ECONOMIC CRISIS SUSTAINS BLACK MARKET

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Abstract:
The purpose of this research is to bring out the fact that during the periods of economic crisis, the black market finds a warm place to develop and even to diversify the ways of expressing. Based on some data of the National Institute of Statistics and the Organization for Economic Co-operation and Development (OECD) I’m trying to prove the fact that during the last two years while the world economic crisis has occurred, the black market has been increasing and there have been new forms of expressing this phenomenon. Although there are some positive ways of this phenomenon, on the whole, the increasing of the black market percent of GDP represents a wound within a healthy economy, which if it cannot be stopped at least to be reduced. This work intends to make radiography of the present economic society, a period of economic crisis, during which the black market has found a warm place to express and extend, in most of the countries, including the developed ones, this phenomenon has reached alarming limits.

Key words: economy, black market, crisis, companies, fraud

Jel Classification: E26,H26,O17

1. INTRODUCTION

The black market has alarmingly increased in the developed countries as well, in the last two years, at the same time with the crisis appearance, according to the calculation made by the international economists. Black market and avoiding taxes or salary taxes have become more and more frequently even in the developed countries.

"Because of the economic crisis, the black market will increase in 2010 in the developed countries, after it had increased anyway 2009", it is written in a recent study of Friedrich Schneider, Austrian economist and specialist in black market and one of the most prolific authors in the field of black market. According to his calculation, the rate of black market in the gross domestic product (GDP), in OECD countries has increased from 13,3% in 2008 to 14% in 2010.

The increase may seem small, but finishes the tendency recorded at the end of '90. The Baltic and Mediterranean countries are facing the biggest rate. The black market represents 25% of GDP in Greece and around 40% in Latvia and Estonia. Belgium has the fifth biggest black market from the countries members of the Organization for Economic Co-operation and Development (OECD). Only Greece, Italy, Spain and Portugal have a worse score than this country. In 2010, 61 billion euro, black money, will spread in the black market in Belgium, which is 17,9% of GDP.

The companies accept such a situation to compensate the profit loss profit, and the employees accept working on a black market for fear not to lose their job. "Many people try to compensate the falling incomes, participating in the black market " (says the economist Friedrich Schneider).

Among the top industries which feed the black market, there are also construction, craftsmanship and restoration, as the specialist noticed.

Black Market – a good thing?

Despite all these controversies, the black market is not always a bad thing. "I believe that an increase in the black market within a crisis can avoid a bigger recession. Individuals and companies earn more money, which they can spend in the true economy", thinks Friedrich Schneider.

1 OECD-Study from underground economy, 2010
2 Friedrich Schneider-underground economy 2009
3 Friedridh Schneider-University of Linz, study u.e. 2010
4 F. Schneider, Size and development of the Shadow Economy, 2010
But, to avoid the mass fraud, the investigation committees from many European countries join together to find the guilty. It is the case of France, which has started an investigation regarding the crisis results over the French companies by means of anti-fraud investigations. To avoid the major conflicts, the investigators were trained to be flexible.

**In Romania, the Fiscal Administration makes the law. Or it doesn’t…**

In our country, the Government tries to organize the economy by the Fiscal Administration. Over 15 million euro added to the state budget thanks to fines charged by the Fiscal Administration in the first five months of 2010. The financial officers charged fines for a total amount of 118 million lei, which is 28 million euro, and under these conditions the level of Charge was over 50%.

How will the Fiscal Administration succeed in stopping the black market of Romania is to be seen, as long as its employees confiscate wedding dresses and hairdryers, which are later sold in auctions. Increasing the VAT from 19% to 24% encouraged the black market, think the representatives of Employers’ Union in Industry, Agriculture, Construction and Services in Romania (CONPIROM). According to them, the Black market reached already 60% in fields as bakery. To reduce the black market, the Employers’ Unions suggest that all individuals over 18 years old to declare their incomes. According to the last estimations, the black market reached in our country 36-38% of GDP – OECD study.

