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The implication of gray
economy on the modern
crime

Saso Kozuharov; Jana Ilieva



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>> **FICHA TÉCNICA****THE IMPLICATION OF GRAY ECONOMY ON THE MODERN CRIME**

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>> ABSTRACT

In recent years, there is a strong tendency of most today's modern economists, to clearly define the terms of the hidden, unofficial, informal, irregular activities that are behind the functionality of today's modern economy. This effort is implemented exclusively in order to bring the size of the contribution of such activities to the economy in the present day as a whole. Within this framework occurs widely extensive vocabulary, coloring the codes of the different types of economies, characterized by practices today, which are attributed to "white", "black", "beige" and "gray" color of the economy. Accordingly, this approach highlights the knowledge behind the gray economy today, considering its activity that is not based so much on the scope of an economy in a legal state, as far as the motivation and behavior of legal entities that due to the conjuncture of circumstances in which they are located, are turning to illegal activities.

Hence, in order to sum up this correlation between the informal and criminal economy, it is important to analyze the correlation of today's modern economic activities in the gray zone of activities. Therefore, the below implemented master thesis, can be implemented as criminal - economic study, which incorporates the main subject of research, directing it towards the process of implicating the criminal activities in relation to the creation of the gray zone of economic activity in modern legal state.

Key words: *gray economy, law, state, market, crime, corruption, money, illegal activities, legislation*

>> INTRODUCTION

In order to be understood the modern economy today, it is necessary to be known its formal and informal part. The justification of that hidden, unregistered form of the economic activities derives primarily from the need to conduct efficient macro-economic politics of one country. It is fact that in the today's modern economic literature there is no completely clear definition of the term "gray economy". Generally speaking there are two approaches of defining the gray economy. The first one sees the gray economy as unregistered economic activities, definitional approach; while the second approach processes the term explaining and emphasizing the motives for those illegal behaviors, implementing the behavioral approach.

The gray economy begins to attract significant attention of economists, compared to transformation of the state - from a bureaucratic structure to one of the most important market participants. From an economic point of view, the core of this transformation is the implementation of a new relationship between the state and citizens that are most likely to observe the economic principles in keeping the public accounts, and less in keeping the accounts of the citizens (Ehsan, Rosser and Rosser, 2004)

Taking into consideration the criminal, illegal hidden activities, which are implemented under the protection of the gray zone, the gray economy is determined as activity that exceeds the appropriate legal regulations. It is about the economic activities which in certain elements are undeclared, unregistered and untaxed. The economic activities that are drawn from the society norms and control, in which terms are actually illegal, including also those that are exclusively prohibited and whose performance is crime related – the black economy. Regardless of the extremely clear distinction between the gray and the black economy, in valorization of their amount it is difficult to identify a clear border. (Krakowski, 2005).

A growing number of authors are trying nowadays to estimate the gray economy however facing difficulties to conduct that more accurately. Therefore, frequently used definition is the one in which the gray economy is highlighted as a phenomenon that covers unregistered economic activities that contribute to the officially estimated GDP (Ehsan, Rosser and Rosser, 2004). Also, studies have confirmed a strong correlation between the number of regulations and the rate of the gray economy. Thus, taking into account the level from one to five, where five indicates the highest number of regulations, the rise of the level to one degree, will increase the participation of the gray economy in GDP per capita in amount to 8.1 percent.

The gray economy according to the activities and the implementation of the illegal approaches is completely opposite direction of the social norms, and can be declared as “the Achilles heel of any legal country” (Bruce, 1990). In this regard, Thomas (1991) explaining this informal economy, has stated: “In broad concept, informal economy refers to all activities that are not entered in national accounts due to reasons.” He divides these activities into four groups: household, informal, irregular and illegal sector. (Maddah and Sobhani, 2014) All the activities categorized in this sector are more or less accompanied by a kind of illegal matter such as tax or regulations (like work laws and safeguards in workhouses) evasion, forgery in social insurances and so on.

Regarding the fact that it is about complex phenomenon, numerous are the causes and the factors that contribute to the appearance of the gray economy

Among the more important factors that affect to the making of the final decision for entering the gray economy of working, are the quality of the legal system as well as the institutional mechanism for implementation of the legal regulations and norms, the level of the administrative control as opposed to the economic liberalization of the official economy, the tax burden, macro-economic instability and the disrupted payment system.

