



FINANCIAL ANALYSIS OF THE IMPACT OF THE INFORMAL ECONOMY ON THE ECONOMY OF SERBIA AND EUROPEAN COUNTRIES

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Abstract

In this paper, the authors point out the informal economy of the Republic of Serbia and European countries as the biggest problem for every country. The following is the share of industries as well as the gross domestic product of nations. They are reasons why the informal economy is so ubiquitous as well as the idea that it is necessary to decrease it. The paper deals with research aimed at determination of the impact of the informal economy, in which sector of the economy it has the biggest, why it persists, and financial losses because of the informal economy. The paper discusses secondary damages due to the informal economy and the causes of why they go on. The paper also analyzes the influence of the shadow economy on the EU and OECD countries' GDPs. The authors discuss why the informal economy persists and what measures should be taken to prevent or at least reduce it.

Keywords: financial analysis, informal economy, shadow economy, illegal work, economic loss.

1 INTRODUCTION

Informal economy according to the Economic Dictionary: "It is a part of the economy characterized by irregular and illegal business. It can be seen as a shadow economy, i.e., a business that can be legalized by taking certain actions (for example, paying taxes), and a black economy that cannot be legalized (for example,

drug trafficking). It exists in underdeveloped and developed countries, but an increase in economic development decreases its share in the social product. All countries implement measures to suppress it to increase tax revenues." (Acimovic, 2010, p. 465).

The United Nations Development Program defines the informal economy as: "Economic activities, funds and transactions, often illegal, which are not registered or otherwise reported to the appropriate state authorities, and which thus avoid taxation or other types of inclusion in state economic statistics, sometimes described by

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synonyms in the shadow, underground or as the gray economy." (Glovackas, Woolfson, & Tuch, 2012, p. 29)

The International Labor Organization defines informal employment as "employment without secure contracts, benefits for workers or without social protection." It consists of two basic components: self-employment in informal enterprises and paid employment in informal jobs."

According to the Economic Dictionary, the informal economy or shadow economy is "a set of activities carried out outside the institutionalized economic environment, fictitious economy, informal economy, and other hidden or illegal business transactions." It is classified statistically into registered and unregistered. From the aspect of legality, it can be legal and illegal. From the fiscal aspect, it can be:

- taxed,
- taxable (but the entire income or part of the income is hidden from the tax authorities; so-called gray economics), and

- other (for it, there are no clear tax regulations, and it exists in gaps the legal regulations).

Particular attention states should pay to the so-called third economy (black economy), which is strictly prohibited and whose activities bind with criminal and organized crime activities.

2 INFORMAL ECONOMY IN THE REPUBLIC OF SERBIA

In the Republic of Serbia, the gray economy includes:

1. Illegal economy (illegal business entities)
2. Illegal work (employees who work illegally)
3. Money laundering and financial fraud (illegal transactions, tax evasion, etc.)

In 2018, the Union of Employers of Serbia conducted research within the project Effective Suppression of the Gray Economy, which we will present below. Based on their previous experiences, they concluded that the informal, gray economy is best known by directors and managers of the formal economy.

Table 1 *Illegal traffic by industry*

Agricultural branch	Participation in %
Trade (all forms)	32.55
Construction and construction material industry	14.58
Services	12.88
Agriculture, forestry, and water management	8.81
Tourism and catering	4.75
Craftsmanship and entrepreneurship	4.75
Traffic and connections	4.41
Leather and textiles	4.40
Lumber industry	4.07
Media, publishing, and graphic activity	3.05
Chemistry and non-metals	2.03
Metal industry	2.03
Healthcare and pharmacy	1.69

Source: (Poslodavci, 2018)

The share of goods turnover in trade is 32.55% and thus it is convincingly in the first place in the structure of the total turnover of goods in the gray zone, which leads to the conclusion that there is insufficient control of the market by the competent inspection authorities and the existence of parallel channels for trade in unregistered goods on the whole territory of the Republic of Serbia. In second place is the construction industry with the building materials industry due to fictitious companies with

one, two, or no employees, without significant assets and founding capital. They operate for an average of two to three years, complete a few jobs obtained in the public procurement process, and then disappear from the market. Fictitious companies for the completion of contracted jobs often hire construction companies that have been in business for years, assuming the role of intermediaries between the client and the contractor, during which between 10 and 50% of

the value of the ordered work disappears. That phenomenon in construction can be prevented if only companies with significant references, a certain number of permanent employees and assets, and an annual turnover not less than the value of the specific public procurement could participate in the procurement process.

The service sector has the largest share in the gray economy in the EU. In Serbia it is in third place in terms of participation, where small, subcontracted services and so-called household services dominate.

