

# **Corruption, Informality and Cross-Border Trade: Their Implications to Democratic Developments**

## **A Preliminary Report**

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The analysis presented in this report is based on the study and surveys of formal enterprises designed and implemented by the Albanian Center for Economic Research, (ACER), Custom's officials and experts opinions on the issues of cross border trade. ACER would like to thank all its collaborators that helped in implementing the surveys on the field.

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Empirical analysis presented in this report is matter of a research-in-progress and in this phase ACER takes the responsibility for errors and omissions. Comments discussions and suggestions before finalizing the report are welcomed.

For more information, please contact Albanian Center for Economic Research.

## **Some of main findings<sup>1</sup>**

The targeted groups of survey were enterprises, customs officials and economic and legal experts.

### **Enterprise survey**

#### *Business environment*

Based on the methodology criteria for designing the sample, 96% of the sample represent LTD enterprises, out of which 60% are operating in the wholesale sector. (Tab.1)

The most goods sold are foods, beverages and tobacco, constructing materials, clothes, and mixture of industrial items.

➤ *Most of the enterprises interviewed were established during 1994-1996, Taking into consideration the importance of the stable environment in flourishing of the business activity, the firms' establishment reached the peak in 1995 (more than 60 enterprises), followed by a recession during the next years.(Graph.1)*

➤ *About 52% of the enterprises have renewed their import-export licenses during the last year.*

That means that the rest of 48% of the interviewed enterprises didn't. It is because of several reasons:

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<sup>1</sup> Albanian Center for Economic Research conducted in 2000 a survey on Features of Cross-Border Trading in Albania.

The aim of the survey conducted by ACER was to study cross border trading trends and features of Albania related to its neighbor countries during the last year and currently, as well as to estimate its role and impact on economy of Albania. The survey was extended into 5 main districts of Albania, targeted on import - export enterprises. The survey sample size was 348 import-export enterprises, in Tirana, Shkodra, Gjirokastra, Vlora and Korca

Some of the enterprises didn't have any more business activity. They probably had finished their activity times before we designed the methodology, but the changes haven't been reflected from the governmental officials, representing wrong statistical data

So, approximately 20% of the enterprises resulted without any activity, or inexact addresses, some of them didn't reported exact addresses to the tax departments, in order to avoid tax authorities and tax dues. Some others got the business license, just to have a possibility to have a visa for going abroad, and not doing any business activity

However, because of the sample size, (there were included more enterprises than forecasted to be interviewed, in order to avoid the refusals, or the closed enterprises) it is already representative

- enterprises are not having a favorable and enhancing environment to develop their businesses, which is mainly followed by a change of the company's destination, or sometimes followed by their bankruptcy;
- they are prepared and prefer to develop an informal activity, or
- they want to avoid tax dues, by not renewing the license.

The procedure for getting an import consignment is very bureaucratic, It should be provided 5 or 6 signatures accompanied by delays and considerable time consuming. About 46% of those who got the license confirm this fact.

➤ *The cross-border trading sector is characterized by SMEs activity.*

70% of the interviewed enterprises, turned out to be in the wholesale and retail trade sector. Most of them are small and medium sized enterprises, of which over 45% are operating in the local market.(Tab.2)

Furthermore, taking into consideration the fact that from the volume of imports realized during 1999, more than half of enterprises (56%) have had an import volume of less than 20 million leks (133300 USD), it can be said that Albanian economy is continuously characterized by SME's activities (*Graph.2*)

➤ *Cross Border trading is mainly developed with Greece and Italy*

Regarding the neighbouring countries most involved in cross-border trading activities, the survey shows that Greece has the greatest share (50% of enterprises are importing the goods from Greece). Italy is the second most important country (37.4%), followed then by Bulgaria (7.4%) and Turkey (6.7%), and other countries (14.1%). (*Graph.3*)

**Tab.3 Where are the most goods coming from**

	Greece	Italy	Macedonia	Monte Negro	Bulgaria	Turkey	Other country
<b>Manufacturing</b>	5%	8%	1%	0%	2%	1%	2%
<b>Wholesale trade</b>	39%	24%	2%	1%	5%	3%	10%
<b>Retail-sale trade</b>	6%	4%			1%	2%	2%
<b>Constructing</b>	0%	0%					
<b>Other</b>	0%	1%					0%
<b>Total</b>	50%	37%	3%	1%	7%	7%	14%

*If we refer to the items they imported from, of which foods, beverage and tobacco constitute the biggest share of imported goods, the above mentioned ranking fits to the National statistical data of 1999. So, during the last year, the import volume of foods, beverage and tobacco from the Italy decreased by 16.2%, while those from Greece increased by 29.2%*

➤ *It is obvious that main goods are coming from the EU countries.*

It is in accordance with the INSTAT figures, where during 1999, Italy and Greece taken as a whole had reached at about 69% of total of trade imports. Year 1999 recorded the highest level of trade transactions with EU countries (Graph.4)

➤ *Businesses are continuing to use cash payment instead of transfers through banking*

The most used way of payment has been cash payment (over 85% of them) while only 13% of them are making transfers through banking. So, it is too much to do in terms of accelerating the process of e-payment in Albania. It doesn't function very well the mechanism of custom's control regarding money outflow out of Albania.