Also to the size of the gray economy, great influence has the size of the corruption, that is considered as one of the basic criminal activities, which enters into the frames of the modern crime, especially in the developing countries, among which is also Republic of Macedonia; where the higher level of regulation has as consequence significantly increased size of bribery, held on the heavier involvement of the official legal activities and their entrance into the informal economy.

The distortion i.e. the non-adjustment in the market economy and the desire for fast enrichment with the low possible risk, are in the base of this illegal activities and are essentially factors of the economic nature. Here we must mention, besides the economic, the psychological factors that motivate the individuals in most of the countries to decide for activity in the gray zone of the economy. Such factors include the disbelief in the legal state, the people’s mentality and their disagreement with the purposes and measures of the economic politics of the country.

As one of the most major factors that contributed to the extensive and excessive expansion of the gray economy in Republic of Macedonia, can be mentioned several interdependent factors: year of military conflicts, long lasting negative economic trends, unemployment, low living standard, slow process of transition, not constructed legal and economic system and

effective economic policy, lack of system solutions for combating the gray economy and the criminal activities that maintain the gray economy in the country.

According to that, taking into account, combating the gray economy, it is very important, in addition to the implementation of effective modern measures and approaches, as well as the strengthening of the legal protection and functionality of the legislative norms and regulations in the country, it must be paid attention to the size of the criminal activities that represent a column of growth and development of the gray economy, such as bribery and corruption within the modern organized crime today.

>> RESEARCH

After determining the problem and the purpose of the survey, a general hypothesis is created. It reads: The gray economy has seen increased growth and development based on the economic inequality, unequal implemented incomes, inefficient legislative provisions and inefficient implemented social norms and rules that serve as a barrier to the efficient population to have success in the formal economy, at the same time encouraging the same activity in the gray area of the economy. Within this framework the circle of factors influence to the appearance and expansion of the gray zone, is helped with the implication of the modern criminal activities within which enters corruption and money laundering as a product of the increased activities of illegal operations in the gray economy. The main source of data are taken from national statistical offices, as well as European investigative databases in terms of economic statistical analyzes. The implemented research analysis is categorized to qualitative analysis using the research method of case study:

- **Sample survey** – *is accessed only to part of the total population for extracting data*
- **Advantages** – *uses less time and resources than the census, allowing more effective monitoring and precise control of the applied methods*
- **Disadvantages** – *the gathered data may exclude many other aspects*

The research primarily uses structural analysis and complete review of gathered statistical data. The reason why this method of data collection is used is in fact the problem of research in which are implemented additional control variables that are not additionally measurable.

Within this research, will be implemented a well-known method of ESM, and the method of MIMIC. In this case, the ESM will be implemented as one of the better material indicators regarding the declarative and non-declarative economic activities in the Republic of Macedonia, taking into account the movement of the percentage rate of GDP.

Through MIMIC will be implemented the effective structural modeling where the gray economy will be seen as a latent variable, taking into account the causes and the indicators of the illegal economy.

Taking into account the results, the relative size of the gray economy in Macedonia is actually reduced in the last decade by 2010 with 35% of GDP in 2000, reducing even to 24% of GDP in 2010. The methodology within the ECM results shows a decrease of 34% in 2000 to 24% of GDP in 2010, while the MIMIC approach shows an increase of the gray economy to 52%

in 2007 and then decrease to 47% in 2011. (Center for economic analysis, 2012)

However, regardless the comparative assessment of the implementation of various types of methods, it can be noted that the gray economy, on the basis of the assessment is extremely strongly represented and developed in Republic of Macedonia, which is not surprising taking into consideration the transitional period, global economic crisis, military conflicts in Macedonia at the beginning of the new century, unemployment, inefficient operation of the competent institutions, bureaucracy and similar.

Accordingly, regarding the application of the policies and the proposed methods and approaches by the authorities, the government bodies in order to initiate the process of combating and placing barriers to the growth and development of the gray economy, trying to make it less attractive to the Macedonian population, reducing its size, Republic of Macedonia implements such approaches constantly by taking certain steps in strengthening the sanctions and legislation, reforms in tax and social security systems, and more effective implementation of the legislative system in the country.

