

Pál Belyó

# *Properties of hidden economy*

SALDO KIADÓ, 2009



As the author himself underlines in the preface, *hidden economy* is one of the most thrilling scopes of economic research currently under way in Hungary, for the size of this economy is big and growing all over the world, but a fitting method to measure it, the social roles it plays, its effects of central budget, and its management in economic policy are all under controversy, and answering the questions raised by this issue is hindered by a number of problems in content and methodology. Therefore, the topic of the book has been selected cleverly. Publication of the book could foster additional research into the subject and better understanding of actual problems, and also the development of the right social assessment of this slice of economy.

■ Chapter One aims to clarify the notion of hidden economy. Readers unacquainted with the topic may even be surprised to see a definition. In the explanation, however, it becomes

clear that neither the activities connected to hidden economy, nor the terminology used in analyses are standardised. For instance, a wider 'statistical' view in the analysis comprises (specific) activities that are *not measured in statistics* on one hand, and to-be-measured but *unreported* activities on the other hand.

▶ The group of *unmeasured* activities are not uniform, either; some of them, including household work and favours, are entirely legal, but most criminal activities are also listed in this group.

▶ The hidden percentage of activities that should be measured in statistics is most often called *underground* economy. This group consists of illegal production activities, such as the making of and trafficking in drugs on the one hand, and

▶ *black* economy on the other hand (previously called secondary economy in the Hungarian terminology), comprising work

done by unregistered 'entrepreneurs' (companies under the radar of various authorities, as well as individuals working without being registered employees), and non-reported activities conducted by registered companies.

Widespread in Hungarian public opinion and also used in some chapters of the book, the terminology most often uses the above described definition of 'black economy' for hidden economy. At times, however, some components of non-measured activities are also included here, for instance community house-building (page 23), and the barrier between legal and illegal activities in case of sexual services is also undecided. Leaving statistical aspects out of consideration, an interpretation based on ethics, limiting this scope to activities that are harmful to the society, is not rare, either. Since this topic is closely related to the concept of public taxes – and the lack of registration in the scope of 'black' activities most often stems from tax evasion – uncertainties in terminology may have implications in practice.

■ Nearly all chapters of the book attempts to give some clues to estimate the full scale of the hidden economy in Hungary (which is inherently a very tough task). The focus of these efforts is centered around defining the weight of unregistered – and thus tax-evading – black activities, resulting in a 'fork' of two values. Right on the first pages there is a statement that 'unreported and unpaid taxes and social contributions are currently estimated to amount to nearly HUF 1,000 billion' in the Hungarian economy (page 25). Based on the results of calculations that include certain unmeasured components, it is also stated in the book that 'the size of hidden economy in Hungary dropped to nearly 25 per cent by 1998 in terms of GDP from the 33-percent peak measured in 1993, and has been decreasing ever since' (page 79). According to the chart using this latter calculation, the annual value of the output realised in hidden economy amounts to

HUF 5,000 billion at current prices, a multiple of unpaid taxes and contributions (page 80). The reviewer, however, who believes these figures are underestimated and is also doubtful about the slow retirement of hidden economy, is sorry to see no attempts from the author to list the most significant totals at least.

It is hard to decide whether the aforementioned percentage – which is high in international comparison – should be regarded acceptable or an exaggeration considering the local environment. Accounting for roughly two-thirds of the book, the analyses explain the ECOSTAT surveys that attempted to give an answer to this question. The surveys were conducted in the corporate and household scope in 2000 and 2005.

The surveys conducted in the *corporate* scope focused on the reasons and methods for legal and illegal tax reduction, and also to possibilities in curbing the latter. Both surveys stated that company managers assessed Hungary's taxation system mostly negatively (pages 84, 111), regarding taxes too high and contributions strongly excessive, and sharply criticised the bureaucratic approach of the system. No surprise, they reckoned that approximately half the companies were likely to be involved in hidden economy (pages 93, 117), and estimated the size of hidden economy relatively high at a quarter of economic activities on average (pages 90, 199). They reckoned construction industry was the most infected.

Most company managers in the survey were familiar with a very broad array of illegal tax evasion methods, and indicated these were employed in a more or less extensive scope, according to their experience. Both surveys depicted various perks employed for the purpose of tax savings as a wide-spread legal technique; in 2005 the scope of 'legal methods' was increased further by the employment of experts with cost-cutting purposes and also by lobbying activities aimed at securing orders –

with the average remuneration being nearly 20 (!) per cent of the price invoiced for the orders. In the company of illegal techniques, unreported employment and no-tax-payment claimed the top of the list, and responders reckoned that perhaps 40 per cent of companies had slush funds to finance these practices. Company managers estimated non-invoiced sales at 25 per cent of total sales on national level. At the same, rejection of these practices were almost typical.

Experiences gained in the *household* survey complement the corporate results nicely. Back in 2000, already more than one-third of responders stated they knew at least one person among their acquaintances that had been doing unregistered works regularly in the preceding six months; roughly half of them had heard of instances when work was done in return for unreported benefits, and more than half were familiar with the practice when employers registered employees at the official minimum wage and paid the taxed amount out of a slush fund (pages 154–155). A slight improvement showed by 2005, as only 16 per cent of responders were aware of unregistered employment, 40 per cent had heard of work paid for in a no-tax scheme, and a smaller percentage in both groups were aware of employees having been registered unreasonably at minimum wage (page 181). In both scopes, there was a high percentage of responders that considered sales without invoice or underbilling a regular practice, and many had information about invoice collection for other entities and sale of fictitious invoices. Matching popular opinion, tips proved wide-spread in specific sectors, but one-third of responses in 2000 and one-quarter in 2005 mentioned unpaid work made for the personal purposes of their superiors. (pages 170, 196).

