The informal sector in transition: Tax evasion in an institutional vacuum

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Chapter 3

Politico - Economic Institutions and the Informal Sector in Albania

"The historical laboratory of the transition economies has revealed that liberalization, stabilization, and privatization may be necessary but are by no means sufficient conditions for creating ‘market economies’”


3.1. Introduction

New free-market economies are developing throughout the former socialist countries. Though these countries generally differ in essential features like culture, political background and economic potential, they are often characterized by a history of large-scale government and massive bureaucratic intervention in the economy. Besides building up new and democratic institutions, countries in transition face major problems of overcoming the lingering influence of the former institutions.

Each country addresses these problems in distinct ways. The relevant politico-economic institutions - democratic decision-making bodies (implying voter influence on policies); central banking policies (independent or not); the organization of privatization of industries; the regulation of private firms; and the role and influence of private banks - all have an impact on this transition period.

When these institutions prove unfavorable for the development of free market economies, one reaction in many countries is the spontaneous development of informal economies. ‘Institutional economics and underground economics are highly complementary. The former examines the rules of the game, the latter the strategic responses of individuals and organizations to those rules’ (Feige, 1997:25).
Chapter 3

The main country studied in this thesis is Albania, a country in transition. This chapter provides background information about this Balkan nation and is split in two main parts. The first describes the politico-economic characteristics of Albania. The second part discusses one of the few existing studies on the informal sector in Albania. This study is a modest and early field research of street vendors in Tirana, conducted by the Albanian Center for Economic Research (ACER) in 1996.

The organization of this chapter is as follows. The following section gives a general description of the politico-economic situation in Albania during the last decade. Special attention is given to the phenomenon of the money market (pyramid schemes), and the development of the private sector and its influence in the labor market. Section 3.3 discusses briefly the occurrence of the informal sector in Albania. In addition, it provides some information about statistics in Albania. Section 3.4 describes the survey of street vendors in Tirana in 1996, accompanied by its main results. Section 3.5 analyzes the significance of the informal sector for the Albanian economy as a whole. Section 3.6 concludes.

3.2. Albania – A politico-economic overview

Albania is a small European country, located in the western part of the Balkan Peninsula, with -as any other country- its own specific history. Several detours, dead ends, shortcuts, severe struggles, unexpected outcomes and, especially, survival characterize its history. Noteworthy for the politico-economic analysis is that Albania has hardly ever had a democratic political system. This can be explained by the existence of antagonistic political and cultural entities. As a consequence of this internal division, this country has traditionally been used to satisfy the voracity of international powers.

3.2.1. The politics

For about four decades, Albania was a completely isolated country, due to the highly repressive communist regime of Enver Hoxha. The political regime was a dictatorial one, while the economic system was completely socialized. No other country in Eastern Europe had a socialisation of property as complete as Albania did.\(^\text{52}\) Consequently, in the early 1990s,

\(^\text{52}\) For a survey of this period, see Schnytzer (1982).
Albania was the last of the Central and Eastern European countries to allow political pluralism, establish democratic institutions and introduce market mechanisms.

It is quite difficult to pinpoint the exact year in which real political pluralism and economic reforms started. In fact, democratic reforms (including the introduction of political pluralism) began in 1990, as a result of the massive demand for changes. Often, however, the 1992 elections are considered to be the real start of the changes, because this is when the communists had to transfer their power to the opposition. As a consequence of the grave political and economic recession that Albania suffered in the last years of communist rule, the newly established Democratic Party of Albania (DPA) won the democratic elections in March 1992 by a landslide. Following the democratic elections, the Albanian people had great hopes for the future of democracy in their nation, counting on the flexibility and diplomacy of the new political elite.

While the Democratic Party was in office (1992-1997), dozens of new parties were established, an open foreign policy was followed and democratic freedom was provided to everybody, at least at the beginning of DPA's governance. The largest opposition party in Albania – until 1997 was the Socialist Party of Albania (SPA), the majority of whose members came from the former communist party.

The DPA grew on the basis of traditional loyalties, with the socialists soon facing disintegration in northern areas, while in communist strongholds in the south the DPA only developed slowly (Vickers and Pettifer, 1997). This provided a fertile starting point for the enforcement of 'clan policy' by this democratically chosen government. Similar to the communist party, government policies of the DPA during the democratic period favored clans with partisan spillovers to the south and north, respectively. As a result, Albanian society was polarized.