### **Business views**

- *Cigarettes, Oil and coffee are the three most usually imported goods entering in the informal way, avoiding payment of custom dues<sup>2</sup>.*
- *More than 60% of informal imported goods are passing through custom points*

It seems that there is a direct link between the items imported in formal and informal ways. They are quasi representing the same group of goods.(Graph.5)

From the survey it can be seen that more than 60% of informal imported goods are passing through custom points (over 83% of respondents accept this fact).(Graph 6) This is also confirmed by the interviewees made with economic experts.

➤ ***So, this result demonstrates the level of corruption of customs officials.***

➤ ***Tax volume as % of imports volume is 29% in average terms.***

Considering the fact that most of the enterprises (56% of them) have realized an import volume of Lek 20 million, the level of tax bargain to them is a considerable one. So, it consisted of about 29% of the import volume during 1999

Taking into consideration also the fact the people are used to use informal practices in order to gain profits, both through avoiding the taxes or custom's dues or hiding the revenue or profits, it exists an unwritten but well-known rule that the higher the taxes, the higher the share of informality. It was the high level of import taxes considered by the interviewed experts as the main reason of informality (Graph.7)

On the other hand legally operating businessmen find themselves forced to deal with the unfair competition by using also some informal practices themselves, (such as avoiding tax payments) which escalates the extent of informal and illegal business activity (Graph 8)

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<sup>2</sup> **Informality/administrative violation at customs** Each action or non-action contradicting dispositions foreseen in Customs Code, with regulations and other enforcement dispositions, except the natural disasters.

**Smuggling:** Avoidance or tendency to avoid in any case control and/or customs supervision on goods with the intention of payment avoidance of import-export liabilities.

It is necessary to stress the fact that taxes (in average terms) consisted of 29% of the imports volume during 1999, which in fact does not enhance business development, but makes it more difficult.

➤ ***The medium level of informality in cross border trading is at about 10-25%.***

As for the consequence of the extension of cross border trading to the neighbor countries, they are mostly coming from Greece and Italy.<sup>3</sup>

Even at expert level it is unanimously agreed that there is the informality in cross-border trading.

So, the existence of a corrupted and informal business environment, oblige the legal enterprises to use a mixture of formal and informal ways in managing the enterprises rather than expecting the state to do something to stop the informal activity and unfair competition. This increases much more the level of informality in trade economy.

➤ ***Informal traders are undercutting the price of formal traders by 25-30%***

The interviewed businessmen do not support the informal trade sector, because it undercuts their prices in the market, decreases their profits and increases their costs for the same products. Most of the respondents think that the effect of the informal market on the formal one (in terms of market price) is 25-30%, putting the formal traders in a difficult position in relation to the unfair competition from the informal sector.(Graph 9)

*People who were generally used to smuggling or informal cross border trading are the big known enterprises, which have very important links with several institutional chains. (graph.10)*

➤ ***The high level of VAT and excise taxes the most reasons for informality***

The high level of VAT as one of the most reasons for not declaring the real values of imported goods has to be taken into consideration.

<sup>3</sup> **How to estimate the tax efficiency?**

Let's try to use the following identity:  $T - I r = R$

T- Volume of taxes imposed by Government as a % of imported goods

I r - Informal rate as a % of imported goods

R - Government revenues

T= 29%; I r=10 - 25%

$$R1 = 29\% - 10\% = 19\%$$

$$R2 = 29\% - 25\% = 4\%$$

If we consider such identities, we can say that the efficiency of state in yielding the revenues depends upon the informal rate, which indeed depends upon the state control.

So, the greater the control, and supervision, the lower the Informal and smuggling rate, the higher the state revenues.

Businessmen are always asking for lower VAT rate for their businesses. It seems that the state mechanism for reducing the informality and increasing budget incomes doesn't function very well.

The Albanian customs service is far from efficient, which in turn weakens the ability of the state to enforce policy. Among the main reasons for the extent of informal cross border trade, alongside the high levels of taxes (VAT and import taxes), over 14% of the respondents consider the inability of the state to control and increase the efficiency of customs as the main reason for increasing informality. (Graph. 11)

- ***The inefficient state governance and state control as well as inefficiency of customs' officials are considered as factors that favor the smuggling, corruption and informality.***

It is also evident from the classification of the custom's officials regarding their professionalism and efficiency, where over 95 percent of the respondents (businessmen and experts level) are considering them as inefficient.

**Tab.5 Level of efficiency of custom's officials**

	N	Minimum	Maximum	Mean	Std. Deviation
<b>evaluation of the professional ethics and efficiency to custom's officials</b>	96%	1	5	2.60	.96
<b>1 = very inefficient;</b>					
<b>5= very efficient</b>					
<b>Valid Percentage</b>	<b>96%</b>				

They consider the customs' officials as inefficient and easily corrupted. They were also ready to reveal some corrupt practices, which can not be used or made public to protect anonymity of responses.

- ***Inconsistency in custom's regimes (especially the terms of references) does not effect so much fight against smuggling, informality, and corruption.***

Taking into consideration the most common practices of smuggling and informality in cross border trading, such as false declaration of value and quantity, the state has found itself forced to change continuously the rules and terms of reference, making them unpredictable. However, both businessmen and customs officials consider this policy as an ineffective one. Perhaps more reliance should be placed instead on enforcing higher penalties in cases where infringement of the law has been determined

- ***Business consider smuggling as a barrier for formal trade development***

However, the respondents are aware of the positive and negative impacts of smuggling and informality on the economy. Among "positive impacts", they consider informal employment opportunities, (which in fact would be possible

even under the formal conditions IF RULES WERE CHANGED) and lower market prices. As for the negative impacts of smuggling and informality, respondents consider these phenomena as barriers to formal trade development because of the unfair competition. Additionally there are negative impacts on the state budget income. As a consequence there is less money for infrastructure investments, less foreign investments in Albania, and bad conditions for all the operators in the market.