The only branch that records a surplus in the foreign trade exchange of the Republic of Serbia with the rest of the world, agriculture, forestry, and water management are in fourth place in terms of participation. Every second small agricultural producer works in the gray zone, which is a significant loss for the state on the one hand, while it prevents these individuals from receiving loans, subsidies, etc. from the state. The consequence of this is a long-term attachment to small holdings and a small volume of production, thereby losing the possibility of development and raising the standard of living.

The total number of obligations depending on the economic branch and the activities of companies and entrepreneurs is higher, so it is clear to what extent companies operating in the gray zone are at an advantage compared to legally registered companies.

Who represents unfair competition? 83.26% of the surveyed respondents cited natural persons as unfair competition operating in the gray zone, 46.46% cited legal entities operating illegally, and 38.33% of respondents answered that natural and legal entities operate illegally in their activities. Note: respondents could circle more than one answer to the above question.

Regarding the distribution of illegal goods, most complaints are about sales through advertisements, 51.98% of respondents said so. It is followed by the sale of illegal goods in the markets at 47.14%, and in third place is the sale in undeclared shops at 44.05%. Then, improvised stalls on the street 38.77%, illegal distribution centers 29.96%, illegal sales at doorsteps 18.5%, sales of illegal goods in legal establishments "underhand" 15.42%, and illegal sales in establishments of legal entities 14.54%.

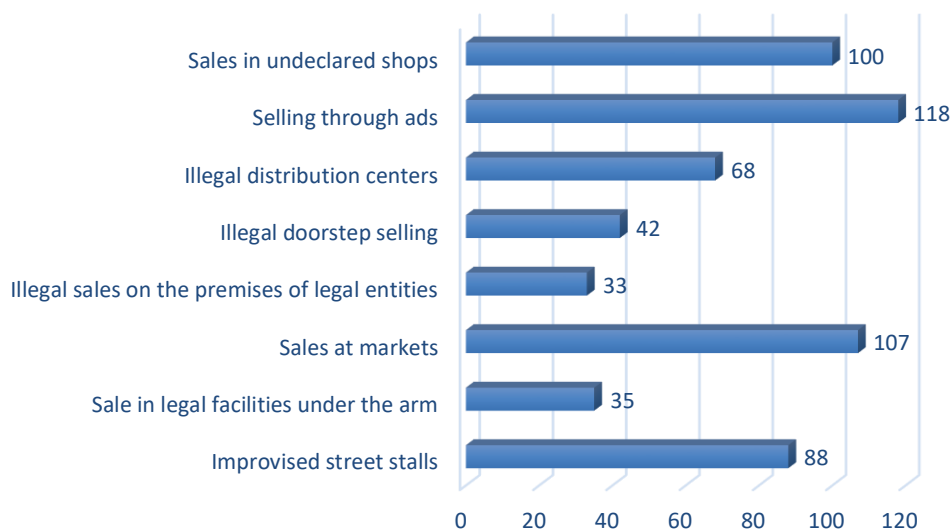


Fig. 1 Distribution of illegal goods

Source: (Poslodavci, 2018)

Illegal provision of services by natural persons such as bookkeeping, engineering, consulting, and marketing and propaganda services is very pronounced. Goods arriving in the country through illegal channels are also a big problem.

Figure 1 shows the distribution of illegal goods in Serbia.

In the Western Serbia region, the sale of illegal goods on the markets is highly widespread, and 66.7% of respondents from this region stated that goods reach customers in this way. This type of distribution of illegal goods is less widespread in the larger cities of the Republic of Serbia. In the city of Belgrade, the sale of illegal goods through

improvised stalls is lower than the average at the level of the Republic of Serbia.

Doorstep sales are specific to western Serbia. Sales through advertisements are more pronounced in large cities. 33.3% of respondents from central Serbia reported that method of distribution, while the average for the Republic of Serbia is 51.98%. Sales in undeclared improved street stalls were expressed in central Serbia by 63.3%. The lowest number of complaints about this type of distribution was in Belgrade, 31.34%. That is lower than the average at the level of the Republic.

3 FINANCIAL AND OTHER LOSSES DUE TO THE INFORMAL ECONOMY

The total financial losses among survey participants on an annual basis were estimated at 4,420,240,000 RSD¹. Fig. 2 shows the data on the structure of financial losses of economic entities.



Fig. 2 Secondary types of damage due to the informal economy

Source: (Poslodavci, 2018)

As secondary damages due to the work of the informal economic sector, the largest number of respondents mentioned a decrease in turnover and difficult placement of goods and services on the market 44.05%, then the occurrence of price reductions resulting from unfair competition from the informal sector 19.38% and loss of reputation among consumers 18.5%.