The Democratic Party of Albania won again the general elections of May 1996. However, intimidation and fraud in favor of the DPA were generally thought to have characterized these elections (Rama, 1997). After some dramatic and violent events (close to a

53 In fact, there were democratic elections in 1991, as well. These were won by the communist party.
54 For more details, see Gërshani and Schram (2000).
55 The SPA won the elections in 1997.
56 'Clan' is a group of people related through kinship, culture, religion, race and language, as well as through political interests.
57 For a broader qualitative and quantitative evidence of clan-based policies in Albania, see Gërshani and Schram (2000).
civil war) that took place after the collapse of the pyramid schemes, and under international pressure, new elections were held in 1997. The Socialist Party of Albania won by a landslide. The current government is a coalition of mainly left-oriented parties, where the SPA dominates.

3.2.2. The economy
Aside from political repression, the Albanian people also suffered from a deep economic crisis under the communist regime. The growth rate of the economy, in the period 1970–1990, was sharply decreasing and eventually became negative. There were no foreign investments after 1980, which was reflected in a very slow economic growth after the split up with China (Gërxhani, 1998). Real income per capita declined, an increasing number of goods and services were lacking in the market and, as a consequence, the gap with the West grew. At the end of the communist regime, in 1991, there was neither a plan nor a market, but just a state of chaos, which was further aggravated by the fierce political conflicts, strikes and absurd physical destruction such as burglaries and the burning of social property (Gërxhani, 1998).

This was definitely a time for starting economic reforms. The new democratic government started the implementation of a profound market-oriented economic program, including macroeconomic stabilization and price liberalization.\(^{58}\) In light of the high expectations of the Albanian people and the very poor state the country’s economy was in, this government applied a ‘shock therapy’. However, a ‘big-bang’ or ‘shock therapy’ strategy may undermine popular support and may unnecessarily lead to reform reversal (Dewatripont and Roland, 1995). Furthermore, fast reforms often stress speed at the cost of institutional balance (Nuti, 1996). This is what happened in Albania. Former institutions vanished before fundamental new institutions had time to develop. For example, Sadiraj (1999) argues that proper financial institutions were missing.

One of the main strategies considered by the government in order to reach its goal of stabilization and liberalization was privatization and the development of the private sector. This was considered to be the most important institutional change in transition to a market

\(^{58}\) The development of the economy is discussed in more detail, below.
However, the privatization process was also used by the democratic government to increase its popularity through various economic and political favors to certain individuals, strata and social groups (Shala, 1997 and the Ministry of Public Economics and Privatization, 1997). The liberalization process, on the other hand, was shown to be the most complicated and delicate procedure regarding all economic and social aspects. This reform, despite the social consequences, aimed at the transformation of the planned economy into a free market economy, where the free domestic prices would regulate supply and demand, and would also try to be as close as possible to the world market prices. Consequently, the Albanian system of foreign trade was legally free of restrictions, followed by some protectionist measures to help domestic production later on.

Table 3.1 presents the main macro-economic indicators of the 1990s. GDP fell by 10% in 1990, 28% in 1991 and 7.2% in 1992, followed by an increase until 1996. In the early 1990s, previous export-import arrangements could no longer be sustained, state enterprises went bankrupt and closed down, agricultural collectives collapsed, and investment activities practically ceased.

