Effects of informality in Albania’s small enterprises

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Abstract. Employment is a major concern for Albania, while it transitioned from a centralized economy to a market economy. Labor conditions are an important factor of showcasing the economic wellbeing of the country as a whole. The main concern regarding the labor market is tied to the effects informal employment brings in the economy. Informality in Albania may be as high as 50 percent of its official Gross Domestic Product, or even higher. When manifested in the economic sphere, informality plays a critical role for creation of jobs and reduction of poverty. Seizing informal economy and especially in the labor market is no easy task. But when achieved it provides visibility to those employed by the sectors, and the contribution they bring to the economy. Informality in the labor market mirrors informality in economy. The paper will focus on effects of employment in the Albanian informal economy, and provide results on a survey held in one of its capital main streets, targeting small businesses.

Keywords: informality, non-official economy, economic crises, labor market

JEL Codes: E26, J40

1. Introduction

The economic crisis that hit the world in the beginning of the 21st century once again showed the importance of making changes and shifts to befit the reality. Informal economy is no longer considered just something that happens out there, but something that impacts the lives of those who live in it. When institutions are slow, entrepreneurs intend to move swifter in that area in order to help them cope with that reality.

2. Materials and methodology

Some reference points that have been used for the paper were various theoretical studies of renowned researchers of the field, including Schneider and Este, Feige, etc., as well as the experience of Albania. This study uses official data gathered through various means by prominent Albanian institutions, those made available publicly. Method used for gathering information is direct interview, to gather as much possible information. This survey was conducted in one of the busiest streets of Albania’s capital, Tirana. A standardized questionnaire was compiled, using closed, fixed responses, given that respondents are not used to interviews. The type of used interview is a structured one, in such a way that all respondents were asked the same questions with the same wording, and in the same sequence. Business activities ranged from newspaper boy; to cashiers working for different stores, such as grocery, carpet, clothes, woodwork, pet;

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beauty salons, restaurant, fast food, ice-cream store. It focused on those economical units considered as small businesses. Following is a synopsis of findings.

3. Research results

The wind of change that swept throughout Eastern Europe in 1990, did impact Albania as well. The country transitioned from a centralized economy to an open market. The transition brought about two major changes: economic efficiency or in other terms material wellbeing, and a political democracy, including protection and adherence to human rights. However, major social problems sprung, including poverty, unemployment. Initially it was very difficult, given that it was a phenomenon which was previously controlled, and now it faced the necessity to be resolved. Unemployment as a macro-economic problem highly impacts the lowering of one’s standard of living, without mentioning psycho-social problems of affected individuals. Labor market underwent a huge reform. Prior to the 90s the state was the only job provider, and regulator of economy.

After the 90s, the state ceased being a direct and sole regulator. Unemployment increased due to several factors:

- Disintegration of enterprises and agricultural cooperatives, though providing an opportunity to farmers to possess land, farming units were small, ranging between 0.52 to 1.13 hectares, and they also lacked tools. Recent data indicate that rural population in Albania carries its activities through 368,997 agricultural economic units, known also as farms.
- Privatization of state owned enterprises; many became unemployed or were under social welfare.
- Political stability of the time did not attract many direct foreign investments.

The demographic map of Albania changed during the transition years mainly due to inner migration. Inhabitants coming from every corner of the country settled in around main cities, and created approximately 800 informal zones, establishing some 150,000 illegal settlements, whose construction costs range $3 to $4 billion. A very slow legalization process is underway, but as long as these are not legalized, this capital cannot be put to good use, such as for example to receive loans.

The experience of countries that have undergone such radical transitions shows that formalization of an economy is positively linked with the level of reforms in the economic sphere, and well established democratic and regulatory institutions. When institutions are weak, it allows for loopholes, and informality takes hold of certain aspects. Therefore, experience in the case of Albania shows that informal economy and corruption go hand-in-hand, and that there is as strong positive correlation between them. During the transition an important factor to be emphasized is the role employment plays in the market development. The economic wellbeing of a country is illustrated by the labor conditions. Therefore, one of the main concerns regarding the labor market is linked to the effects that informal employment brings in the economy.

Different classifications have been developed to explain trends of informal economy, and the authors of the paper have considered that the informal economy classification developed by Schneider and Enste in 2003, is useful for the study:
Informal economy serves also as an important obstacle to increasing the budgetary revenues. Several researches have been conducted, and this by very prestigious international organizations and institutions. In the last seven years, 2007-2013, the CIA Fact book reports that informal economy in Albania is calculated to be around 50 percent of the official GDP. Due to the high level of informality and the fact that the country develops its economic ties mainly with Greece and Italy, whose informal sector reaches 20 percent, this also influences the high level of informality in Albania. Various materials provide different figures, within the range of 40 percent to 60 percent of GDP. Noteworthy is the fact that no comprehensive study on the size of informal economy in Albania has been conducted.