### **Customs' officials survey**

There were asked 15 custom's officials in 4 districts (Shkodra, Korça, Gjirokastra and Tirana). The custom's officials in Vlora refused totally to answer the questionnaire<sup>4</sup>.

#### ***The share of imported goods passing through informal ways is between the interval [0-25%]. (graph.12)***

On the other hand, Custom's officials are declaring that part of Cigarettes, Petrol and Jewelry are passing in informal way without passing through the custom checkpoints. The main ways of transporting them are by small boats, transporting animals, as well as by small luggage.

Considering the informal imported items passing through the custom points, it is reconfirmed the idea presented by businessmen about the main practices used. So, custom's officials are considering false declaration of product, false origin of product, false declaration of quality, as well as fictitious transit, as the most informal practices used. (Graph.13)

#### ***➤ Custom's officials accept the fact that more than 50% of goods entering in informal way are passing through the custom (Graph.14)***

It means that they are accepting by themselves the presence of corrupted people among them.

#### ***➤ The improvement of technology and qualification opportunities is the precondition for increasing the level of efficiency and productivity, as well as reducing the smuggling cases.***

The poor efficiency of the customs is partly due to the lack of the necessary technology and equipment enabling better control at custom points. One of the most problematic issues for the customs officials was the lack of information and communication networks between several customs points in Albania, as well as with their counterparts in neighbouring countries. Improvement in this aspect should of course increase the level of efficiency and productivity, as well as reduce smuggling.

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<sup>4</sup> Customs officials generally refused to answer to the questions regarding the size of confiscated goods for 1999, being afraid of giving some inadequate or misleading information, or being in conflict with the official data. This behavior was directly attributed to their lack of accountability and lack of efficiency.

As the data shows, it can be noticed that custom officials are less concerned with the issue of higher salaries, (as it was clearly the case two years ago), and more with the chances and possibilities to be trained and qualified, in order to increase their job efficiency. It is because of some changes of government policy in the fight against corruption, undertaken in the last two years, that now the main concern is the training and increasing the professionalism of customs officials.

It is also true and noteworthy, if we remember the declaration of the director of CAM Albania, that the source of corruption should not be simply attributed to the low level of salaries. There were both cases when people with not so high salaries weren't corrupted, as well as other cases when they were.

### ***Suggestions and recommendations***

Considering businessmen, custom's officials and experts views, there can be notified some suggestions in terms of reducing informality, as well as fighting corruption and smuggling.

- The fight against smuggling should be mainly focused on two directions: the actors of smuggling (enterprises) and the "supervisors" of smuggling (customs officials and customs police). The former are doing smuggling through custom points, while the latter are responsible for not allowing the smugglers to operate in this field, but, in fact they are aiding and abetting the process
- The identified enterprises caught smuggling should not be allowed to continue their business activity, either not being given any more business licenses, or suspending their activity for a certain period (5 years or more).
- The penalty measures should be changed: instead of dismissing the corrupted officials, they have to be punished with some financial penalties, in accordance with the volume of imported goods that have been allowed to pass through custom points.
- Strengthening the control, implementation of special efficient methods of control and identifying the smuggling cases.
- The improvement of the legal framework and filling in of the existing vacuum in this field. better cooperation of customs with tax department, as well as strong implementation of the existing laws and regulations.
- It should be implemented a consistent system of references as an effective way to reduce informal cross border trade by businesses, as well as should be reviewed the fiscal package in terms of improving and enhancing the business environment
- Implementation of facilities in custom's dues for certain category of goods

- Better qualification and more specific criteria should be used in hiring people in these sensitive jobs in customs.

*Therefore it should be considered as a priority the implementation of policies for increasing the efficiency and accountability in customs.*

- Designing more transparent acts and regulations regarding custom dues, (especially regarding the terms of references)
- Increasing the share of transactions through banking
- The government should be far from the corruption and not involved in corruptive practices, as it used to happen.
- The role of business community in designing the legal framework and policy should be increased.
- Trying to adapt the experience and practice of the other countries with low level of informality and smuggling.
- The state should have a policy that enhances the development of private sector, through implementing special crediting policies, improving the infrastructure, etc.

**Tab.1 Business legal form and category of business**

business legal form	business category					Total
	manufacturing	wholesale	retail sale	construction	other	
LTD company	19%	58%	13%	4%	2%	96%
collective association		0%	1%			1%
joint venture	1%	2%	0%			3%
anonymous company		0%				0%
other	0%	0%	0%		0%	0%
<b>Total</b>	<b>20%</b>	<b>60%</b>	<b>14%</b>	<b>4%</b>	<b>2%</b>	<b>100%</b>