Table 3.1: Some macroeconomic indicators for the period 1990-1999

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<tbody>
<tr>
<td>Real GDP growth (%)</td>
<td>-10.0</td>
<td>-28.0</td>
<td>-7.2</td>
<td>9.6</td>
<td>8.3</td>
<td>13.3</td>
<td>9.1</td>
<td>-7.0</td>
<td>8.0</td>
<td>8.0</td>
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<tr>
<td>Annual average inflation (%)</td>
<td>0</td>
<td>35.5</td>
<td>226</td>
<td>85.0</td>
<td>22.5</td>
<td>7.8</td>
<td>12.7</td>
<td>32.1</td>
<td>20.9</td>
<td>0.4</td>
</tr>
<tr>
<td>Av. Exchange rate (Lek/USD)</td>
<td>8.9</td>
<td>24.2</td>
<td>75.0</td>
<td>102.1</td>
<td>94.7</td>
<td>92.8</td>
<td>104.5</td>
<td>148.9</td>
<td>150.6</td>
<td>137.5</td>
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<tr>
<td>Trade balance (Mil. USD)</td>
<td>-150</td>
<td>-308</td>
<td>-471</td>
<td>-490</td>
<td>-460</td>
<td>-474</td>
<td>-692</td>
<td>-519</td>
<td>-621</td>
<td>-205.5</td>
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<tr>
<td>Av. Unemployment rate (%)</td>
<td>--</td>
<td>30.0</td>
<td>--</td>
<td>22.0</td>
<td>18.0</td>
<td>13.0</td>
<td>12.4</td>
<td>14.9</td>
<td>17.8</td>
<td>18.3</td>
</tr>
<tr>
<td>Budget deficit (% GDP)</td>
<td>15.3</td>
<td>20.7</td>
<td>15.8</td>
<td>13.7</td>
<td>7.7</td>
<td>8.6</td>
<td>12.3</td>
<td>12.0</td>
<td>8.6</td>
<td>7.4</td>
</tr>
<tr>
<td>Minimum official wage (in Lek)</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>1.200</td>
<td>2.400</td>
<td>3.300</td>
<td>4.400</td>
<td>4.400</td>
<td>5.800</td>
<td>5.800</td>
</tr>
<tr>
<td>FDI inflows (Mil. USD)**</td>
<td>--</td>
<td>--</td>
<td>32.0</td>
<td>45.0</td>
<td>65.0</td>
<td>89.0</td>
<td>97.0</td>
<td>42.0</td>
<td>45.0</td>
<td>43.0</td>
</tr>
</tbody>
</table>

(* ) indicates the average monthly wage in state sector
(**) FDI - Foreign Direct Investment

99 "We consider it (the privatization process) as the final split of Albania from the former communist planned economy and establishment of a 'popular capitalist' system" (Berisha, as quoted in "Rilindja Demokratike" newspaper, 10-1-1995).
Problems of high unemployment, poverty and social insecurity, caused by economic contraction, were extremely severe. They were initially exacerbated by government policies of trade and price liberalization and later by the anti-inflationary measures imposed on Albania by the International Monetary Fund. In 1992 it was estimated that nearly half of the working population was unemployed, while many of those employed did not receive their full wages or salaries. Per capita GDP had fallen to US$ 258, comparable to the poorest developing countries (ACER, 1996).

Table 3.1 shows how the DPA managed to turn around the economic decline reasonably well after coming to power in 1992. Especially successful were the results with respect to inflation and unemployment. On the other hand, major problems still existed up to 1997, with respect to the trade balance and budget deficit. All in all, table 3.1 appears to show that the economic policy of the DPA government was a success. Nevertheless, this table only shows the aggregate numbers. There are various reasons why reality may have been less positive than these aggregate indicators seem to imply.

- First of all, it was relatively easy to get impressive growth rates, due to the very poor initial state of the economy.
- Second, the official unemployment rate is relatively low due to a very widespread informal labor market (Gërxhani, 1998).
- Third, emigration and international financial assistance had a positive effect on the overall economic indicators in the early years.
- Fourth, it has been argued that the short-term goals typically pursued in transition economies are more easily achieved by redistributive activities than by productive ones (Knaack, 1996). This appears to be true for Albania in the period under consideration (until 1996).
- Vaughan-Whitehead (1999) provides a fifth reason by arguing that the systematic presentation of exaggerated figures by the democratic government was a political manoeuvre.
- Finally, Vaughan-Whitehead (1999) also argues that the impressive figures of table 1 were achieved at the expense of very high social costs.
Altogether, it would appear that the success of the Albanian reform may have been more superficial than generally assumed. According to UNDP (1995), the rate of hidden employment was about 34% in 1994. Albanian people were obliged to find their own ways to survive. They went out on the streets to sell whatever they could, they set up their shops/kiosks, and they built their houses without permission. Consequently, a great variety of illegal or informal money-making activities came into existence or became more widespread. Some were harmful. These included smuggling, production and sale of narcotic plants, prostitution (inside and outside of Albania), informal money-lending and extensive corruption by government officials and the police. Others were more legitimate, including a proliferation of small-scale street vendors in Tirana and other major cities and towns (ACER, 1996).

