

Source: MOLDOVA IN TRANSITION: *Economic survey*, N2, Center for Strategic Studies and Reforms, Chisinau, November 1998

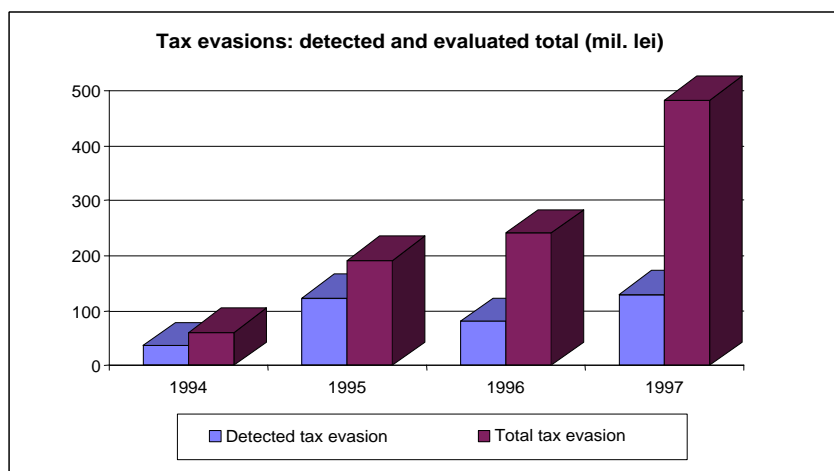
4.7 Economic collapse or the informalization of the economy?

The economic evolution of the Republic of Moldova, similar to other countries in transition, may be characterized by a deep decline. Even if 1997 marked a small growth in GDP, formed about 37% of the level of 1990. The accuracy of this almost three-fold decline, accompanied by an extension of constructions, of the private fleet, of durable goods sales, rises doubts. Undeclared incomes, tax evasion and shadow economy are discussed more and more.

The shadow (underground, informal, second, unofficial, invisible) economy “smoothes” the impact of economic shocks in the transition countries. We can not characterize it unambiguously as being negative or positive. As a complex phenomenon shadow economy includes negative, parasitic, counter-productive aspects, which need to be eradicated, as well as positive, productive aspects. Thus, shadow economy causes losses for the state budget due to tax evasion, it is one of the reasons of the decline of economic discipline and hence of the people’s decreased respect towards state institutions. Being out of the state control, the shadow economy can be one of the potential sources of economic shocks, economic and political instability, in many cases it is closely related to the organized crime. At the same time, the shadow economy brings additional revenues for its operators and members of their families, being sometimes their only source of income, and diminishing the unemployment rate. Shadow economy increases the competitiveness of production, often being cheaper, it can be more elastic, more adjustable to the new conditions, bypassing the bureaucratic obstacles faced by the formal economy, it can serve as a factor of market stability and balance, often offering exactly those goods and services which are in demand in the formal economy. In a way, shadow economy can be a factor of financial stability due to the transactions performed in national currency, covering the monetary excess with goods and services.

In this chapter we will discuss the shadow transactions only in a couple of sectors of the economy, negative aspects of the studied phenomenon will be examined.

Tax evasion is a kind of the underground activity, which actually as a more notable impact on the stability in the economy. The society is tensioned, in a big part, by the failure in the payment of pensions and wages for the budget workers, growth of the state budget deficit and debt. On the other side, the supply of free of charge public services to the whole population, including those not paying taxes, worsens the situation in the budget. Our calculations show that during 1994-1997 the volume of tax evasion grew up very quickly – from 65 million lei till about 500 million lei (from 4% of the consolidated budget income till more than 20%). We should mention that this is a minimal estimation, because there is a assumption of the a perfect honesty of tax inspectors in the base of the estimation.



The reasons for the extension of tax evasions include the weakness and corruption of fiscal control institutions, an overdriven system of tax facilities, a heavy tax burden.

The indicator of tax burden being calculated as the ratio of tax incomes (including payments into the social fund) to GDP varies during 1994 –1997 between 30 – 33%. This indicator, in principle, doesn't exceed too much the average per OECD - 28.5%. This figure has emerged as a result, that a part of economic agents do not pay any tax and the other – carries a much bigger burden.

