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Informal Economy of Armenia Reconsidered

Hrant Mikaelian, Yerevan

Abstract

Informal relations are quite common in Armenia and include broad spectrum of relations within the society. Despite the fact that during the recent years, the government has taken some efforts to decrease corruption and formalize some of activities, the struggle affected the most obvious manifestations of corruption, whereas an informal approach to the problem solving is still considered a model in the society. Certainly, this applies not only to politics, but also to the economy.

The Shadow Economy in Armenia—Its Size and Dynamics

In Armenia, the discussion on informal economy is rather politicized, usually having very weak or no scientific basis. Government estimates informal economy between 30 and 40%, while opposition politicians use higher estimates, exceeding 45%.

As it was noted, there are different methods of calculating the shadow economy. Most of existing estimates refer to period of the mid-1990s to the mid-2000s. They are presented in Figure 1 on p. 5.

As it can be seen from Figure 1, different methods of calculation of the informal economy produce not only different results for the same period, but also, what is even more important, different trends.

The problem is not with the authors of these calculations, but the methodologies themselves seem doubtful and not likely to ensure accurate estimate of the size of the shadow economy. Therefore, it does not seem worth to reproduce these estimates and bring them until 2014. However, it is possible to assume the volume change of the shadow economy by using indirect indicators.

Gutmann believed that illegal operations are carried out in cash, while for the rest of the economy the share of cash out of the money base remains constant in a long run. According to his method, the exceeding volume of cash within the economy, compared to demand deposits, indicates presence of the shadow economy. Since 2008, there was a sharp decline in the share of cash in circulation, demonstrating a reduction of the informal sector. The same can be said concerning the change of the money multiplier (C/D), which indicates the ratio of cash in circulation to the demand deposits in recent years. In 2008 it consisted 3.2 and by the end of 2014 it has decreased to 1.9.

The taxes to GDP ratio also can be used as an indicator for the presence of shadow economy. It is based on the assumption that GDP is accounted better than the taxes are collected. If there was no change in tax size, while taxes to GDP ratio changes, the decrease in the ratio can indicate growth of the grey sector and tax evasion. By the same token, the growth of the ratio is a sign

of the informal economy decreasing. Since 2007, budget revenues grew faster than GDP and budget incomes/GDP ratio has reached its post-Soviet peak (25.1%) in 2014; the same can be said for the tax revenues (23.5% of GDP). These data are presented in Table 1 on p. 5.

According to the data presented in Table 1, the tax income to GDP ratio has grown from 20.5% in 2009 to 23.5% in 2014. This indicates a clear trend showing a decline in the volume of the shadow economy. All five statistical rows indicate the same trend. It shows that the anti-corruption reforms have been rather successful in decreasing informal transaction in the Armenian economy. The rest of this article tries to examine if this reduction can be attributed to a process of formalization of large businesses, SMEs or individual employment.

Are Monopolies and Big Businesses Going Formal?

Informality is not unique to Armenia. In many other post-socialist economies, as well as the developing economies outside the Europe and Central Asia region, local business elites enjoy monopolistic position or oligopoly in various commodity markets. These businesspersons often come from the administration, law enforcements or security agencies, or represent late Soviet nomenclature. What really makes Armenia different from the most other post-Soviet and many post-socialist countries is more profound change of political elites: very few of the local communist elite were able to keep their position after the revolutionary changes of 1988–1992. These changes run deep and impacted all levels of the Armenian society. According to the Life in Transition Survey 2010 (by EBRD), having parent being member of the Community party has a slight negative impact on household assets. Thus, the new elite in Armenia has grown and structured virtually from nothing; cooption mechanisms were varying from education to brave military past, from connections to business skills. It is against this background that one has to examine the connection between large businesses and the political sphere.

According to the BEEPS 2009 database, 19% of the Armenian economy is monopolized. More than any

other country in Eastern Europe and Central Asia, This is caused by the relatively small size of the Armenian economy, the absence of other economic centers in the country outside Yerevan, the “transport deadlock” status of Armenia (Armenia is landlocked country, blocked by Turkey and Azerbaijan).

The linkages between big business and politics and their apparent ability to avoid the constraints that seem to apply to other firms became, in the more recent years, a subject of public debate. But at the same time, one can observe a growing contribution of big businesses to taxes.

In 2008, the 25 largest taxpayers have paid 23% of total taxes, and in 2014—25% while in the first quarter of 2015, this share reached almost 27%.

As for taxpayers holding 26–100 places in the taxpayer information listings, these companies precisely belong to a group led by local big business owners (so called “oligarchs”). The taxation level grew in this category even faster than among the top-25. A preliminary conclusion would consider that these companies started to formalize their assets as a result of the gradual eradication of the “special agreements” which they enjoyed previously. However, since these companies compete to the rest economic enterprises, the change in the share of paid taxes might also be caused by the increase of the market share and additional studies are needed to be able to give a conclusion concerning that issue.

The Informal Economy, Corruption and SMEs

Small and medium enterprises are also often in the shadow. Corruption collusion allows SMEs owners to save a significant part of their turnover, thus increasing their competitiveness.