All in all, whatever the extent of success by the DPA government, the economic results were demolished in 1997, when a collapse of the pyramid schemes led to complete economic and political chaos in Albania. All the main macroeconomic indicators in table 3.1 demonstrate the economic crisis the country fell into in 1997. Since then, under the SPA government, there has been a constant growth of 8%, an abrupt decrease of inflation, an appreciation of currency, a remarkable decrease in the trade imbalance, and a decrease in the budget deficit. However, unemployment has remained high. According to UNDP (2000), this is due to a lack of large investments, shortage of skilled labor, a large informal market, a lack of coordinated state policies on employment, inefficient labor market institutions and a low level of credit. In addition, the standard of living of Albanian families has remained low. As a result, internal migration has increased, mainly from rural to urban areas. Also, the traditional phenomenon of emigration remains.60 A recent development with dramatic consequences is the brain drain. During 1990-1999, approximately 40% of the overall number of professors and research scientists of the universities and science institutions in the country have emigrated (UNDP, 2000).

The political and economic situation became fragile during the Kosovo crisis in 1999. According to UNDP (2000), the number of Kosovo refugees reached 450,000, which represented 15% of Albania’s population. However, this crisis strengthened the ties between

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60 According to UNDP (2000), emigration is a phenomenon that has occurred throughout Albania’s history, originating in the 15th century.
the two peoples and built for the first time, a significant relationship and partnership between Albania and the international community. After recently -September 2000- joining the World Trade Organization (WTO), the main focus of policy in Albania is to gradually become a serious candidate to enter the European Union in the future.

3.2.3. The money market: pyramid schemes\textsuperscript{61}

Originally, private businesses could borrow money from three second level banks in Albania: the Savings Bank, Commercial Bank, and Rural Bank, as well as from the 'Small and Medium Enterprises' (SME) foundation. Due to a lack of experience and incompetence, banks found themselves with more than 30% of their loans not being serviced on time in 1996 (ACER, 1996). These problems, along with diminishing households savings/deposits, put the banks into a difficult situation, hence, they reduced the available credit to businesses. While grants and inexpensive credit were available from German, Italian and American funds, it was not enough to fulfill the borrowing needs of the business community. The only Joint-venture bank -between the National Commercial Bank and Banca di Roma- dealt exclusively with money transfers and payments. In 1996, three new private banks were licensed as branches of their headquarters' banks in other countries. Despite many requests and applications from different firms, no license was given to establish an Albanian owned private bank.

As in other Central and Eastern European countries, the state sector in Albania provided most of the physical capital for the new emerging private businesses. As expected, this physical capital was not sufficient. It was redistributed only to a few people, and furthermore, additional capital was needed to start a business. Capital increase, either for starting up a business or for extending an existing business, remains the largest problem for Albanian entrepreneurs. In some other CEEs, foreign investors have played a catalyst role by providing the essential initial capital, whereas in Albania this phenomenon was highly problematic, because foreign investments did not take place at any significant level. In May 1996, the Tirana stock exchange was opened, but it has not shown any ability to attract capital for business growth. The Tirana stock exchange has focused its activity on trading in Treasury Bills, and the second level banks are its only clients.

\textsuperscript{61} For a detailed analysis of pyramid schemes in Albania, see Sadiraj (1999) and Jarvis (1999).
As a result, most individual savings were not deposited into the banking system to support economic investments and hence to contribute in higher rates of overall growth. They were mainly concentrated in the informal market, which emerged in Albania. Due to the incapable formal financial institutions, the system of investing in pyramid schemes became very popular. It is believed that the money-borrowing firms and foundations absorbed more than US$ 1.2 billion (Jarvis, 1999).

The main reasons why this market emerged in Albania are (briefly):

1. path dependence - Albanians had been isolated for about forty-five years and had no experience with market institutions;
2. high and attractive rates of interest offered by the companies (5 – 10% per month) and foundations (about 50%) involved; their long activity (over 2-3 years); and interactions with money laundering and other suspicious activities;
3. the inefficiency of the banking system (e.g., delays in services and the lack of a modern payment system, which led consumers to make their transaction in cash);
4. the government’s failure to prevent the extension of pyramid schemes (e.g., by better law enforcement) and moreover its implicit support of the schemes; and
5. the ambiguity of legal system, which often left room for several pragmatic interpretations.