Tax burden (excluding excise)

	1996	1997
VAT (mil. lei)	613.9	800
Profit tax (mil. lei)	358.6	380
Individual income tax (mil. lei)	219.1	230
Payrole tax (mil.lei)	765	920
Sum (mil.lei)	1956.6	2330
GDP (mil.lei)	7317	8280
Share of taxes in GDP(%)	26.74047	28.1401

An evaluation of the tax burden in the real sector of economy for 1992-1997 was done on the base of information derived from the form N2 "Financial results' statement" of all enterprises which submitted this form to the Department for the Statistics.

Average tax evasion per taxpayer

	1994	1995	1996	1997
Total legal entities and individuals	1.58	4.92	3.41	7.68
Recorded individuals	3.09	9.50	7.37	12.01
state enterprises	11.53	48.98	11.30	22.00
collective enterprises	6.07	7.68	53.07	33.38
rented enterprises	5.57	9.12	0.94	5.23
all kinds of cooperatives	3.08	9.06	14.74	19.13
including colchozes	7.18	23.90	43.18	54.10
L.T.D.	0.41	1.00	3.25	9.60
joint stock companies	7.82	10.39	18.09	12.39
enterprises with foreign investments	1.82	1.40	18.07	62.08
social organizations	0.78	0.16	0.85	1.78
insurance companies	0.08	2.41	47.62	7.13
associations, concerns	1.97	1.78	19.19	1.85
farmers	0.00	0.01	0.06	0.02
budget institutions	0.05	0.08	0.43	0.44
other legal entities	0.18	-0.85	5.93	17.00
Individuals - total	0.02	0.06	0.18	0.91
individual enterprises	0.02	0.06	0.21	1.19
collectiv societies	0.12	0.02	1.64	2.00
socien.with unlim.responsib.	-0.10	0.00	1.63	0.35
other	0.03	0.08	0.00	0.10

The calculations showed that the tax burden reached much bigger values (the total in 1997 – 45%, in industry – 50%, in agriculture – 40%, constructions – 38%).

The tax burden is, evidently, much heavier in the Republic of Moldova and it suppresses the economic development. This burden “pushes out” a bigger part of economic agents to the shadow sector of the economy, reduces the tax base in the future and aggravates the problem of budget deficit.

Our calculations show, that in average, the rise of the tax burden by one per cent entails a rise of the “tax evasion/consolidated budget income” ratio by 2.5 per cent. However, diminishing of the tax burden will not be followed sine qua non by the growth of tax collections.

Evolution of tax burden in real sector of economy

		Total taxes (million lei)	GDP (million lei)	Tax burden (%)
1992 (including cooperatives)	Total	60.8	176.1	34.5
	Industry	28.3	60.6	46.7
	Agriculture	13.7	59.6	23.0
	Constructions	2.8	9.5	29.5
	Trade	1.9	5.8	32.8
	Communications	0.6	1.6	37.5
1993 (including cooperatives)	Total	456.3	1183.6	38.6
	Industry	183.8	452.9	40.6
	Agriculture	99.7	494.0	20.2
	Constructions	23.2	69.6	33.3
	Trade	19.9	53.7	37.1
	Communications	3.7	11.0	33.6
1994 (including cooperatives)	Total	1484.6	3520.9	42.2
	Industry	751.8	1365.8	55.0
	Agriculture	229.0	980.8	23.3
	Constructions	84.5	193.5	43.7
	Trade	80.0	155.8	51.3
	Communications	22.9	56.1	40.8
1995 (excluding cooperatives)	Total	1782.0	3976.6	44.8
	Industry	638.1	1221.4	52.2
	Agriculture	389.1	1233.9	31.5
	Constructions	97.7	221.0	44.2
	Trade	172.9	353.1	49.0
	Communications	107.5	174.7	61.5
1996 (excluding cooperatives)	Total	1924.5	3751.8	51.3
	Industry	742.2	1186.9	62.5
	Agriculture	412.7	725.6	56.9
	Constructions	96.0	288.1	33.3
	Trade	280.6	566.1	49.6
	Communications	108.8	292.4	37.2
1997	Total	2227.3	4957.2	44.9
	Nonresidents	223.7	329.3	67.9
	Industry	683.3	1369.4	49.9
	Nonresidents	43.9	79.6	55.2
	Energetics	262.7	-235.1	z
	Agriculture	468.3	1188.3	39.4
	Nonresidents	0.9	3.8	23.7
	Constructions	106.3	276.8	38.4
	Nonresidents	1.2	5.8	20.7