**Tab.2 Share of market to which operate the enterprises**

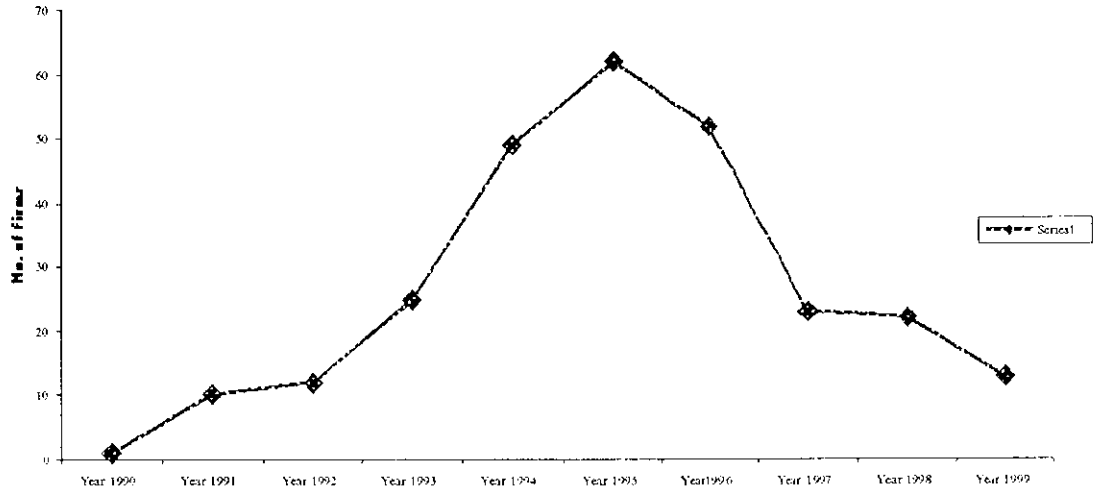
	Valid Percent	Cumulative Percent
local	45	45
regional	29	74
national	21	95
international	5	100
Total	100	

**Tab.4 taxes as % of Imports volume**

value of taxes as % of imports	Percent
1-10%	11
11-20%	9
21-30%	42
31-40%	28
41-50%	8
over 50%	2