3.2.4. Private sector activities and the employment gap

As mentioned previously, one of the main strategies of the newly elected democratic government was privatization and the development of the private sector. New private business development is the primary source of job growth, because it serves as the principal mechanism for reallocating labor and capital from state to private sector (Johnson and Loveman, 1995). Indeed, the private sector emerged as the most dynamic and significant engine to economic growth in Albania.

In the period up to 1996, good results were achieved in the establishment and gradual extension of the private sector in agriculture, trade and services, accompanied by some joint ventures between former state enterprises and foreign enterprises. Privatization of state

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62 In fact, the informal money-lending market was introduced in Albania in 1992 by a Swiss businessman of Albanian ancestry.
Chapter 3

enterprises had also begun. However, according to Johnson and Loveman (1995), Albania (like Bulgaria and Romania) continues to have a very weak private sector primarily because these activities were tightly controlled under the old regimes and because the new economic policies have not clearly encouraged it. As a matter of fact, only a few of the new enterprises in Albania could generate a surplus that could be invested in other private businesses and in enlarging the scope of the private sector as a whole, particularly to include capital-intensive sectors. The majority of new private enterprises were concentrated in trade and services. This is mainly a result of the lack of substantial financial support. Foreign investments in Albania did not have the same strategic and significant role they had in some other Eastern European countries, due to several reasons like the lack of an adequate legal system, especially in attracting foreign investors; bureaucratic procedures and a high level of corruption; the flow of non-serious foreign investors mainly aimed at short-run and very profitable investments, sometimes even suspicious ones; and the unstable political situation in the country and generally in the Balkans. Table 1 shows that the amount of the foreign direct investment (FDI) inflows to Albania is not that big and it has sharply decreased after 1996. This amount is particularly small if compared to the remittances of Albanian emigrants. The latter represent approximately one fifth of the GDP, almost twice as much as foreign exchange revenues from exports and almost four times more than the value of direct investments (UNDP, 2000). Although emigrants’ remittances have been an important source of finance for domestic investment, they are considered more as private transfers than as capital-flows. Meanwhile, the financial support from banks has been almost zero because of the very strict limit on banks’ ability to give credits, and their reluctance to support new private enterprises. This financial situation got even worse when most of private savings were deposited in pyramid schemes instead of banks. Aside from the financial problem, new entrepreneurs were facing management problems as well. The old methods of the communist regime were not appropriate anymore, therefore, they had to adapt to the new free market mechanism. Consequently, due to very limited financial support, and lack of managerial abilities, starting over in the private sector was limited and did not have the same importance and influence as in other countries of Eastern Europe.

Fast privatization of farmland was another major element of government’s policy in this period. This was completed by 1994 and there are now 466,670 private farms (INSTAT,
which try to meet, to some extent, the country's needs for milk, meat, fruits and vegetables. A substantial portion of these products is traded in the market by street vendors.

In addition, the privatization of small, medium, and latter on, large enterprises was another important component of the government's economic strategy. The total number of licensed private businesses in Albania was 30,535 in 1996 (Luçi and Kraja, 1999). By 1996, six years after the start of the privatization process in Albania, 70% of the formerly state enterprises were privatized, and 75% of the GDP was generated by the private sector with small enterprises dominating. The private sector was also the source of 89.6% of exports, which resulted from the liberalization of imports (Gërxhani, 1998). The main activities of registered private enterprises in 1996 in Albania were: trade (52.2%), services (17.5%), transport (14.9%) and industry (10%), followed by construction and agriculture activities (INSTAT, 1999).

However, this economic progress did not have an immediate effect on reducing official unemployment. The shrinking of the state sector played an important role. By 1993, over 60% of state sector employees had lost their jobs (ACER, 1996). Unemployment benefit (for those registered in the Labor Office) was about 66% of the minimum wage (about US$ 33 a month), where even the latter is obviously insufficient for basic human needs (ACER, 1996). The newly privatized enterprises gave priority to the existing employees of the formerly state enterprises rather than to the redundant labor force. On the other hand, the de novo private enterprises were relatively small, hence they could not absorb much labor. All in all, the potential for obtaining remunerative full or part time employment in registered state or private enterprises was very limited, both with respect to availability of jobs and the low level of wages. There was thus a need for the unregistered and registered unemployed to seek ways of gaining some income to supplement the unemployment benefit, such as being involved in informal activities. In addition, although registered private activities developed rapidly, they could not by themselves lead to a reduction- from 30% in 1991 to 12.4% in 1996- of the official unemployment rate. It is therefore apparent that either the official statistics on unemployment are a substantial understatement of the real situation or those who are not employed in registered/formal activities are actually employed elsewhere in the economy, i.e. the informal sector. According to UNDP (2000), the volume of informal labor continues to be huge, although no official figures exist.
The 1997 crisis had a depressing effect on private business as well. The ups and downs in the development of the private sector coincide with the change in the GDP during the same period (UNDP, 2000).