The policy of diminishing the tax burden with the aim of stimulating production output is a gradual process and has to comprise a set of measures as follows:

- explanation to the population of the need to adjust budget expenditures along with the temporary reduction of budget incomes;
- preparation of a training program targeted at explaining the impact of tax evasion on the society's welfare, cultivating a negative attitude towards tax evasion;
- psychological preparation of the economic agents through all possible means of information (mass-media), concerning tougher fiscal controls, and explaining the expected positive effects of these measures, including the diminution of tax burden;
- creation of a unique body vested with sufficient power and rights in fighting tax evasion, including the right to apply administrative sanctions, which would promote

- an integral and consistent policy of investigating, detecting and penalizing the tax evaders;
- toughening the fiscal controls (rising penalty rates and frequency of controls to the level that makes the tax evasion economically inefficient);
 - as the last step – diminishing the tax burden.

Illegal import-export transactions. Basic forms of illegal transactions in Moldova are: smuggling, “pseudo-barter”, “pseudo-export”, “pseudo-transits”, import-export operations with unjustified unproved modification of prices and “sharing” the benefits among the partners, obviously non-equivalent exchange operations, and finally exceeding the export quotas.

According to the Romanian data (“Curierul National”), the volume of sugar exports from Moldova to Romania exceeded in 1997 the produced volume on the territory of Moldova 1.8 times. Generally speaking, a big part of this sugar is made in the Ukraine, but the certificates of origin of production are faked with the intention of taking advantage from the free trade agreement between Romania and Moldova.

Within the investigation a comparative analysis of Moldovan and Russian sources of information regarding export-import operations was accomplished. The data was compared on a selected number of goods accounting for 47 % of Moldova’s imports and 54 % of its exports. The analysis disclosed essential discrepancies. Thus, the discrepancy reached 55% for imports and 93 % for exports. It is evident, that this degree of deviations cannot be explained by Transnistria’s share in Moldova’s international trade. In terms of this selected group of goods, the budget losses accounted for 35 million lei, resulting from nonpayment of VAT; losses caused by nonpayment of excises, only for wines, accounted for 48 million lei. It is important to notice that a series of goods registered in Moldova as exported (cigarettes, champagne) were not registered in Russia, which allowed the exporters to avoid payment of excises.

According to Moldovan sources, the price but of exported “vodka” practically coincides with the price of the imported “vodka”. Russian sources show a tripled price. The import of Moldovan wine in Russia, according to the Russian source of data, is almost twice bigger than that recorded in Moldovan source, the price “increasing” by 30%.

The absence of temporary customs between Transnistria and the other part of Moldova, and existence of two fiscal systems on this territory, generate considerable losses for the Moldovan budget. The absence of VAT levying on the territory of Transnistria implies the fact that many imported goods pass the customs at Transnistria, then transit to the right bank of the river Nistru then being shown as produced on the territory of Moldova. Thus, these goods are avoiding payment of VAT and are engendering an unfair competition to local goods.

Tobacco complex. As an approach of measuring the scale of the black market, can be used the analysis of discrepancy between production and distribution of tobacco products. This method was proposed by the Norwegian Institute of Social Applied Sciences and was used by the Central Statistical Bureau of Latvia. Within our investigation an attempt has been made to estimate the minimal volume of shaded transactions in the tobacco industry.