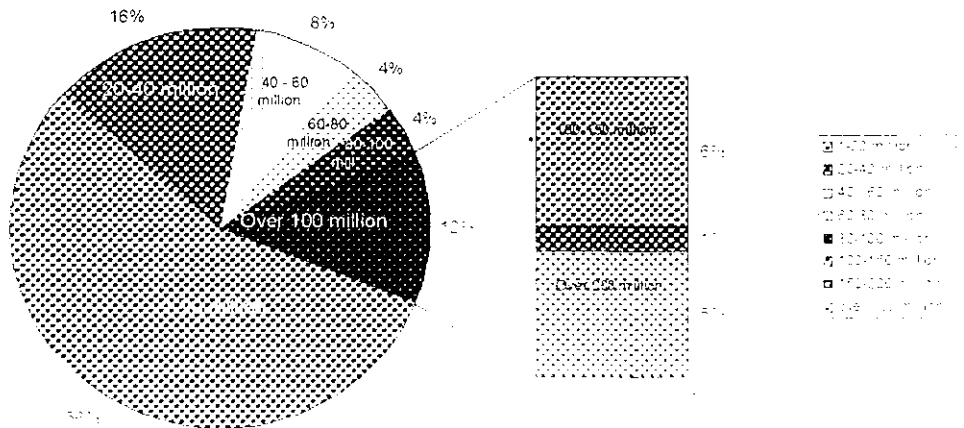
Graph 1

the progress of business establishment during the years



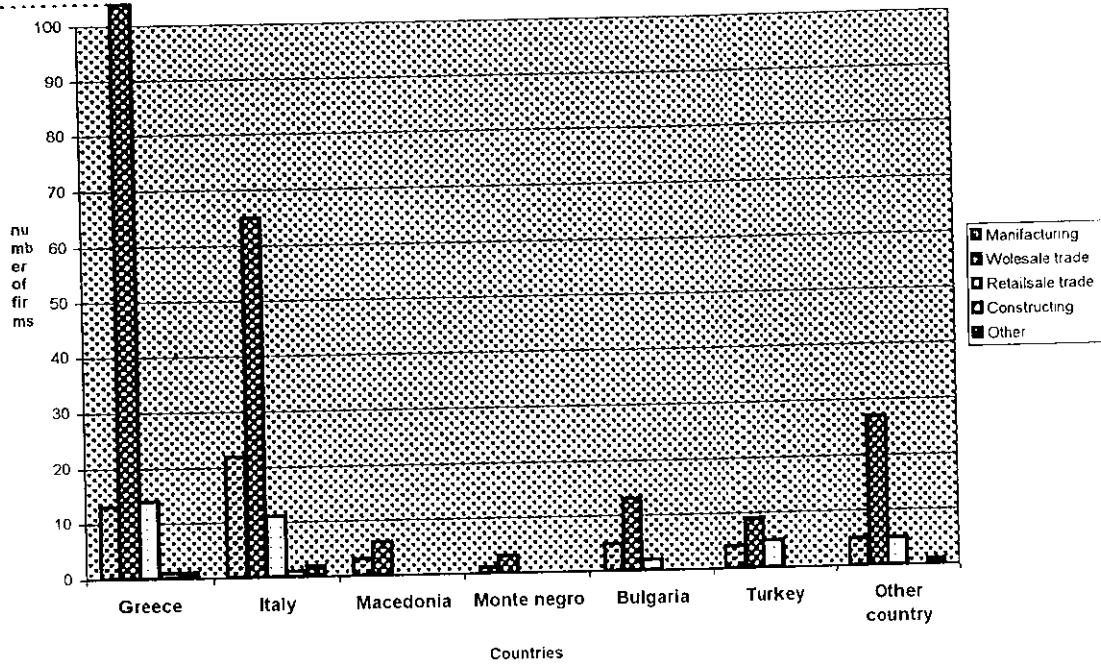
Graph.2

Volume of imports realized during 1999



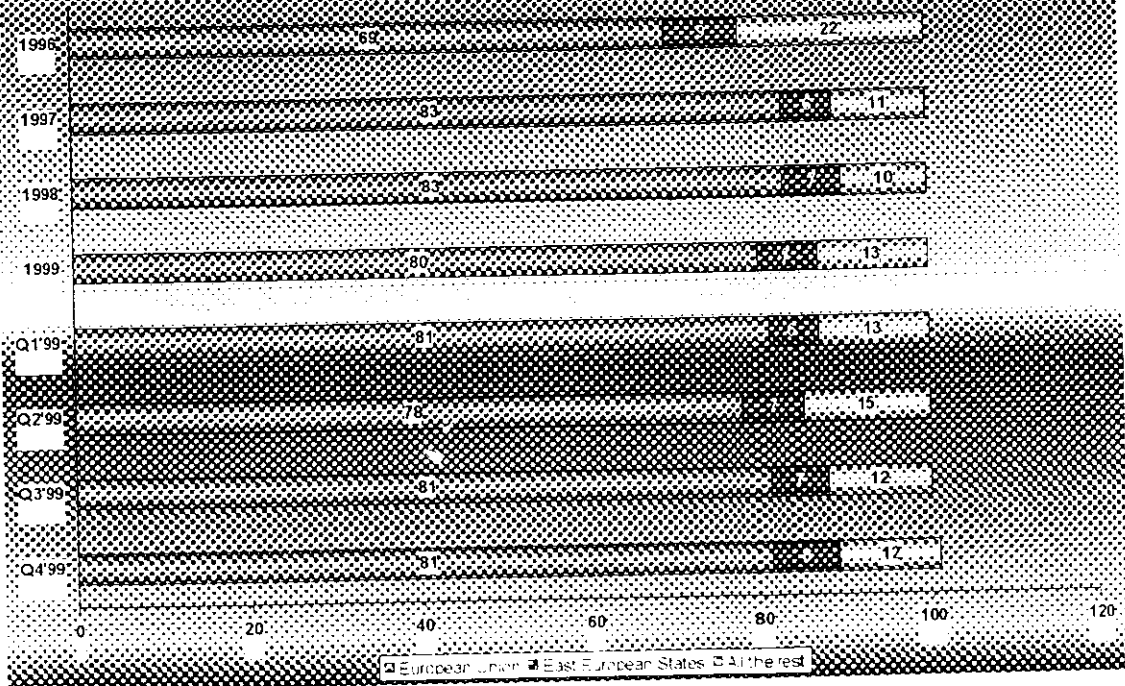
Graph 3

Where are the imported goods mostly coming from?