However, taking into consideration the education, compared with the economically developed countries, especially the education and formation of legal entities regarding their attempt to avoid the formal economy in the country, activating towards the informal, encouraging the importance of effective operating, not only for their organizations, environments, but also for the economic growth and development of the country; Noticing the extremely low efficiency of the education system compared to European countries, in the last few years the Government has already started to apply access to harmonize the Macedonian educational system with the European educational system, where the results of this approach should yet be observed, taking into consideration their effect on the gray economy. Within this effect from the effective education and the effective implementation of public services in the society through efficient operating of the competent institutions and the legal system, with assumption of X3, is expected the impact in the following years of such approaches and strategies to affect negative on the growth and the development the gray economy.

However, it should be mentioned the fact that on the basis of the implemented method of ESM can be seen four reasons for implementing, growth and development of the gray economy, which is based on taxes, legal regulations, penalties, fines and corruption .

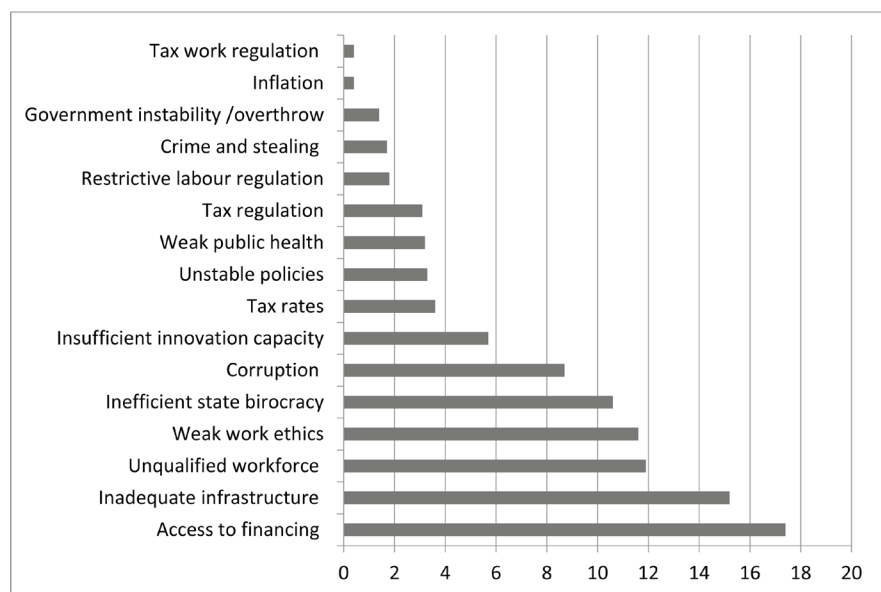
The unemployment rate in Macedonia was about 25% in 2010 - Macedonia has a very high official unemployment rate (from 31% to 38% in the reference period) with low rates of its decline. If the results of ECM for the

gray economy are projected to the unemployment then the unemployment rate would have been reduced significantly - from 7p.p. to 13p.p. depending on the year under review (Center for economic analysis, 2012).

The application of the ECM method shows that as the percentage of the gray economy reduces as a whole regarding the GDP, the gray economy has a growing trend in the industry between 2003-2006, and after that it declines. In fact the gray economy in the industry (steel, iron, non-metals, chemicals, building materials, food and beverages, textiles, paper and printing, engineering and other industries) is higher than the gray economy in other sectors (covering transport, households, agriculture and other sectors). Although expected the industrial sector to occupy a smaller part of the activities in the gray economy regarding the services sector, the application of the EMC method to the industry sector in Macedonia shows inverse proportion. The reasons for this can also be methodological or statistical, but it remains to be further researched.

The reevaluations for the unregistered part of the economy in Macedonia obtained with Electricity Consumption Method - ECM and the Statistical Office of the Republic Macedonia show generally uniform trend in the period analyzed in this study. The valuations of the gray economy made with Multiple Indicators Multiple Causes - MIMIC show that taxes and social

Graph no. 1. Barriers to conduct the economic productivity in the Republic of Macedonia – 2013/2014



Source– World Economy Forum, International Concurrency Report, 2013-2014, c260 - WEBFORUM

transfers paid by the state are statistically significant causes of the gray economy in Macedonia.

In Republic of Macedonia, the area most affected by the gray economy, as already mentioned is the labor productivity, which proves to be extremely concerned tendency of reduction of this productivity in Macedonia. All this leads to a decline in the gross wages in the country for -0.5% in Q4 for 2013 (Ministry of finance, 2014). Besides, there are several factors that interfere with the emphasis on the labor efficiency and productivity in the formal economy in the country, they are shown in the graph.