According to the official statistics of Moldova, 9.6 billion cigarettes were produced in 1996. From them there were exported \$ 49.7 billion of tobacco products (\$ 20.89 million to NIS, or 2 billion cigarettes, and to other countries - \$ 28.85 million, or 5.8 billion cigarettes). There were registered as imported \$ 0.42 million (0.04 billion cigarettes). Statistical data in a long run show that the consumption of cigarettes in the Republic Moldova reaches 5 billion cigarettes. The balance is the following:

9.6 billion pieces + 0.04 billion pieces < 5 billion pieces + 7.8 billion pieces.

9.64 billion pieces < 12.8 billion pieces by 3.16 billion pieces.

These more than 3 billion cigarettes may mean either unrecorded import, or undeclared production. In both cases this means that the budget of Moldova incurred about 110 million lei in losses. This is a minimal estimation, because, according to some sources, the import of cigarettes amounts to about 2 billion pieces. In this case the discrepancy could constitute 5 billion of cigarettes, and income, consequently, bigger.

From the other side, according to the official statistics of Moldova, the retail sale of cigarettes in 1996 amounted to 17.3 million lei (about 350 million cigarettes). This means that the recorded sale of cigarettes equals to only 7% of the total amount.

On October 15, 1998 a common agreement for fighting smuggling between the custom service of Moldova and Cernauti region (the Ukraine) was signed. Even if this is a positive moment, still about 30-40% of the state border are not under control. In the Republic of Moldova practically two custom territories exist. An adjusting of the existing institutional system to the current situation in the country is needed. The territory of the right bank of r. Nistru should become a distinct custom territory for the flows of goods (but allowing free movement of population).

A solution of the problem of illicit export-import demands a set of measures adjusted to the real situation:

- immediate dislocation of a temporary customs service between Transnistria and the other part of Moldova;
- customs' reform;
- attracting of foreign specialists, paid out of technical assistance, funds, assigned to decision making positions in customs structure.

Power-energy complex. The lack of a competitive environment and existing system of granting compensations to producers, implies the growth of shadow transactions in this complex, as well as over-pricing. The growth of electricity losses share can be considered as a signal of expansion of embezzlement. Losses of electricity in the Republic of Moldova are comparable and sometimes exceed their production in the territory of the right bank of r. Nistru. The share of losses and embezzlements grew up from 10 % of the total consumption in 1990 to 30 % in 1997, amounting to about 300 thousand lei per day, based on some estimates, or 100 million lei annually. According to international standards, average losses in the power distribution network accounts for 9-12 % of the total consumption. In the Republic of Moldova this share cannot be explained just by the obsolete equipment; it is caused also by spread of embezzlements. These losses can be observed in geographical differentiation. Thus, in the first semester of 1998 the share of losses in the electric power network amounted to 14.6% in Chisinau, 43.8% in the center of Moldova, 41% in the North, 40.7 – North-West and 46.8% in the South of Moldova.

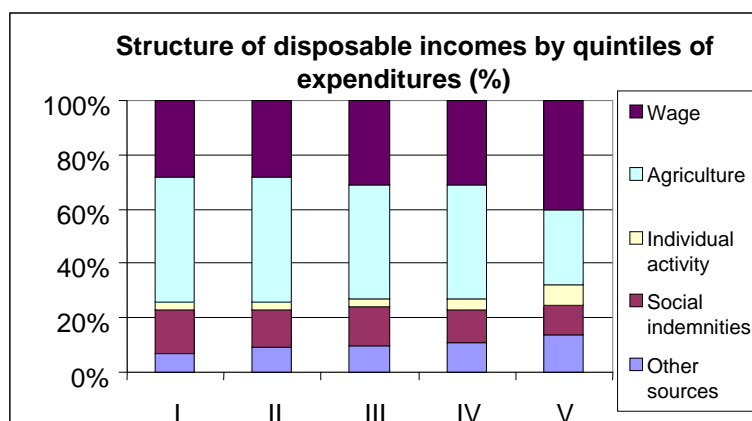
If the growth in prices for energy during the Great Economic Depression implied a restructuring of the economy towards production of less energy-intensive goods, and, as a result, a two-fold decrease of consumption of energy per unit of GDP, then in the Republic of Moldova the consumption of energy per unit of GDP increased during the last three years by 21%. The debts of the energy sector grew quickly.