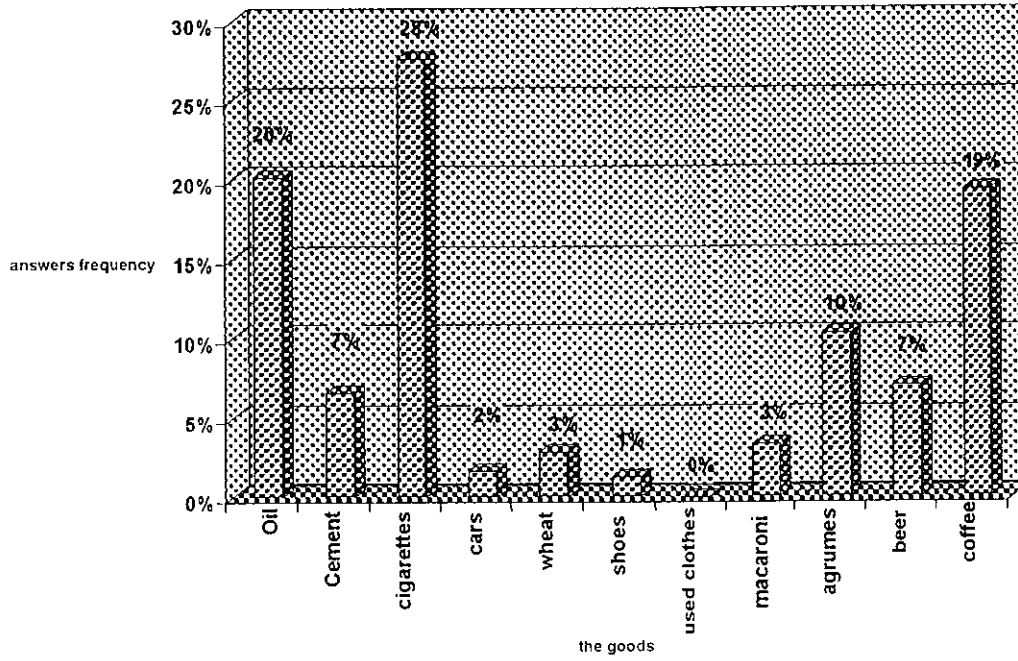
Graph 4

Structure of Imports



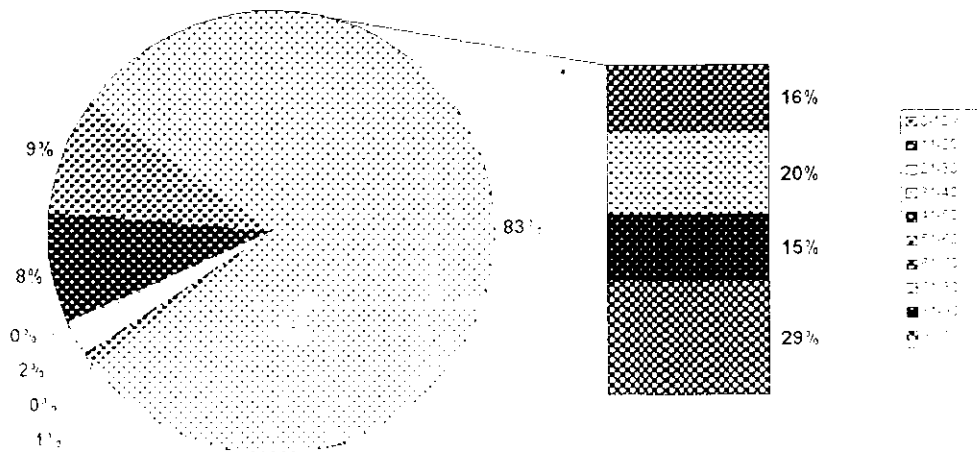
Graph 5

The most imported goods during 1999, that are passing in informal way through customs' points