Research about informality in the labor market in Albania provides an average figure of 25 percent, which is quite considerable for the labor market dimension. One of the characteristics of the informal labor market is lack of formal job contracts.

The latest Labor Force Survey published by the Albanian Institute of Statistics showed that during the second trimester of 2013, labor force in Albania reached 1,106,480 persons, and registered unemployment rate is 12.8 %. Out of these 282,034 persons work in the non-agricultural sector and the figure has increased by 0.3%. A total of 518,796 persons work in Albania’s private agriculture sector, while the number of registered unemployed seeking a job is 141,850 persons, where 5.5% are on welfare.

The authors of this paper conducted a survey in one of the busiest streets of Tirana, known as Durres Street. It is one of the main arteries of the capital, and links the city center with the main highway, leading to the second largest city in Albania. Business owners and employees were interviewed. Based on data gathered thus far, the sample was made of 41 businesses, referred to as economic units. Table 1 shows number of employees reported by employers.
Table 1. The number of employees reported by employers.

<table>
<thead>
<tr>
<th>Number of employees</th>
<th>Employer</th>
<th>Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 10</td>
<td>37</td>
<td>90%</td>
</tr>
<tr>
<td>Between 10 to 19</td>
<td>4</td>
<td>10%</td>
</tr>
<tr>
<td>Total</td>
<td>41</td>
<td>100%</td>
</tr>
</tbody>
</table>

Out of 41 economic units 90 percent of them have employed between 1 to 10 employees, and 4 of them between 10 to 19 employees, or 10 percent. Graphically is illustrated as per the following.

![Employee Distribution](image)

Fig. 2: Employees reported by Employers

The same set of questions was asked to employees, and the following table shows the outcome.

The following table shows number of employees reported by employers.

Table 2. The number of employees reported by employers

<table>
<thead>
<tr>
<th>Number of employees</th>
<th>Employer</th>
<th>Weight</th>
</tr>
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<tbody>
<tr>
<td>Less than 10</td>
<td>30</td>
<td>73%</td>
</tr>
<tr>
<td>Between 10 to 19</td>
<td>11</td>
<td>27%</td>
</tr>
<tr>
<td>Total</td>
<td>41</td>
<td>100%</td>
</tr>
</tbody>
</table>

30 employees or 73 percent reported that in the economical unit that has hired them work between 1 to 10 employees, and 11 employees or 27 percent said that in their economical unit work between 10 to 19 employees, displayed graphically as following.
If we were to graphically present the number of employees reported by employers and employees, the following graph would best describe it.

![Employees](image)

**Fig 3. Employees reported by Employees**

Looking at the graph we noted that there was a mismatch between what each claimed. Only in five of the interviewed units, figures corresponded. Therefore, it shows that there are unregistered employees working for the economical units, thus those working in informality.

Following is a graph of gender disaggregation of what employers reported, where out of 203 employees, 150 were female and 53 male.
While figures reported by fellow-employees showed that out of 282 employees, 140 were female or 53 percent; and 122 were male, or 47 percent. Graph follows.

When each worker was asked if the economic unit was registered with the tax authorities, 5 out of 41 units reported that it was not. And when asked on reasons why, the reason they provided was that there was a cost to become formal.

There are different reasons why businesses operate informally. The aforementioned data showed that not all workers were formally registered with tax authorities, some of those not registered were family members of business owners, and in the case of the beauty salon one was an intern.

When employers were asked if the economic unit has been registered with the tax authorities, 70 percent of respondents said that the business was registered, 10 percent that they were in registration process, and 20 percent that they had not been registered. While when employees were asked the same questions, 45 percent said that the economic unit they work for is registered, 25 percent that it is in registration process, 5 percent that it is not, 10 percent that they do not know whether it is registered or not, and that 15 percent did not want to respond. Graph follows.
To the question of what is the legal status of the company, employers have reported that their company is a registered limited liability company. While according to employees, 67 percent said that their company is a limited liability company, while 11 percent that the company they work for is registered as an individual ownership and 22 percent that it is a joint stock company.

Fig. 7 Economic Unit registration with tax authorities

Fig. 8 Legal status of the enterprise

To the question of where do you normally undertake your job, employers said that on 55 percent of cases they held their activity in office, workshop, kiosk, independent from their house, while 45 percent said that the place where work is undertaken is within or close to their home. While employees said that 55 percent of cases work done is close to home, and 45 percent that it is undertaken in office, workshop, kiosk, independent from home. Graph follows.
When employees were asked if they had a job contract, 75 percent of them said that they were not hired based on a written contract, and only 25 percent of them said they work based on a written contract or agreement. Graph follows.

