty money, the most affected sectors by tax evasion being tourism, constructions and retail.

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