■ When the Hungarian morale of tax payment, or rather non-payment, is to be assessed, one cannot disregard the fact that, based on

other probes into the matter, the status quo outlined by Pál Belyó may be regarded as relatively gentle. For instance, the study *A fekete-munka elleni küzdelem [Fight against unreported labour]*<sup>1</sup> authored by Károly Horváth reports not only of regular black work made by individuals regularly, but also of organisations specialised in intermediating and trading black (i.e. unregistered) workers and also of a wide scale of bureaucratic obstacles that hamper the fight against these entities, and also of indications of organised crime in this scope. The article *Az adócsalás gazdaságpszichológiai megközelítése [Economic-psychological Approach of Tax Evasion]*<sup>2</sup> authored by Ms. Erzsébet Papanek, however, indicates that in a minor (and anonymous) survey conducted with the participation of psychological majors nearly all small-business managers and employees “admitted” to employing some – today regarded minor-league – tax-evasion methods. And let's not mention the implications of the author being 'understanding' toward the recent tax-evasion acts of the wealthy. For the book makes almost no mention of amounts siphoned off to tax havens via off-shore companies, estimated by some to total many hundreds of billions of forints, which has only increased in recent years.<sup>3</sup> And few words are spent on corruption, too, including “payola schemes” related to construction projects of motorways, bridges, and underground lines, which are also estimated at many hundreds of billions of forint and counting.<sup>4</sup>

The analyses offer a clear answer to the question that probes into the size of hidden economy in Hungary, making the author's opinion clear repeatedly that this extents should be reduced, and also his efforts of looking into the possibilities (methods that could make the reduction possible). He assesses government efforts that have been made in this direction in recent years as positive, the undoubted curbing of frauds in the scope of excise tax (most

notably the shady businesses that developed in the early 1990s in fuel trade); stricter and more efficient control of the scope eligible for social security; developments in the IT landscape of the tax authorities, but he believes additional steps are necessary. His recommendations, based on international comparison, urge stricter control in labour issues; more transparent tax legislation and lower tax burdens; simpler economic regulations; better communication; and “orientation” for the Hungarian society which is prone to be generous about a number of tax evasion methods.

■ In every study it's easy to list topics the author should have elaborated more. Nevertheless, the reviewer does not find it unjustified to mention his wish to read more about economic policy related to hidden economy. He is convinced, for instance, it is important to differentiate objectives and concentrate efforts in this scope. He believes community work, which fosters social relations and the idea of “giving a helping hand” – for instance grape harvests made by family and friends – should not be restricted but supported; and decidedly illegal conduct, such as organised crime, cannot be curbed by taxation methods but by law enforcement actions only. Imposing and collecting taxes is harmful where costs are

equal or even higher than the available income (although some surveys indicate there are several of these taxes in force).<sup>5</sup> An analysis into the correlation between the tax burden and tax evasion in Hungary (the Laffer Curve) would have been a welcome sight, and also a survey to show what effect the tax extent in Hungary has on the expansion of unregistered labour – on output retention wide-spread in a number of economic segments but unmentioned in the book, and also on relocating production facilities to neighbouring countries with lower tax burdens. But a warning would be equally important that tax payment morale is enhanced when tax payments serve the achievement of objectives (even local ones) that are deemed important by the society. Since the centrally-imposed administrative burdens in terms of GDP is a multiple the international average<sup>6</sup>, it would have been useful to describe some proposals to reduce tax bureaucracy. Had economic policy conducted all these analyses a decade ago, there would have been chances for Hungary's economy to get closer than it is now to the situation depicted on pages 228 and 229, namely a 3-percent GDP growth and also 3-percent budget deficit in terms of GDP.

*Gábor Papanek*

## NOTES

<sup>1</sup> In: Papanek, G. (Ed.): *Jogbiztonság a magyar gazdasági életben* [Legal Security in Hungarian Economy], Filum Kiadó [Filum Publishing], 1999

<sup>2</sup> In: Hunyadi, Gy. – Székely, M. (Ed.): *Gazdaságpszichológia* [Economic Psychology], Osiris, 2003

<sup>3</sup> BDO Könyvvizsgáló Kft. [BDO Audit LLC] In: *Keresik a kimentett vagyont* [Rescued Wealth Sought], Magyar Nemzet, 25 April 2009

<sup>4</sup> See, for example, Varga, Sz.: *A korrupció és a védekezés lehetőségei* [Corruption and the

Possibilities of Fighting It], *Vezetéstudomány* [Management Science], Issue 3, 2009

<sup>5</sup> See, for example, Szirmai, P. – Szerb, L. – Madarassy, T. – Petheő, A. I.: *Közvéleményre hangolva* [Tuned to Public Opinion], manuscript, Corvinus – PTK, 2008

<sup>6</sup> See, for example, Mester, Z.: *Kormányzati programok a versenyképes üzleti környezetért* [Government Programs for a Competitive Business Environment] In: *A gazdasági környezet és a vállalati stratégiák* [Economic Landscape and Corporate Strategies], MTA IVB, 2008