It is generally assumed that corruption and tax evasion are the results of weak institutions. Overregulation can push businesses moving in the shadow, or at least creates incentives for corruption. Thus a closer look at the dynamics of Armenia’s position in the World Bank Doing Business ranks presented in Table 2 on p. 6 can be helpful.

Until recently, paying taxes in Armenia faced serious burden of overregulation, which could be one of the factors supporting the informal economy. While in “paying taxes” subrankings, Armenia has recorded noticeable progress during recent years, the international trade remains a problematic sphere. Therefore, despite of the good performance in other areas, problems in tax and customs everyday practice and regulations are sufficient to push a significant part of business into the shade.

Moreover, in the provinces of Armenia, which are significantly poorer than Yerevan, tax evasion is often

included in the companies’ business strategy. Therefore, when the crisis of 2008–9 hit Armenia, the state started to take measures aiming at increasing of the level of tax collection. Many of SMEs in the regions have closed, being unable to remain competitive. Fighting corruption and enforcing tax collection can have many indirect effects, especially in countries like Armenia, where the informal sector provides a “cushion” against economic hardship.

Informal Employment in Armenia

Informal labor activity in Armenia involved a significant portion of the adult population. Approximately half of the population is considered to be self-employed or informally employment, which ends up to be de facto the same. Most of those people are active in the agricultural sector, which in Armenia is based almost entirely on small farms. In 2013, 444,000 self-employed were active in agriculture, while it was estimated that 146,000 were informally employed outside the agricultural sector, i.e. 19.7% of all employees in the non-agricultural sector (in 2009 their share was 24.6%). Informal employment in the non-agricultural sector can take many forms: informal employment in formal enterprises or informal enterprises, self-employment, partial declaration of wages,

Informal enterprises are more frequent outside the capital. In Yerevan, about 19% of workers are employed in the informal sector, in other towns the number is about 29%, and in the villages already 81% of employment refers to the informal sector. Excluding agricultural sector, the informal economy in the rural area would consist of 27% of total employment. Informal economy reveals gender imbalance as well: men make up 65% of all formally employed, while among informally employed their share drops to 53%. Thus, the share of informally employed is higher among women, depriving them of the guarantees provided by the labor code. and making them more vulnerable

By sectors, the largest share of informally employed in 2009 were involved in the construction works—the figure reached 58% of all those employed in this field. Informal employment was high in the field of most of the services as well (wholesale and retail trade, repairs—38.7%, hotels and restaurants—38.5%, transport, storage, and communications—21.5%), whereas in the real estate, renting, and business activities it was as low as 9%, education 1.2%, and in financial intermediation it was non-existent. 22.4% of involved in the industry were informally employed 22.4%. The average for the non-agricultural sector—as has been said consisted 24.6% in 2009 and 19.7% in 2013, showing the decrease of one-fifth during four years.

Conclusion

The informal economic relations, despite of the decline in recent years, still remain widespread phenomenon for Armenia. They involved both large companies and small and medium businesses.

Armenia has virtual secondary trade and renting markets operating via newspapers like “Gind” and internet-sites like <www.list.am>. Except for the selling apartments and advertisement used by the trade chains, most of the deals in these markets are informal. Renting real estate is officially taxed at 10%, but the government ignores the fact that virtually all real estate renting transactions other than renting company offices are informal.

In recent years, the reforms have been carried out in many areas of the economy and public administra-

tion. Largely, the reforms were the result of the political and the 2008–2009 economic crisis and forced the government of Armenia to seek incentives to improve the quality of administration, since foreign direct investment had a sharp decline since the beginning of the world crisis, while the initiative to open borders with Turkey had failed.

However, the reforms led to a significant reduction of the shadow economy, according to all the indirect indicators. As in many other aspect of economic development, the success of these reforms depends on their continuation. If they stop, there is a risk of gradual pull-back to ineffective governance and an increase of the shadow economy.