**The state has sent the economy underground**

Heavy taxation and aggressive regulation have stimulated the tax evasion, black market and smuggling, as well as of others forms of manifestation, even cross border.

In the last week, the black market was publicly discussed because new solutions were tried to be found to reduce wages and pensions or to increase taxes. Fighting against this phenomenon, which is 40% of the Gross Domestic Product (GDP), challenged the journalists, trade unionists and politicians who competed themselves in offering solutions. There was no one to mention its causes: aggressive taxation of employees, excessive regulation, and inherent corruption of public acquisition. And when causes are not known, the solutions can be irrelevant.

**Right level: 40% of GDP**

The black market is being talked a lot, each having in mind something else. No one says what is black market. (Black or grey or parallel or informal). Unfortunately, there is no established definition, the variants being created taking into consideration its way of measuring (by the method of the demand for money or electricity consumption for instance). A more comprehension definition would be that according to which the black market should contain any economic activity conceived to avoid paying the income tax, VAT or any corporatist to avoid paying the income tax and social contributions, any activity meant not to abide by the Labor Code (minimum wages, maximum working hours, safety standards) or the regulations established by the state in various economic fields. According to this definition, and to diminish the errors of relating to a single indicator, two economists, Roberto Dell’Anno and Friedrich G. Schneider, conceived a calculation method – MIMC (Multiple Indicators Multiple Causes)\(^5\), where the level of black market is not calculated depending on a single variable, but on many indicators, from the fiscal burden and level of public expenses to the index of economic freedom, unemployment rate and GDP per inhabitant. According to Friedrich Schneider’s calculation in 2009, made in 120 countries of different areas, depending on the economic development, Romania holds the eleventh place in the rating of 19 states from Central and East Europe and Central Asia with a black market of 36,6% of GDP in 2010, at the same level with Bulgaria, with 10 percent over Hungary, Poland and Slovenia and 20 over Czech and Slovakia. The latest two states, otherwise, have a level of the black market close to that of developed countries, OECD members, with an average of 16% of GDP.

Given the fact that the rising rate of informal economy of Romania, which increased from 33,6 in 2000 to 34,6 in 2004 and to 36,6 in 2010, made larger by the economic crisis from the last two years, in 2012 its level may overpass, according to the pattern of the two, 40% of GDP.

**Was the Romanian born a tax dodger?**

In the eyes of public opinion, the black market is usually mistaken for a controlled area of criminal structures, with a hostile attitude against the authorities and the state of law. Although this is also a component of

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\(^{5}\) MIMC-Multiple Indicators Multiple Causes, Roberto Dell’Anno and Friedrich G. Schneider, 2009
informal economy, the economists’ research show that, in general, the economic activities characteristic to the black market take place at the level of small and medium companies and the low income population. Generally speaking, the poor countries, those poor developing countries, are characterised by high levels of black economy. The transition economies, with a poor state of law, whose legal system does not guarantee contract compliance are also characterised by this phenomenon.

The key question is: are the causes of black market economy subjective and cultural (was the Romanian born to avoid taxes more than the Czech or the Slovakian?) or some are objective and institutional?

The economists choose the second one. Data, but also the economy actors’ predictions show that in Romania, for instance, the activities more likely to ‘dive’ in the black field are: cigarette, alcohol and petrol trade (approximate 35% of those market shares). The second place belongs to the fiscal evasion of the labour force, estimated by MFP to 5,8-6% of GDP. What do these fields have in common? An extremely high level of taxes which move the real price way too much over the balance level that would have been established on a free market. The importance of sales tax and VAT in the price of sale tax products is over 60%, reaching, when speaking about cigarettes, to 80%. As a result of last week, when the minimum sale tax for cigarettes was raised from 91 to 96%, the price of a cheap cigarette package (for instance Carpați in România will be 8,4 lei. Only a few dozen kilometres towards east, in Moldavia Republic, their competitor, Plugarul, is 1 lei. A package of Kent is 9,9 lei in Romania, while in Moldavia Republic it can be bought with 2,9 lei. The result is a difference in price of 7 lei/package and a profit potential of over 500% in case of selling on the black market with 5 lei of the illegally brought products from the neighbour country.