3.3. The informal sector

For the majority of formal or legal business in Albania, the single greatest expense, in both money and time, is dealing with bureaucratic obstacles. The former governments of Albania and other similar countries were essentially antidemocratic, legislating behind closed doors and reacting and responding to interest groups without taking into account the needs and desires of the majority of the population.

Currently, because of the deficient legal institutions used for governing and economic regulation, money is wasted in these undeveloped countries. Economic opportunities are missed, both those that could be exploited with purely internal resources and those that require international resources for their effective realization.

As everywhere else, especially in countries in transition, the informal sector became evident in Albania. The establishment of a legal and institutional framework for a market economy in Albanian society has caused new economic, political and sociological phenomena. Inter alia, Albania is facing a high level of unofficial employment, widespread tax evasion and a large informal sector in general.

The previous chapter emphasized the existence of the informal sector in former socialist countries. Although there is no official evidence on the existence of informal activities during the communist period in Albania, we believe that it also existed then. Our belief is based on the similar situations characterizing Albania and other countries for which the evidence does exist. During the transition period in Albania, the level of this 'hypothetical' informal sector was further increased due to economic and financial factors such as the United Nations embargo on Yugoslavia, large-scale emigration of Albanians to Western countries, a high level of unemployment, the closure of several former state enterprises and the privatization of others, and the extended contacts with neighboring countries. Social factors such as the overall dissatisfaction with the previous regime and the informal pre-transition norms and

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63 For more insights, see Sadiraj (1999).
behaviors of the population have played a substantial role as well. In addition, the government's inability to build up the proper institutions, for example to establish the rule of law and define and enforce property rights, contributed to encouraging the growth of the informal sector in Albania.

Sources of information and statistics in Albania

National economic and social statistics in Albania are still incomplete and unreliable, although efforts are being made to upgrade them. The main sources of information, used in the survey of the Albanian Center for Economic Research as well, are the offices of social services, the Institute of Statistics, independent surveys from national or international organizations, the financial police, tax offices and banks.

Considering that the existing statistical data are not reliable enough, the application of the indirect method to analyze and quantify the informal sector does not seem to be applicable in Albania. Despite its disadvantages (cf. chapter 2), in this case the direct method appears to be more relevant. As a matter of fact, most of the information about the economic situation in Albania is derived from independent surveys conducted by various national or international research institutes, including the Albanian Center for Economic Research. ACER has carried out various relevant surveys on informal sector activities (e.g., the informal financial market; second jobs of government officials; and street vending in Tirana).

3.4. Survey of street vendors in Tirana

3.4.1. Role of street vendors in the informal sector

Retail services in Tirana are an extremely important part of the economy. In 1996, there were about 19,328 private businesses registered in Tirana, more than half of which were involved in the retail sector (INSTAT, 1998). They appeared as anything from the most exclusive fashion shops, modern supermarkets and expensive restaurants, to ambulant vendors selling a few cigarettes, packs of chewing gum or bananas. There were various types of retail outlets

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64 Note that these norms and traditions were set up in a centrally planned system. New norms and behaviors were required with the change of this system. This is when the clash between the two occurred and phenomena like tax evasion emerged. For example, the tax mentality of the population during the socialist period was non-existent due to the fact that all taxation was indirect or deducted at source. As a result people appear not to pay direct taxes even during transition although it is legally required (see EBRD, 1996).

65 For more comments on this survey, see Muço and Saiko (1996).
between these extremes like specialist shops, general stores, bars and cafes, and temporary buildings, including kiosks and awnings. Little is known about the commercial activities of all these different types of registered retail outlets. Competition is extremely fierce, which leads to expectations that many will not survive. Yet, up to 1996, most commercial businesses appeared to be prospering.