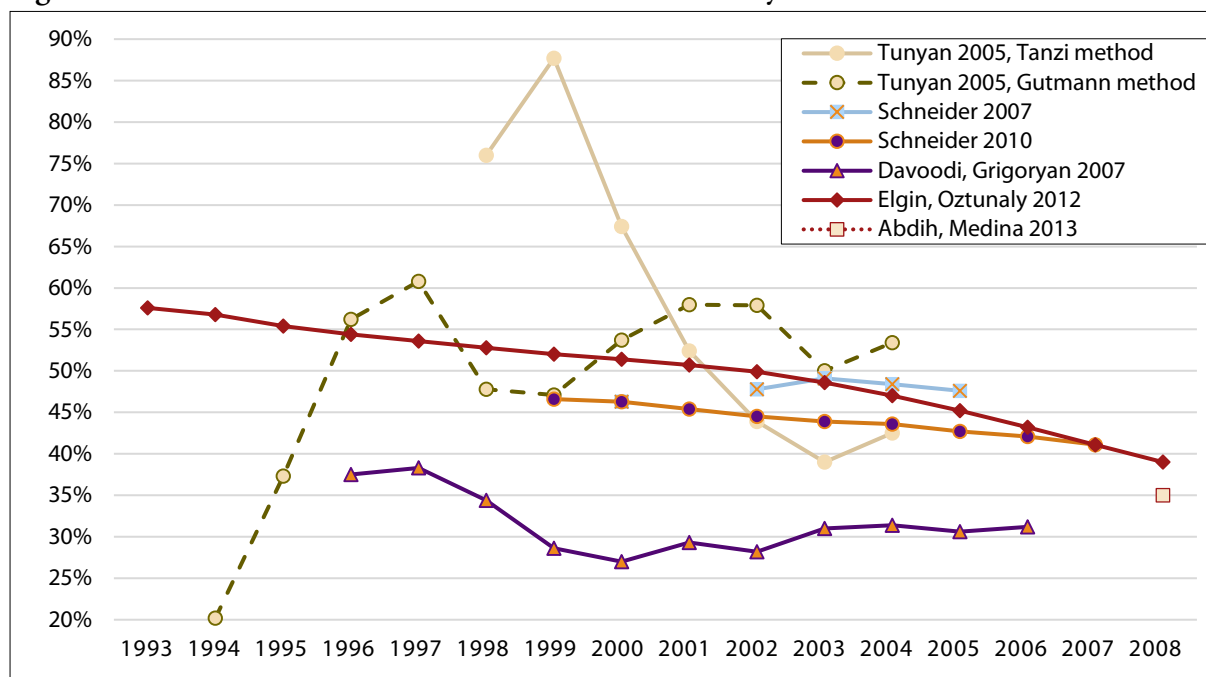
About the Author

Hrant Mikaelian is a researcher in social sciences at the Caucasus Institute, Yerevan.

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Figure 1: Past Estimates of the Size of the Informal Economy of Armenia



Sources can be found in "Further Reading" section. Compiled by Hrant Mikaelian

Table 1: Indirect Indicators of the Shadow Economy

	Money multiplier (C/D) ^a	Velocity of money ^b	CG budget incomes ratio to GDP ^b	Taxes to GDP ratio ^b	Share of cash in circulation of money supply, % ^a
2007	2.483	4.568	22.2%	15.7%	47.3%
2008	3.171	5.068	22.4%	20.6%	44.9%
2009	2.708	3.881	22.7%	20.5%	34.9%
2010	2.372	3.823	23.2%	20.8%	33.6%
2011	2.127	3.377	24.0%	21.1%	31.2%
2012	2.378	2.994	24.4%	22.5%	28.7%
2013	1.935	2.795	24.9%	23.4%	25.1%
2014	1.898	2.680	25.1%	23.5%	20.7%

^a Amount of cash is given at the end of respective year

^b The ratios were calculated using GDP accounted by the SNA-1993 methodology for the whole period (1991–2014)

Source: National Statistical Service of Armenia, author's calculation. Compiled by Hrant Mikaelian

Table 2: Paying Taxes and Trading Across Borders in Armenia, According to the WB Doing Business Index^a

	Period	Overall position	Paying taxes rank	Number of payments per year	Hours spent on paying taxes per year	Total tax rate (% of profit)	Trading across border rank	Docs to export	Docs to import
2015	Jun. 2013–May 2014	45/189	41	10	321	20.4	110	5	8
2014	Jun. 2012–May 2013	37/189	103	10	380	38.8	117	5	8
2013	Jun. 2011–May 2012	32/185	108	13	380	38.8	107	5	8
2012	Jun. 2010–May 2011	55/183	153	34	500	40.9	104	5	8
2011	Jun. 2009–May 2010	48/183	159	50	581	40.7	82	3	6
2010	Jun. 2008–May 2009	43/183	153	50	958	36.2	102	5	7

^a World Bank frequently changes the methodology of the rank, adding new parameters. However, revised data is not included into the table – the information concerns only data that was actual by the time of publishing each report and not revised.

Sources: World Bank Doing Business Rankings (2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015). Compiled by Hrant Mikaelian

Table 3: The Share of Taxes Paid by the Top-100 Tax-Payers of Armenia

	Total amount of tax incomes of the budget, bln. AMD	Taxes (share), paid by top-25 tax payers	Taxes (share) paid by the next 75 tax payers ^a
2008	736.4	171.9 (23.3%)	98.7 (13.4%)
2009	642.8	148.8 (23.2%)	83.5 (13.0%)
2010	718.4	169.1 (23.5%)	94.8 (13.2%)
2011	797.0	192.9 (24.2%)	106.8 (13.4%)
2012	898.4	224.8 (25.0%)	125.0 (13.9%)
2013	1000.9	258.9 (25.9%)	151.2 (15.1%)
2014	1064.1	264.7 (24.9%)	171.6 (16.1%)
2015 1 st quarter	232.5	61.9 (26.6%)	36.4 (15.7%)

^a This includes 26-100 positions of the full list.

Sources: Taxpayer Information Listings, Tax Service of Armenia (2008–2015). Compiled by Hrant Mikaelian