Solution of the energy complex problems implies such measures as:

- restructuring of the complex, including enhancing debts collection, disconnection of consumers, who are not paying for energy usage;
- privatization of the enterprises of the energy complex;
- elaboration and approval of a set of clear, exact, transparent and predictable rules regarding the operations of the enterprises of the energy complex considered natural monopolist;
- after privatization it is necessary that the state assumes debts of the sector and reschedules them in such a way, so that they do not impact on the future pricing in the complex;
- shifting from the system of subsidizing energy producers to the system of direct subsidizing for the vulnerable parts of population.

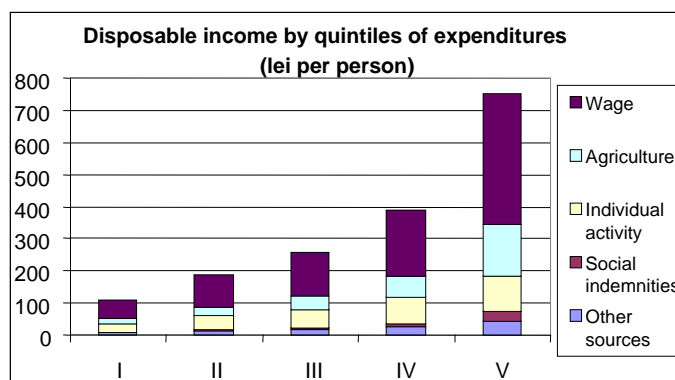
A broad material for the analysis is contained in Households' Budget Survey made by the Department of Statistical and Sociological Analysis under the technical and financial assistance of the World Bank. According to the data of the opinion poll, in 1997 the decile ratio (but, better say, quintile ratio) of the incomes of 20% of the richest population is

more than 7 times bigger than the incomes of the poorest 20% of the population (7.34 – by incomes, and 6.24 by disposable income). The structure of these incomes shows that as the income grows, the share of incomes from agriculture diminishes, and this sounds logical. If we apply absolute values, and take these data in lei per person, the picture changes essentially. Thus, incomes from agriculture in the fifths quintile (the richest one) exceed the same indicator



for the first quintile (the poorest one) by more than 4.4 times. That is to say, in most part, incomes of the richest population come especially from the work in agriculture. This is doubtful.

More suspicious is the situation in the social indemnities. As soon as income grows, the share of social indemnities diminishes, and this makes sense. At the same time, the sum of the social indemnities per person is almost 5 times bigger in families with the maximum level of incomes. The most social benefits enjoys the richest population which is an unfair social system. The situation is especially difficult in the case of failure of the fiscal policy in the Republic of Moldova.



According to the methodology of the Households Budget Survey, the respondents must complete the files regarding incomes and expenditures of the household in order to balance the incomes and expenditures of the household. And the initial discrepancy between incomes and expenditures shall be explained by gifts and loans.

All respondents of the survey were grouped in quintiles (from I till V). There were selected all households which receive incomes from the agricultural sector and they were divided in the public and private sector, and the same was done with the non-agricultural sector.

In the picture we can clearly see the growth of expenditures for every good simultaneously with the increase of at incomes. The comparison of expenditures per capita shows that the expenditures for the primary goods (foods, clothes, shoes) are almost the same. Nevertheless, the expenditures for the consumption of meat and vegetables in the private agricultural sector are, on average, 64-65% greater than in the public one.

The expenditures for clothes and shoes in the non-agricultural private sector are on average 38% smaller than in the public sector. The situation changes radically, when on compared the living standards (more specific, the presence of new video- audio consumer goods, refrigerators). Thus, there are on average 19% more color TV, 25% more video-recorders and players, 15% more refrigerators per capita in the private non agricultural sector than in the public one. An exception makes the availability of private cars and minibuses in households due to the widespread practice to register these goods under the possession of retired parents, who belong to inferior quintiles according to their incomes.