In addition to the secondary damages due to the shadow economy, there are also other damages

such as difficulty in legal employment and more difficulty finding workers ready for legal work with lower wages. Entities operating illegally avoid paying taxes and contributions on wages and all other allocations to the state and can offer (seemingly) higher wages. Large companies state the impossibility of technological development due to reduced income due to shadow economy activities including avoiding quality control of goods offered to customers through illegal channels. Due to the activities of the informal sector, 6.17% of respondents said they were forced to stop doing business partially or completely.

4 WHY DOES THE SHADOW ECONOMY PERSIST?

Answering the question of what enables the existence of the informal economic sector in Serbia, most of the respondents, 46.7% of them, indicated the weak work of the market and financial inspection and the lack of political will to solve this problem. 17.18% of respondents stated that the problem is corruption, and 4.41% of the respondents stated that the problem lies in deficiencies in the legal regulations.

From the above-mentioned data, the main reason for maintaining a high level of the informal economy in Serbia is the weak work of state authorities in suppressing this form of economic activity. A measure that could repress illegal work is the reduction of taxes and contributions. There is also an extensive burden on legal business entities, while those from the informal economy are uncontrolled, which sends a message to them to continue with illegal work. One gets the impression that businesses have had enough of an expensive and inefficient state that fails to bring order to economic flows.

5 INFORMAL ECONOMY IN EUROPE

The informal shadow economy is a big problem at the global level. A chart presented in figure 3 shows shadow economy participation expressed in % of GDP in central and Eastern Europe.

¹ approximately 37.7 million euros

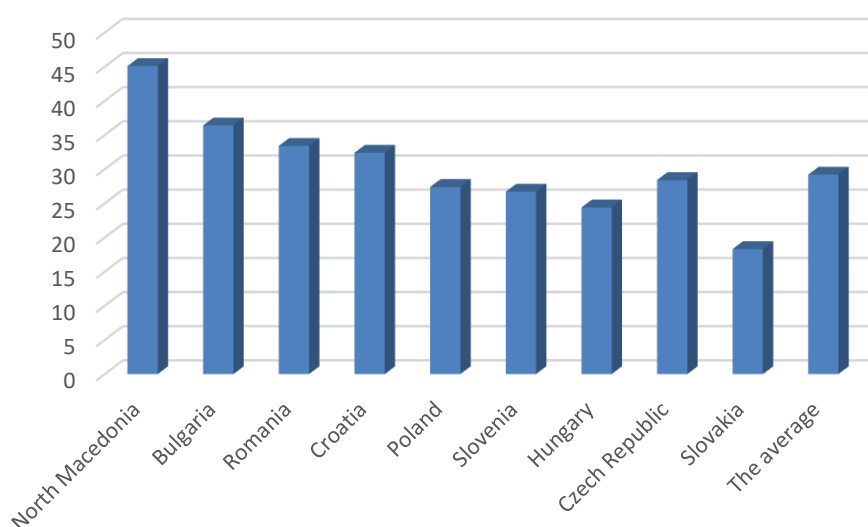


Fig. 3 Share of the shadow economy in %GDP in Central and Eastern Europe
Source: (Kelmanson, Kirabaeva, Medina, Mircheva, & Weiss, 2019)

From figure 3 one can conclude that the largest share of the gray economy in GDP is in North Macedonia at 45.1%, Bulgaria at 36.4%, Romania at 33.4%, Croatia at 32.4%, Poland at 27.4%, Slovenia at 26.7%, Hungary at 24.4%, the Czech Republic at 28.4%, and Slovakia at 18.3%, while

the average of the countries of Central and Eastern Europe is at 29.2%.

Figure 4 shows the participation of the gray economy of 21 OECD countries.