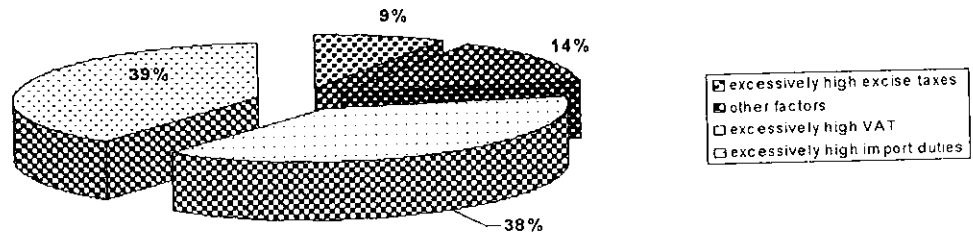
Graph. 6

% of informal goods passing through the custom points

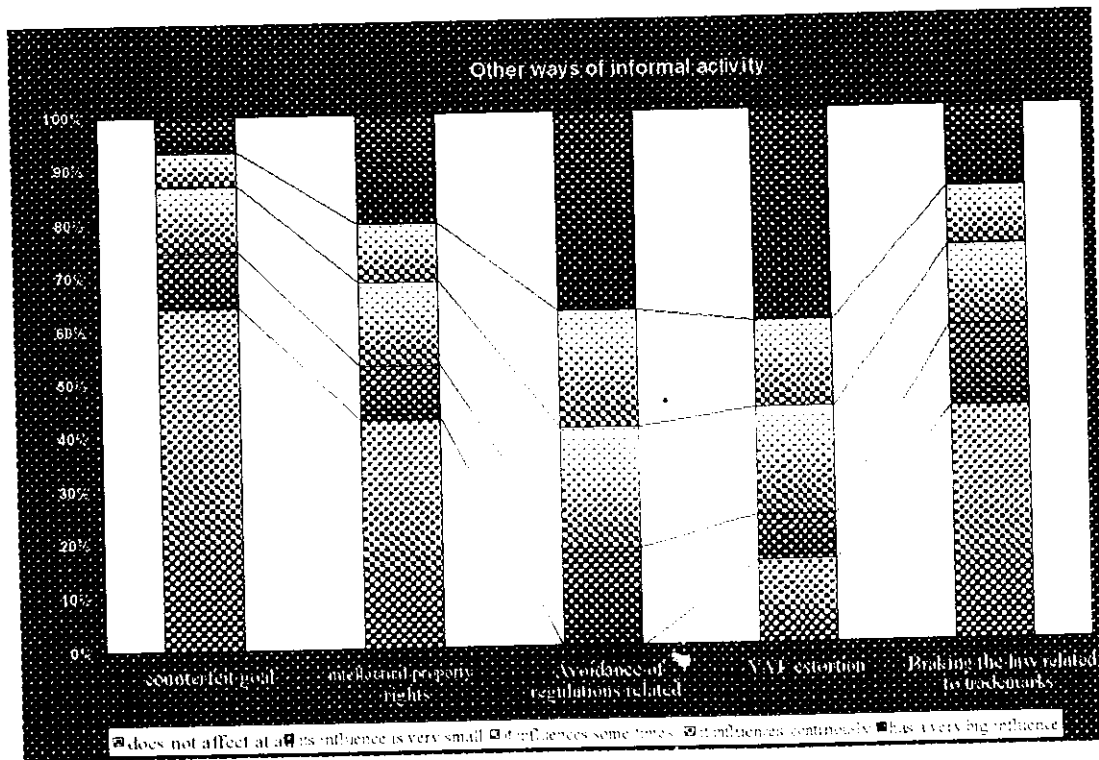


Graph. 7

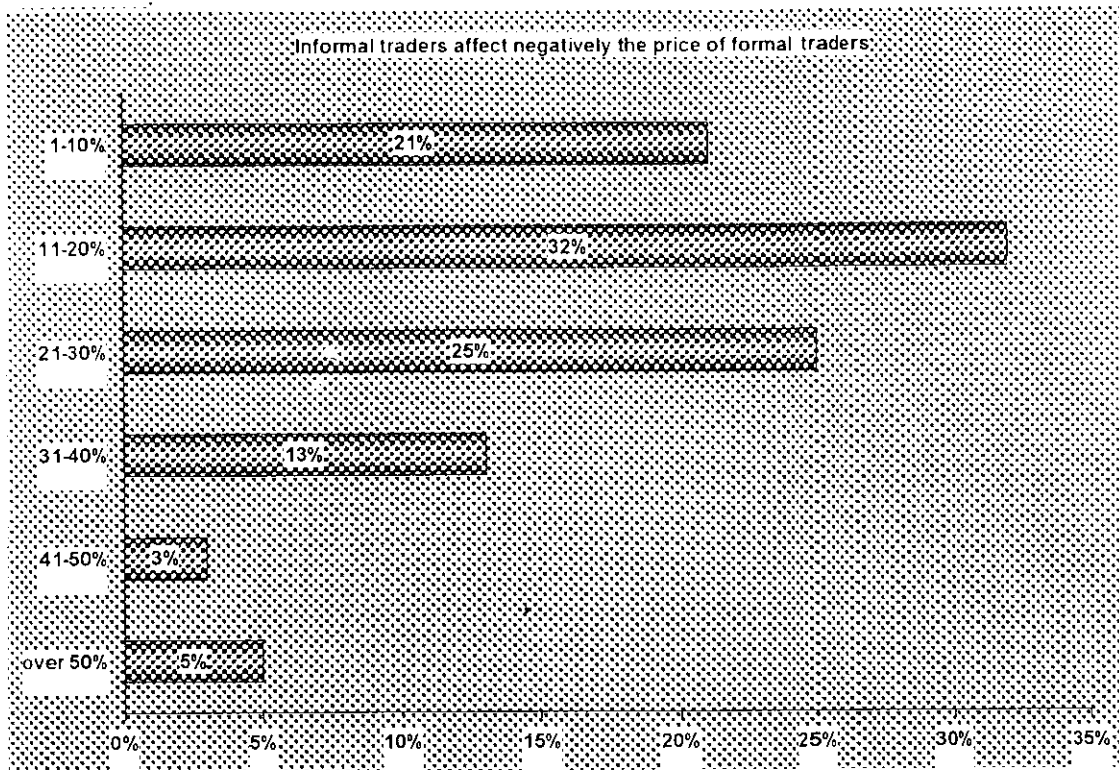
The main factor that enhances the informal trade development