Even if it is supposed that the employees of the public sector, unlike those from the private one, do not have any undeclared incomes, these from the private sector, having formally the same incomes, posses approximately 20% more durable goods, or in reality belong to superior quintiles by their incomes. If we suppose that those from the private sector do have undeclared income, the discrepancy will be even larger. Possibly, this is one of the reasons of unfairness in the social sector.

Expenditures for basic goods of households from public and private sectors (lei/month)

Bread

	I	II	III	IV	V	Total
Public sector in agriculture	7.05	10.26	18.21	20	27.95	14.74
Private sector in agriculture	11.56	17.06	18.41	23.06	30.97	20.8
Public non-agricultural sector	14.05	17.06	17.85	20	24	21.4
Private non-agricultural sector	11.19	17.31	19.27	20.12	25.62	22.78

Milk

	I	II	III	IV	V	Total
Public sector in agriculture	3.99	13.26	21.12	28.97	32.23	20.77
Private sector in agriculture	4.77	12.77	20.62	22.42	36.49	20.31
Public non-agricultural sector	1.33	5.31	7.17	11.35	17.73	13.34
Private non-agricultural sector	1.92	5.48	6.65	10.32	17.73	13.64

Meat

	I	II	III	IV	V	Total
Public sector in agriculture	5.28	6.97	11.21	17.48	31.97	14.23
Private sector in agriculture	5.6	11.95	16.28	29.42	47.12	23.02
Public non-agricultural sector	1.63	6.29	8.3	15.17	33.06	22.65
Private non-agricultural sector	1	5.97	8.07	16.91	29.68	22.11

Vegetables

	I	II	III	IV	V	Total
Public sector in agriculture	10.29	23.04	34.31	37.04	47.41	31.23
Private sector in agriculture	14.01	20.16	25.57	27.78	34.92	25.12
Public non-agricultural sector	7.87	12.01	15.52	18.29	26.83	21.61
Private non-agricultural sector	5.22	12.19	13.5	16.3	25.73	20.89

Fruits

	I	II	III	IV	V	Total
Public sector in agriculture	1.26	2.03	4.89	7.77	12.68	5.69
Private sector in agriculture	3.44	7.99	10	15.63	11.34	9.43
Public non-agricultural sector	0.93	1.99	2.77	5.97	8.33	6.27
Private non-agricultural sector	0.1	1.17	2.36	3.05	7.14	5.13

Clothes and shoes

	I	II	III	IV	V	Total
Public sector in agriculture	0.04	3.55	6	14.04	47.64	12.34
Private sector in agriculture	0.53	3.46	6.29	11.2	29.43	10.78
Public non-agricultural sector	2.15	3.25	3.54	9.47	40.1	24.47
Private non-agricultural sector	0	2.03	5.44	9.96	53.32	33.84

Durable goods in private and public sectors (pieces per capita)

Cars, vans

	I	II	III	IV	V	Total
Public sector in agriculture	0.1	0.0588	0.1667	0	0.2308	0.1026
Private sector in agriculture	0.012	0.0563	0.0902	0.1382	0.1221	0.0872
Public non-agricultural sector	0.1	0.0845	0.1759	0.1973	0.2928	0.2213
Private non-agricultural sector	0	0.1333	0.0444	0.1333	0.2018	0.1551

New color TV sets

	I	II	III	IV	V	Total
Public sector in agriculture	0	0.0588	0.1667	0.15	0.0769	0.0769
Private sector in agriculture	0.0482	0.0875	0.0574	0.122	0.1679	0.1002
Public non-agricultural sector	0.05	0.1268	0.0741	0.1769	0.2025	0.1601
Private non-agricultural sector	0.0625	0.2222	0.2	0.2111	0.1973	0.1981

New video recorders, players

	I	II	III	IV	V	Total
Public sector in agriculture	0	0.0588	0	0.05	0.0769	0.0385
Private sector in agriculture	0.012	0	0.0328	0.0569	0.0458	0.0291
Public non-agricultural sector	0.025	0.0423	0.093	0.884	0.0685	0.05872
Private non-agricultural sector	0.0625	0.111	0.0222	0.0333	0.0942	0.074