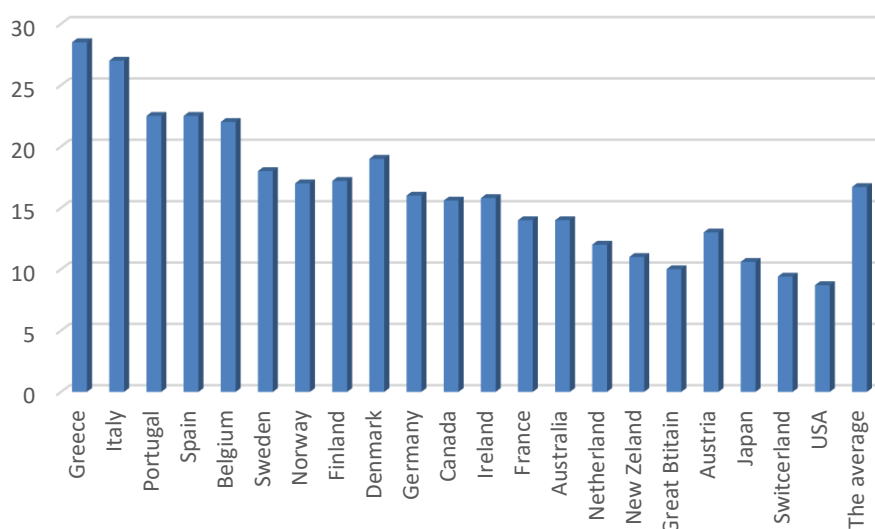


Fig. 4 Share of gray economy %GDP in OECD countries
Source: (OECD, 2022)

The largest share of the shadow economy is in Greece at 28.5%, followed by Italy at 27% and Portugal at 22.5%. The shadow economy shares in GDP are in Spain and Belgium at 22%. Sweden, Norway, Finland, and Denmark have shares of 19 to 17% of the shadow economy in GDP. Germany, Canada, Ireland, France, and

Australia have shares of 16%-14%, the Netherlands, New Zealand, Great Britain, and Austria 13%-10%, Japan 10.6%, and Switzerland 9.4%. The minimum participation of the shadow economy shows the USA with 8.7%. The average participation of the informal economy of 21 OECD countries is 16.7%.

Effects on the Official Economy

A change in the size of the shadow economy can reflect in changes in:

- Monetary indicators. Shadow economy transactions tend to be in cash. The growth of the gray economy will most likely increase the demand for cash.
- Labor market participation rates and working hours. As growing numbers of people work in the hidden sector, participation rates in the official economy may fall. Similarly, as people work more hours in the hidden sector, hours worked in the official economy may fall.
- Output statistics. As the shadow economy grows, production inputs, especially labor, move at least partly out of the official economy. This displacement may depress the official growth rate of the economy. (Schneider & Enste, 2002)

6 CONCLUSION

Like in the Republic of Serbia, in the countries of Central and Eastern Europe, and in the 21 countries of the OECD, the problem of the gray economy is not negligible. The reasons for the creation and survival of the informal economy are significant taxes, contributions, and state levies. It is difficult to calculate the participation of the shadow economy in the total economy, but not impossible. There are various methodologies:

- *Direct approach.* It implies research. The disadvantages of the effects of the shadow economy research reflect in how many examinees are ready to cooperate and give sincere answers. If the questionnaire is composed well and examinees reply correctly, the research can give a more detailed analysis of the shadow economy, which is a significant advantage. In addition, field research can be used for tax monitoring.
- Indirect access implies indicators that are usually of macroeconomic type. The most significant are currency demand and electricity consumption. They show the share or the effects of the shadow economy on the legal economy.

We have concluded that the size and share of the gray economy in the Republic of Serbia, Central and Eastern European countries (developing countries), and OECD countries are similar. The shadow economy is a complex phenomenon, results they say that it will increase cargo taxes, contributions, and social protection of employees in combination with increased state regulatory activities are the strongest driving force of power strength, size, and growth grey economy. The biggest role in the shadow economy suppression has the state. The states are expected to their regulations and regulations reduce grey the economy.

The largest share of the shadow economy is 28.5% in Greece. The next are Italy with 27% and Portugal and Spain with the participation of the shadow economy in GDP of 22.5%. Belgium has a share of 22%. Sweden, Norway, Finland, and Denmark have shares of the shadow economy in GDP of 19 to 17%. Germany, Canada, Ireland, France, and Australia are at 16%-14%, the Netherlands, New Zealand, Great Britain, and Austria at 13%-10%, Japan at 10.6%, and Switzerland at 9.4%. The lowest participation of the gray economy is the USA, with 8.7%. The average participation of the informal economy of 21 OECD countries is 16.7%.

The share of goods in the turnover is 32.55% and is convincingly in first place in the structure of the total turnover of goods in the shadow zone. That leads to the conclusion that there is insufficient market control by the competent inspection authorities and the existence of parallel channels for the circulation of unregistered goods throughout the territory of the Republic of Serbia. In second place are the construction industry and the building materials industry due to the existence of fictitious companies with one, two, or no employees, without significant assets and founding capital. They usually exist for an average of two to three years, finish a few jobs obtained in the public procurement process, and then disappear from the market. The service sector has the largest participation in the gray economy in the EU, while Serbia is in third place in terms of participation. Small, subcontracted services and so-called household services dominate there.

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