Graph. 8

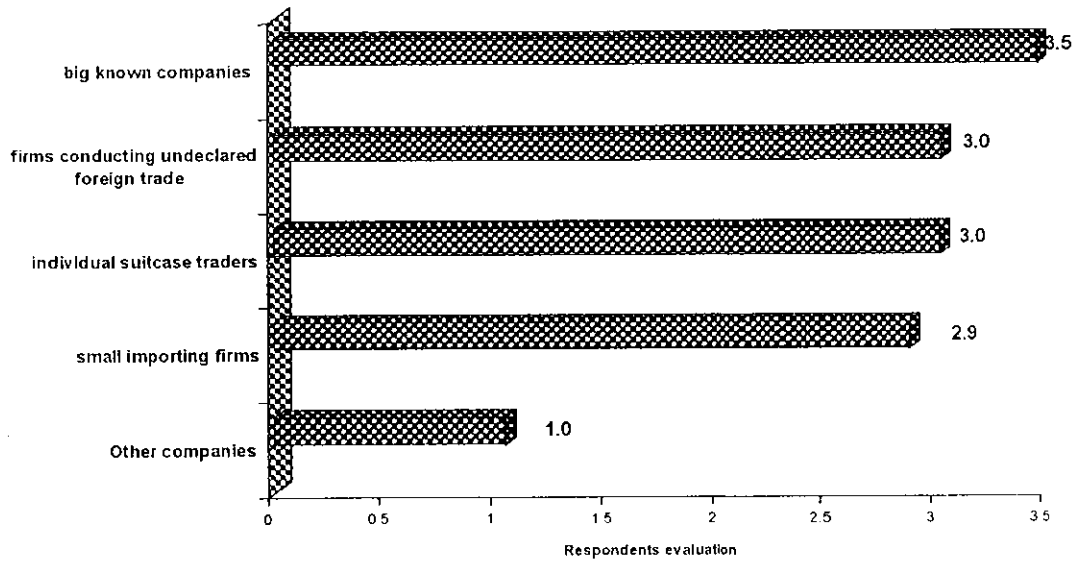


Graph 9

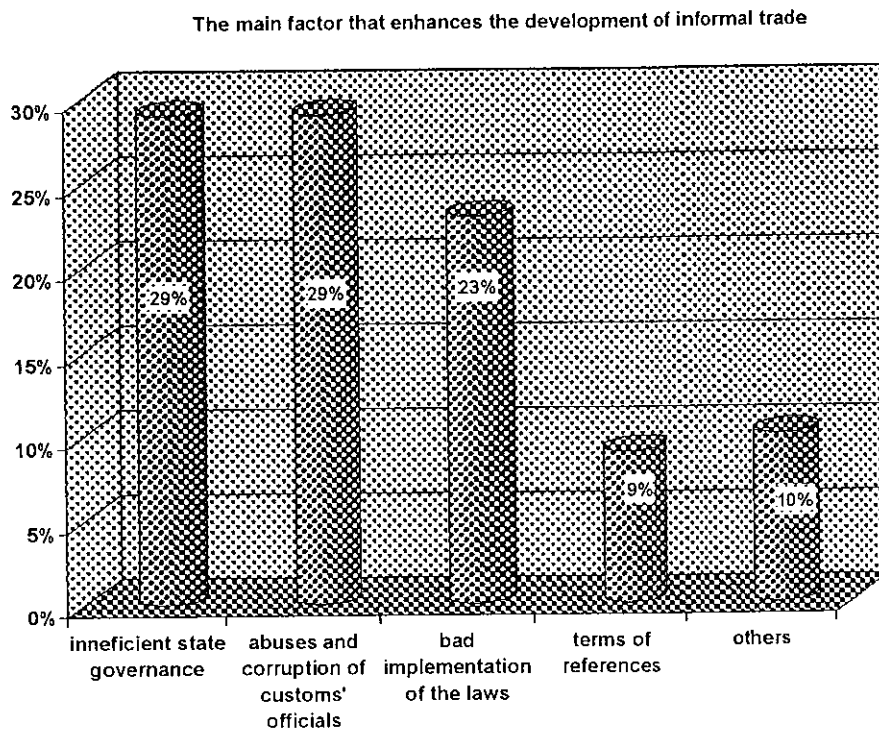


Graph 10

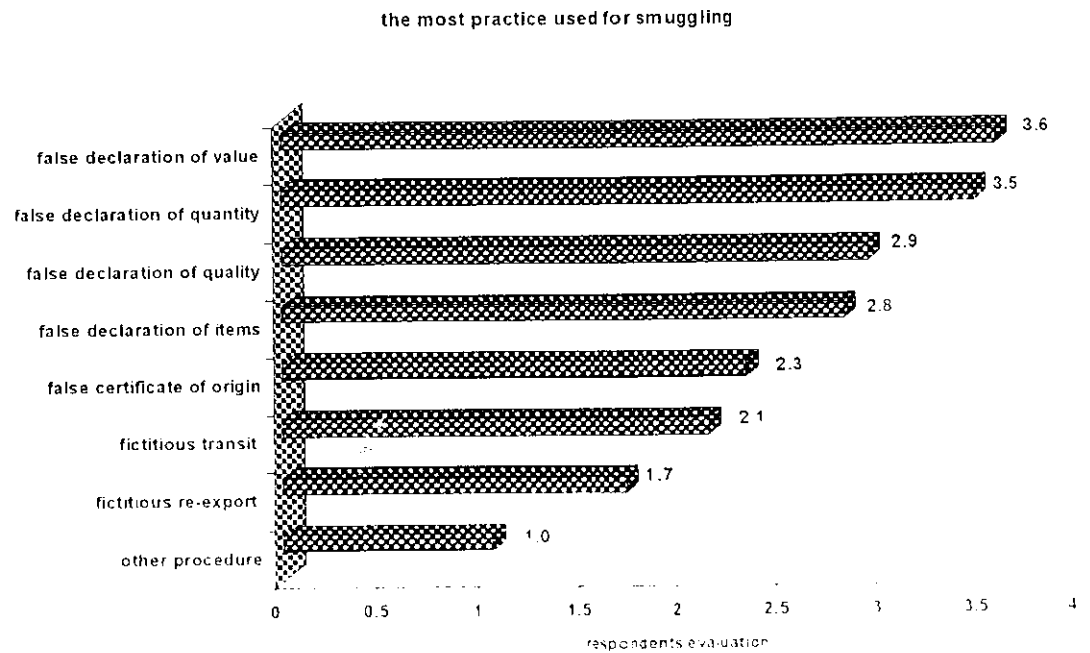
The subjects that are mainly doing smuggling



Graph 11

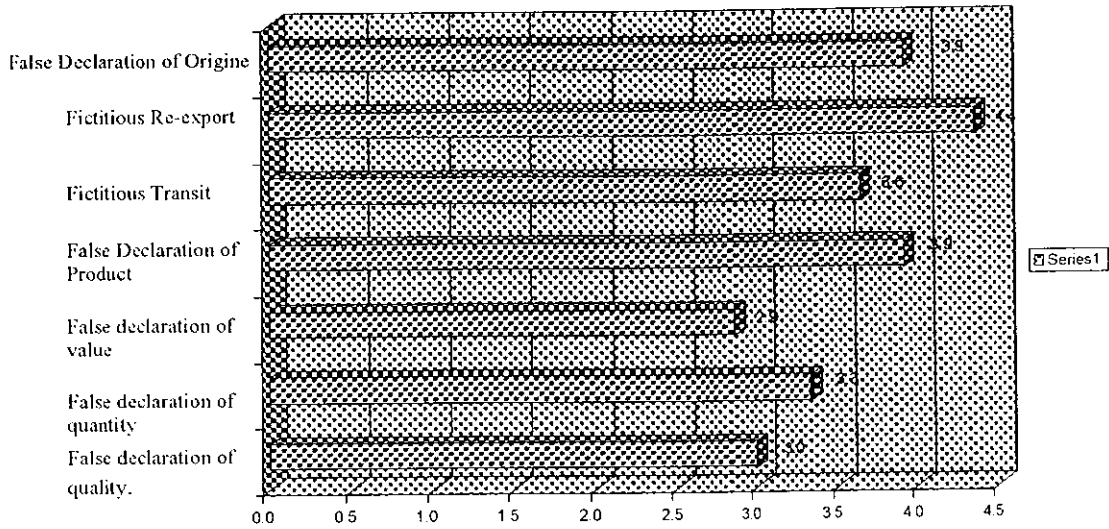


Graph. 12



Graph. 13

The most used Informal practice  
(Customs' Views)



Graph. 14

what % of the goods is entering in informal way?  
(Customs' views)