This is an offer that cannot be turned down especially by the enterpriser without money. These ones do not even have to expose themselves because there is plenty of unqualified labour. Those unemployed from Moldova-Botosani, Vaslui, Tulcea (the poorest areas of România), facing the alternative survival or a fine (most probably jail), are tempted to engage in this kind of activities for some small incomes. Otherwise, it is not hard to guess what would happen if in Germany, for instance, the sale taxes raised 10 times (to represent a similar value to that from Romania related to the purchasing power) and if Germany had a number of kilometres of frontier similar to that in Romania with countries with a more reduced level of sale taxes: most likely that only as a result of smuggling influence with sale tax products the black market from the country with the most praised labour ethics and citizen honesty would not be 15,3% of GDP, but closer to that from Hungary and Poland (25%).

On the labour markets, the situation is similar. The importance of social contributions in the gross income (employee and employer) is of minimum 43,5%. It can reach, depending on the risk degree of the carried out activity, over 60%. This high level cancels in fact the results of introducing the flat income tax. The employees are facing the following alternative: I agree to be paid without being employed, risking that when I am retired to get a poor pension, or I choose to be pay taxes, to get in a dozen years a bigger pension promised by the state. The population evolution and the immigration of young people make, beyond the state loss, its promise unrealistic. So why would employees ‘grasp a shadow and let go a substance’? The conclusion of economists studies is unanimous: the high level of tax income and of social contributions is the most important reason of tax evasion on labour market. A study made in USA shows that any increase with one percent of the tax income represents an increase of black market with 1,4%. Watch out those who agree to increase the flat income tax from 16 to 20%.

Formal Oligopolies and Informal Competition

But what about the food market evasion, for instance, estimated by some of the producers between 20 and 70%, depending on the field? For this segment, the second reason identified by the experts as responsible for increasing the black market is valid: excessive regulation of the state. To activate in this field, an enterpriser must fulfil many conditions, to obtain many certifications and licences, from the number of meters built or square meters of water per animal and sanitary and veterinary certifications to environment certification. All these need investment way over the financial power of a farmer. To legally sell their production, he should find a bank willing to credit him only based on the security interest of real property (his property), and not on the future incomes. Because the payback established by state regulations would be an extremely large one. No bank in the world, except the state banks, willing to accept losses at political orders, will finance such businesses. The EU membership brought the immediately adoption of communitary acquis, which includes many of these standards, while the agriculture funds have been lining up at the European level for years (now, these are a few times more reduced than those received by the European farmers). So Holland is the main exporter of pork, despite the lower agricultural potential than Romania’ and Poland’, for instance. For he has no choice, the Romanian farmer chooses to go on the black market, thus obtaining lower prices for his products and thus opening way to VAT evasion.

The economists have two estimation methods of the regulation excess. The first refers to the number of new rules adopted by a state. In this field, Romania has an absolute record: in the last 8 years, starting with 2004, an average of 7.000 rules was adopted, among which only 300 laws voted in the Parliament. The rest belong to the Government, ministries and hundreds of regulating agencies.
The second is that of the regulation index (an index varying between 1 and 5). One point rise of this one leads to an increase with 8.1% of black market, it is shown in a study of economists Simon Johnson, Daniel Kaufmann and Pablo Zoido-Lobatón⁶. Another study, made in 76 developed countries, in transition and developing, estimates this impact to 10%.

Excessive regulation also raises another problem, especially in the poor countries. If in OECD countries the black market and corruption seem to have a substitution character (the biggest one of them, the smallest the other), in the transition states, for instance Romania, the character is of complementariness: they rise or fall simultaneously. The reason can be found in a study published in USA by Luciana Echazu and Pinaki Bose⁷: any new regulation implies more agents: the person, who regulates, establishes the criteria to enter the formal market and at least a bureaucrat who issues the licences according to the regulations and checks the criteria compliance. The institution that issues the licences can be different than that which verifies on the field whether the enterpriser possesses or not those licences.