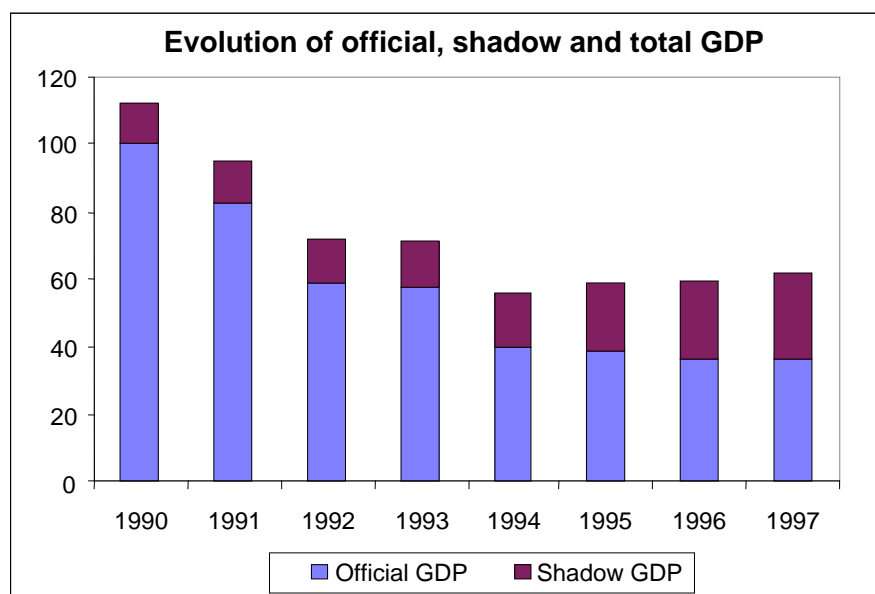
New TV sets

	I	II	III	IV	V	Total
Public sector in agriculture	0	0.2353	0.2222	0.1	0.0769	0.141
Private sector in agriculture	0.1084	0.15	0.1393	0.1626	0.1908	0.1535
Public non-agricultural sector	0.125	0.169	0.1019	0.2041	0.271	0.2111
Private non-agricultural sector	0.0625	0.3333	0.3111	0.2667	0.2242	0.2482

New refrigerators

	I	II	III	IV	V	Total
Public sector in agriculture	0	0.0588	0.1111	0.1	0.1538	0.0897
Private sector in agriculture	0.0241	0.0063	0.0328	0.0325	0.0687	0.0323
Public non-agricultural sector	0.1	0.0282	0.0741	0.0748	0.0779	0.0728
Private non-agricultural sector	0	0.0444	0.0889	0.1	0.0817	0.0788

The evaluation of the proportion of the shadow economy in the Republic of Moldova on the basis of a set of methods, showed that the share of shadow economy compared to that of the formal economy reached up to 60%. Starting with 1994-1995 the national economy, including both, official and shadow parts, started to grow. The real economic decline in the Republic of Moldova is relatively less deep, and it reaches not 63%, as the official statistic says, but a bit more than 40%.



According to the information of the Department of Fighting Economic and Financial Crimes, during the first nine months of 1998 only it registered 2406 economic crimes (174 more than during the same period of last year), the volume of losses is evaluated up to 66 million lei, 27 million lei being reimbursed. There were committed 1321 property violations (4.5% more in comparison with the same period of 1997), 554 financial crimes, 65 cases of tax evasion. The major share of economic crimes took place in the agricultural sector (435 cases) and in the railway system (154 cases).

On October 23, 1998 the Presidents of Moldova, Romania and the Ukraine – Petru Lucinschi, Emil Constantinescu and Leonid Kucima signed a Memorandum for Crime Prevention, which foresees taking common measures for fighting terrorism and international crime, illegal operations with weapons, explosives, toxic and radioactive substances, illegal drug traffic, faking money and certificates, economic crimes. Still, this is not sufficient. The shadow economy is a complex problem, which needs a detailed study by experts in different fields. Elaboration of a methodology of a state strategy regarding the shadow economy, using the international experience in this field, and a real, not declarative, intention to fight the economic crime are needed.