>> CONCLUSION

Regardless of the final view of the definition that refers to the gray economy, it is all about economic trends, activities and the implemented income which is not subjected of taxation nor of the regulation. Such unregistered, illegal activities start from the unreported income from sales of goods and services through financial transactions and barter of arrangements, permutations, to business activities in the independent activity. The complex area of the gray economy has become subject of various studies in the last years, affecting all the countries in the world and Europe, regardless of their economic standard.

However, as we can see from the above implemented data, the gray economy is predominant in the transition countries, in countries where the population is losing confidence in the ineffectiveness of the legislative judicial system in a country where legal or natural persons encounter more barriers and they can not succeed in the formal economy, resorting to informal activities in the gray area of the national economy. Thereby, in order to cover up their activities, and to continue the growth and development of the gray economy, from which they collect their revenues, most of the economic entities or individuals without thinking are resorting to criminal activities, such as corruption, bribery, or money laundering in order to conceal the received material funds from illegal goods or manipulated market prices of the gray economy.

The complex complexity of such implied criminal activities lies in their upgrading and modernization, taking into account that they, with the implementation of the global growth and development of the information technology, improve their methods of realization by criminal groups and individuals whose modernization makes even more difficult to detect and suppress them.

From the above implemented statistical, comparative analysis within the research of this paper can be reliably delivered a conclusion that the gray economy in the framework of its growth and development, is becoming far greater in size and influence, with the help of the modern crime implied therein, which highlights the most through corruption and bribery, especially in Republic of Macedonia. These data confirm with certainty the general hypothetical framework of the research in this paper – The gray economy has seen increased growth and development based on economic inequality, unequal implemented incomes, inefficient legislative regulations and ineffectively implemented social norms and rules that serve as a barrier to the efficient population to have success in the formal economy while stimulating the

activity of the same in the gray area of the economy. Within this framework the circle of the influence of emergence and expansion factors of the gray zone, is helped by the implication of the modern criminal activities within which enters corruption and money laundering as a product of the increased activity of illegal operations in the gray economy.

Accordingly, it should be seriously implemented the methods and modern approaches to combating the gray economy, applying detailed insight into the criminal activities in the gray zone. The suppression of the gray economy, is necessary to define clear operational goals and objectives, and to implement responsibility for non-compliance of the same, which can not be called into question. Although during 2013, are implemented several technological improvements in the process of control the taxpayers, it happens surprising increase in the tax indiscipline and the gray economy in the framework of the previous 2012. Major discrepancy between planned and realized results of tax authorities shows the absence of systematic framework for monitoring the work of the tax authorities. Therefore can be concluded that the systematic framework to combat the gray economy must include a methodology for monitoring and controlling the tax authorities of the Republic of Macedonia, with clearly defined operational goals and objectives. Also, is more than clear that the allocated technological advancements are unable to compensate the shortcomings of the existing system framework for combating corruption.

So the actual tax authorities, with the planned technological improvements, plan to transfer the additional funds from the gray economy. While the implementation of the legal obligations of registration the turnover by the fiscal registers was adequate and successful measure where the commitments for wireless calculation of fiscal registers during the 2005/06 did not bring the expected results.

Thus, the implementation of data from the registered turnover through the fiscal registers, has not contributed to systematic promotion of the field control of taxpayers nor to efficiently detect any tax evasion. Given that the process of monitoring of fiscal registers was preceded by loan growth of administrative costs as burden to taxpayers and the economy, asking the logical question of the effectiveness and essence of the planned introduction of the far more modern methods in order to be to cope with far more modern implementations of the criminal activities in the gray economy.

At this point, still can not be seen how most methods could contribute to the systematic improvement of the tax control and detection of illegal activities as well as combating corruption and money laundering with the serious risk for repeated failure of the already implemented modern methods it

should be noted that the current concept of most approaches and plans to suppress the illegal economy, should apply far more effective measure against the gray economy in the following years.

However, if not implemented far more effective method for prevention and referral, as well as controlling corruption and modern criminal activities within the gray economy, failing to suppress the gray zone of activities, the low efficiency of the collection of public income undoubtedly is expected to jeopardize the fiscal consolidation and sustainability of the public finances in Macedonia. From here, in 2015, today is more than necessary to examine the size, scope, and the reasons for this legislative, the legal indiscipline of legal and natural persons, as well as to be applied far more effective system for preventing tax evasion and implementation of the illegal, concealed activities in the economy of the Republic of Macedonia, alongside encouraging the growth and development of the gray economy.

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