Thus, there is a multiple temptation of corruption: on the formal market – when drawing the regulating document and issuing the licence and on the informal market – when verifying. According to both authors, in spite of what it seems to be, the most negative consequences appear not when there are more bureaucrats who ask for a ‘bribe’, but when the process is centralised. The level of corruption is then increased, and also that of black market. In Romania, starting with ANAF to the „decentralized”, the process is centralised. That was the stake of the political appointing, from the centre, of the chiefs for the 40 „decentralised ” in 42 counties, meaning 1.680 managers, 1.680 deputy managers, 1.680 economic managers, with the administrative services. The process of reorganizing of self financed governmental agencies, sent to the direct subordination of the Prime minister or some ministers had the same stake.

Another consequence of the regulation is the process of market oligopoly. In fact, licence tax and many times the corresponding bribe represent the price paid by the companies on the black market to obtain the privilege of establishing an oligopoly price. An extremely negative consequence like the raising of black market is the inflationist one. BNR blames many times the difficulty of de-inflationist process, the lower efficiency of monetary politics over the inflation rate on the fact that the offer’s structure is opportune in Romania. From this point of view the black market has also good consequences on the economy, through its competition, it limits the possibilities of raising the prices for the products of the sectors that the state created oligopoly.

Another cause that intensifies the phenomenon is the social assistance which encourages the population to work on the black market, unemployment, anticipated pension and various backings instead of compensatory salaries, in case to be fired from work on the informal market.

Conclusions:

The solutions to fight against the black market should take into consideration its causes. They should limit the distance between the benefits of the activity on the market and costs. Generally speaking, unfortunately, the authorities focus only on increasing the costs required to the actors of the black market through new regulations, which increases and not reduces their level. According to Schneider, „the governments should emphasize the enforcing of the actual laws and regulation rather than increasing their number. Some governments prefer the second choice of fighting against the black market only because it offers stronger powers to the bureaucrats and determines the increasing of the employment rate in public sector”. Among these we can also mention Romania’s governments from the last 22 years. Otherwise, unfortunately, for Romania, other two reasons for which the companies from the black market could prefer making the activities legal, the access to credits and the possibility of signing contracts with the most important client on the market (state), are not anchored in the present. The credit market has been blocked for two years, as a result of the shortfalls financed on the financial market, and public acquirement are, through the regulation, monopolised by a few companies, most of them belonging to the client politics.

Furthermore, the reasons for which tolerating the black market is more attractive for governments than fighting with it must not be ignored. First, financial losses are moderate, at least two thirds of the incomes generated by this one reaching the legal market and taxed. Thus the state does not lose 30% from the amount of the black market income budget, as some journalists and analysts are claiming, but probably 10%. More, an eventual not likely success of the fight against the black market does not determine the entire legalization of its activity, but only of a part, the rest vanishing with the percent of two thirds that would belong no matter what in the formal economy. On the long run, there might be a positive consequence, the rate of labour productivity being more reduced on this market. But the explanation could be that of the fact that on the black market work mainly unqualified workers. And to avoid the inflationist consequence of oligopoly, the state should quit the excessive regulation, that would limit the control of politic over economic.

⁶ Simon Johnson, Daniel Kaufmann and Pablo Zoido-Lobatón—study from underground economy
⁷ Study published in USA by Luciana Echazu and Pinaki Bose,2009
A second reason, for which the politician would be prudent in fighting the black market, especially during a crisis, is that the income obtained as a result of the activity on this market increase the level of living of at least a third of the population. Furthermore, between 40 and 50% of the black economic activity has a complementary character, creating VAT and contributing to GDP. Last but not least, Schneider notices, those who are working on the black market have less time (not having a maximum number of working hours per week) for other activities which would harm the government, as participating in a protest demonstration.

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