Street vending is considered to be one of the most important and visible activities in the Albanian informal sector. There was hardly a street in Tirana without a full complement of street vendors, where the total number in 1996 was probably over 5,000 or 50% more than the number of registered ones (ACER, 1996). Street vending started when people began to invade the public thoroughfare, the use of which is open to everybody, in order to sell goods and services and for commercial transactions - without obtaining permits, giving receipts, or paying taxes. Most of them are fruit and vegetable sellers, closely followed by sellers of cigarettes, soft drinks, snacks and common consumables. However, even within street vending, there is a wide range of activities consisting of some vendors selling newspapers, books, clothing, kebabs, plumbing and electrical equipment, and second hand goods or hardware. Nevertheless, street vending itself represents often a low level of business activity, with respect to capital outlays, range of products supplied, and turnover and profits.

3.4.2. The ACER survey
The Albanian Center for Economic Research surveyed 373 street vendors of Tirana in 1996. The survey covered about 7% of the total number of vendors in the city. All types of street vendors were randomly selected and interviewed by 13 interviewers (students) at the same time of day in different regions of the city. 50 out of 373 observations appeared to be inadequate or incomplete, hence they were disregarded for the analysis. ACER has considered the survey to be as representative as possible under the difficult circumstances involving all surveys of the informal sector.
3.4.3. Survey results

- **Registration processes and informal alternatives**

80% of the interviewed street vendors declared that they possessed no official license or registration for their activity. This certainly does not mean that they did not have to obtain and pay for some form of ‘permission’ to locate where they were.\(^{66}\) In order to give an idea of what it takes to be formally registered as a street vendor,\(^{67}\) a brief outline of the official requirements is described below.\(^{68}\)

(a) The prospective entrepreneur presents his proposal verbally to the district law court;
(b) The lawyer appointed by the chairman of the district law court decides whether to accept the proposal or not on the basis of commercial law;
(c) If accepted, the prospective entrepreneur pays a fee of 500 Albanian Leks (about US $5) and receives a written permit to be used in the local tariff and tax office;
(d) The local tariff and tax office gives the prospective entrepreneur a license to carry out the private business in his selected field of activity; and finally
(e) The prospective entrepreneur can start her/his own business and is obliged to contact, on a monthly or quarterly basis, the tariff and tax office to report his income and, consequently, pay the relevant tariffs and taxes.

However, due to features of bureaucracy inherited from the communist period, this formal process seemed to be very slow, involving a considerable amount of wasted time, and often money (more than the license fee) because officials wanted to be bribed to process the license application. It was for these reasons that the majority of vendors preferred to use informal alternatives. The most common informal alternative was to bribe the local license inspector or policeman, who, in return, would ignore that the business was unregistered. Another alternative was to associate a stall with a fixed or temporary retail outlet, which was formally registered. In this case, payment would depend on the type of family (or other) relationship between the street vendor and the owner of the retail outlet.

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\(^{66}\) As it will be shown latter, one way of providing this ‘permission’ is by bribing the state officials.

\(^{67}\) The process is more complicated for other types of entrepreneurial activities.

\(^{68}\) Please remember that the provided evidence refers to 1996.
Chapter 3

• **Tax evasion**

90% of the interviewed street vendors said that they did not pay any state or municipal taxes. A few claimed that they paid only the compulsory social security payments in their formal employment. Overall, payment of taxes and social security represented only 6% of family expenditures. The payment of only one-third of this amount was provided by informal sector activities.

• **Reasons for becoming a street vendor**

Being a street vendor was a new type of activity for 90% of those interviewed, 49% of whom claimed to have lost their previous job and only some of whom were receiving unemployment benefit. A further 26% had changed occupations to increase family income. A few (5%) were school-age children not attending school. Most of the rest proved to be in the age-group 20–30, where one is either unable to attend university or cannot receive other types of useful training.

Being a street vendor was not the only informal activity for 61% of respondents. Most of them (68%) refused to say what else they did. The rest (32%) appeared to increase the monthly income by renting living space in houses or apartments, while others were involved in trading other types of (usually imported) goods.

• **Education levels and working experience**

The survey results indicate a very high level of education among street vendors. 68% of street vendors have completed secondary education, 20% had finished university and only 12% had only completed elementary schooling.

Previous working experiences of street vendors varied widely. Most of them (60%) had worked as blue-collar workers, whereas an unexpectedly high proportions used to be military officers or government officials (14% and 16%, respectively).