To the question if the employer pays contribution to the pension funds, employees responded that 30 percent of them are paid, 45 percent said that their employer does not pay their contribution to the pension fund, and 25 percent did not know if they were.
It is understandable that one of the reasons for non-adherence to the law is a reason for acting in the informal economy. Considering what respondents said during the interviews, it once again shows that there is a general mindset according to which the law is not implemented, due to the chaotic situation, and this type of behavior serves as a stimulus to increasing informality. Another important fact is that in order to become formal, there are economic costs tied to that. Acting in the informal economy causes macro-economic, micro-economic, and social problems. Hence, uncollected taxes reduce revenues collected by the state. And in turn would make government increase taxes. Also, informality lowers the quality of services and goods provided, especially when this is considerable. The current level of informal economy in Albania is concerning for the economic stability of the country.

When operating in the informal context those involved think only of just short-term or quick benefits, not considering costs related to informality. Penalties for operating in informal economy might include not profiting from services government provides to formal activities. And one of them is access to the legal system, involving property rights and trade law. Also, when businesses operate in the informal economy they might be unable to access legal support or even lack documents, which implies operating in an environment of uncertainty. In turn, capital costs increase, lowering the rate of investments.

4. Conclusions

The problem of informal economy is utmost important for Albania. Informality is seen practically as a natural reaction, and most likely spontaneous to the inability of formal economy to fulfill the needs of a part of its members. In developing countries, and those in transition, informal economy provides an important contribution for economic growth, despite the fact it is accompanied by a series of problems, which deserve careful attention by policymakers and enforcers.

Informal business activities in Albania boomed after the country transitioned to a free market economy. Reducing the size of informal economy is pivotal, and the working group proposes the following:

A flourishing informal economy makes official statistics over unemployment, workforce, revenues, consumers, not credible. When this happens, drafted programs and policies based on incomplete data, become unsuitable for implementation. Informal economy in Albania was initially incentivized by...
unemployment, given informal economy makes it manageable. People had to have jobs than no job at all, and given informal economy is faster in dealing with changes and making the necessary shift to befit the reality, it was seen as the most suitable in the early beginnings.

As years progressed development of informal economy in Albania factored in other ingredients, such as widespread corruption, arbitrary and inconsistent legal and sublegal framework, bureaucracy both at the national and local government level, lack of information on how to become formal, existence of a family-economy, which makes up for ninety percent of small businesses in Albania, higher level of taxes.

A gradual control and formalization of economy would entail understanding the role it plays in the country, its size and scale in different sectors, developing a legal environment that leaves no room for informal economy, tax collection, state bureaucracy and social insurances, reducing the number of minors working in the informal sector.

Informal economy in Albania takes various forms and shapes:

- Temporary businesses viewed mostly as micro or family businesses
- Families making a living out of rural activities, or known as survival business activities
- Small and medium enterprises operating at various informal settings, who would pay cash their employees, to avoid taxes, etc.
- Even some foreign capital companies have reportedly operated under this disguise
- Illegal and criminal activities, to include smuggling, money-laundry, operating under a legal business cover

One of the most known forms of informal economy is evasion of fiscal obligation, and non-compliance with fiscal legislation. Predominant form of businesses under this category includes those that have not registered with tax authorities or that avoid fiscal obligations. Reportedly 15 percent of taxes went unpaid, but reality shows that it has doubled.

A decline in number of the active labor force in the official economy might serve as an indicator that numbers in informal economy have increased. When it comes to this type of calculation a blind-spot remains that fact that an individual could be employed in the formal, as well as informal sector.

If for estimating the size of informal economy, we were to use the transaction method, it states that there is a constant relation between transactions and total monetary unregistered income. However in order to receive reliable estimates, accurate figures are needed. Albania lacks these data, and there is no base year during the transaction period where there was no informal economy. Therefore variables which need to be calculated are influenced by the informal economy. We would be unable to accurately calculate its size, given the country lack these data.

Paper authors’ survey showed noteworthy results though it focused in only of the roads of the capital of Albania, Tirana. An increase in the number of family members working for small businesses was noted, including male and female ratio difference. Also, unpaid work was reported in the case of interns.

Informality affects the society as a whole. Education and health sectors are also affected, such as doctors and nurses working both a state hospitals and private clinics. Trade unions in Albania are substantially weak, and thus they do not exercise the necessary pressure to protect their members’ rights. Informality hampers honest competition.
Combating informality remains critical in Albania. Establishing a profession and dedicated administration, putting in place monitoring and controlling mechanisms to trace fiscal evaders, treating equally all businesses, regardless of affiliations, will improve the business climate.

5. References

[3] Data from the Albanian General Tax Directorate