• **Family situation**

42% of the total number surveyed consisted of street vendors who were members of families with five or more persons, none of whom were formally employed. Males were mostly involved in street vending (81% of the total), while females often took more responsibility for
other family obligations. However, in Tirana and other cities as well, the extended family has been transformed into a network of commercial and productive relationships.

83% of those surveyed declared a family monthly income of more than 8,000 Leks (about US $77), 15% of 5,000 (about US $48) - 8,000 Leks and 2% under 5,000 Leks. However, street vending yielded only 45% of this income. This supports the evidence in the literature that street vending often serves as an income-supplementing activity rather than as a primary source of income. Some important additional sources of income were remittances from family members who worked abroad, activities in the informal credit market, renting of living space and various state financial benefits. 87% of vendors said they received at least some form of financial assistance.69

3.5. The significance of the informal sector in Albania

The effect that the collapse of the informal money-lending activities (pyramid schemes) had on the whole Albanian society is an extreme example of how the informal sector can have crucial influence on the political, economic and social aspects of a society. Nevertheless, the general belief is that the informal sector has helped the Albanian economy, during its difficult years of transition. The results of the ACER street vending survey in Tirana in 1996 support this belief. They show that the informal sector activities provide families with employment and supplementary income, in the absence of other possibilities. People learn to use their initiative and creativity to create more jobs and wealth. As de Soto (1989) states in general, the social problems are enormous, but the situation would be infinitely worse without the informal marketeers. In addition, the results show that joining the informal sector is a way to protest against the inefficiencies and high transaction costs caused by unnecessary state regulations and bureaucratic procedures. When free initiative and entrepreneurial creativity (informal institutions) are not supported by the formal state institutions, people flee to the informal sector.

69 Another survey (a survey on second jobs of government officials), conducted by ACER in 1996, confirmed that many people are involved in informal activities to supplement their incomes from formal employment. This survey indicated that 33% of government officials in ministries had a second job. In addition, their incomes earned from these second jobs were equal to or greater than their official incomes.
If the informal sector can have positive effects, the question is: to what extent? Again, the negative experience of Albania with the informal financial market raises important questions. With respect to economics, due to the existence of this market in Albania, most of private savings were not deposited into the banking system, hence they did not support economic investments. Politically, it caused serious political instability in the country, which was almost transformed into a civil war. Socially, a majority of people lost their savings and wealth accumulation, and therefore many social problems emerged.

Despite the undoubted benefits of the mushrooming of informal sector activities, including street vending, these activities can have serious consequences for Albanian society. A very high level of unlicensed activities (as the survey indicates) among street vendors is correlated with a very high level of unrecorded income-earners. Consequently, there will be financial losses in the state revenue; the provision of public goods will be misallocated; the main macroeconomic indicators (e.g., unemployment rate, tax rate, inflation and growth rate) will be distorted; and the available statistics will provide a misleading view of the country's economy. In addition, the large contingent of uninsured today will create a great burden for social assistance and welfare programs. Albanian society will have to pay a high cost to reduce poverty in future years (UNDP, 2000).

3.6. Conclusion

The communist regime in Albania was much stronger than in other Eastern European countries. Although late, Albania joined these countries toward a free market economy. Despite many difficulties, good progress was achieved in the beginning.

However, in the meantime, the governing political class was degenerating, the economic capacity of the country was not able to attract substantial internal and external resources, and the state was institutionally weak. As a result, one of the unpleasant outcomes of this situation—pyramid schemes—collapsed in 1997, which in combination with the Kosovo war in 1999, set the country back seriously.

70 However, it is difficult to say how much of the savings would have been channeled through the official banks, in the event that pyramid schemes were non-existent.
Another outcome, which could be considered negative in the long-run but positive in the short-run, is the large development of the informal sector. The results of the ACER street vending survey in Tirana in 1996 show how large and how significant this phenomenon is. Its significance is two-fold: (1) it has helped Albanian families to make a living and survive in the difficult years of transition, but (2) it has not been sufficient to support long-run economic investments and growth. However, the informal sector in Albania is here to stay. Therefore, its integration into the formal economy is a necessity.

The establishment of the proper legal and institutional framework accompanied by the appropriate monitoring and enforcement procedures, is the first step to the legal development of the private sector and the whole economy of a country like Albania. The lack of an adequate system of private banking and stock exchange (financial market) and the related success of pyramid schemes in Albania are good examples of how institutional development is of essential importance in countries in transition.