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## **Gray Economy as a Determinant of Economic Security – View From Serbia**

**Abstract:** *With new tectonic geopolitical changes, aggravation of the global economic crisis, consequences of the pandemic, disruption of the energy market and the economy of the Republic of Serbia, we entered a turbulent period of development at the beginning of the new millennium. Monitoring and studying informal, gray, parallel, hidden economic relations in the domicile economy continues to attract undiminished attention of economists, lawyers, sociologists, criminologists, and scientists from other social sciences, who try to determine its main characteristics, causes, and quantify its scale, as well as socio-economic consequences on economic security. It is possible to achieve the goals of economic security if the economic system of the country fulfils its function completely, in the absence of any form of endangering the economic potential of the national economy. In that sense, the role of the state is important.*

*In the absence of financial activity of the state, the economic security of the country would be endangered, which in turn would endanger the entire economic system, and thereby the state as a whole. In this scientific paper,*

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*the primary goal is to provide an analysis of the deep roots of dual economy in the modern economic fabric, and at the same time to examine the relationship between instrumental measures for its reduction on the one hand and possible action as a factor in its multiplication on the other.*

*The conclusions drawn from the actions of such opposing forces can be significant from the point of view of creating and conducting economic and social policy, as well as measures aimed at reducing the size of the gray economy. The method of research includes an excerpt and application of scientific methods, data selection and research scope.*

**Keywords:** *gray economy, economic security, destruction, crime, security.*

### Introductory remarks

In addition to the fact that more than half a century of conceptual detection of the gray economy has passed, it is difficult to find a generally accepted definition of this phenomenon, since there is no agreement regarding its manifestations. The conclusion is that gray economy is a complex and still insufficiently scientifically processed economic phenomenon, which is reflected in a large number of different conceptions related to its definition and in the existence of several names for this unique phenomenon. Given the relatively short period in which the gray economy is seriously studied and the great variety of its forms, it can be said that this situation is not unexpected. (Čudan, Nikoloska, 2018: 193) In most scientific and professional manuscripts, the term gray economy is far better known and more frequently used. Without entering into the semantic aspect of the name itself on this occasion, we keep it as an adequate expression for the special form of all the negative activities that will be discussed. (Pilić, 1991: 131)

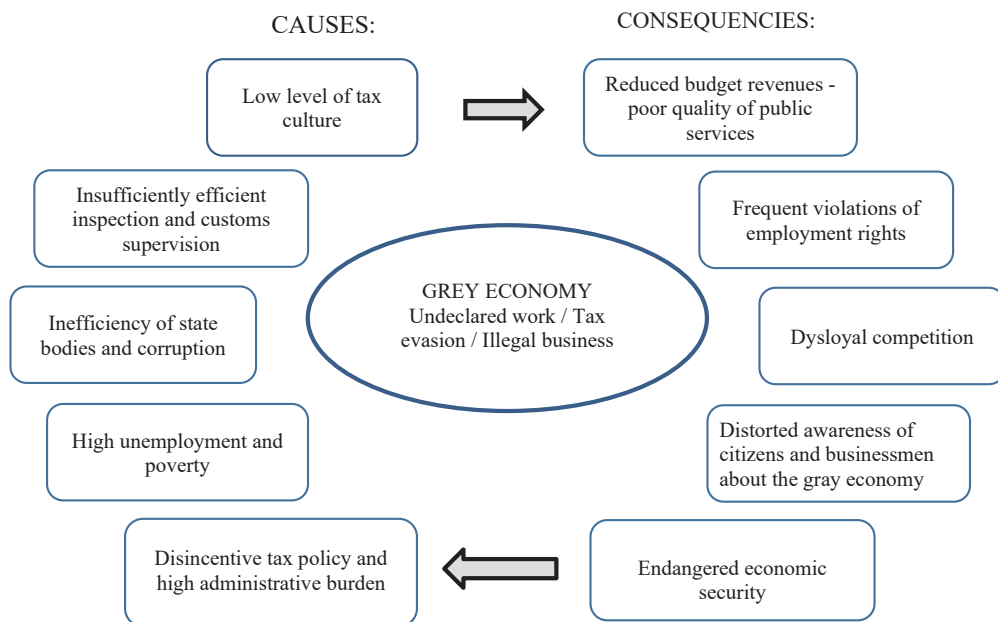
Achieving security goals and the competence of the state determined by law is impossible without adequate economic resources. Lack of development leads to security threats, illegal market, unemployment, poverty, reduced investment, political instability, reduced inflows of budget funds and, ultimately, conflict. Development practitioners have realized that it is impossible to consider developmental aspects without considering conflicts in the economic sphere.

The views expressed point to the fact that economic resources are the basis of economic, and thus national security of the country. By monitoring and evaluating economic indicators, it becomes clear what the

results of the work of the national economy are and what is expected of them.

### Basic Causes and Forms of Gray Economy

In order to be able to approach the empirical assessment of the scope and causes of the gray economy, it is necessary to provide a full understanding of the phenomenon of the gray economy and economic security, and bring them into a functional relationship. The importance of the informal economy and its potential is recognized at both the national and the international level, and especially its interactive relationship with the phenomenon of economic security. In order to solve the problem of the gray economy more efficiently, it is necessary to establish its scope, causes and consequences.



**Figure 1:** Causes and consequences of gray economy

So far, the analyses that have been applied have identified the following basic causes of gray economy:

- the imperative reason is economic power, i.e. profit, which they

reap by reducing their costs, i.e. by avoiding paying obligations to the state or various criminal acts that they keep secret;

- the cause and motive for inclusion in the gray economy may be the provision of subsistence or the realization of additional benefits; members of the lower social strata are often forced to participate in the gray economy, while for some individuals engaging in informal activities it is their voluntary choice;<sup>14</sup>
- institutional factors, the rule of law and the poor functioning of state bodies (judicial, tax, police, budget inspection) are also key causes of the spread of the informal economy;
- weak institutional capacity must not be overlooked, as well as inter-institutional coordination that is not at an enviable level;
- the action of interest groups creates an imbalance in society by distributing social wealth in favor of a well-organized minority, which accelerates the emergence of the gray economy, creating imbalances in the market;
- complicated regulatory framework subject to frequent changes, inconsistent application of regulations, and insufficient knowledge of regulations;
- weak capacity of state institutions and public administration in enforcing regulations;
- relatively high tax and non-tax burdens;
- low level of tax culture of citizens and economy;<sup>15</sup>
- high unemployment and poverty rates.

There is extensive literature on the possible causes of the informal economy, but the most frequently mentioned factors are:

- economic - high tax levies, financial problems, strict sanctions, expected profits;
- psychological - distrust in the state, disagreement with economic policy, as well as the attitude towards risk;
- opportunity factors - include education and work experience in performing economic activities outside the legal regulations. (Čudan, Nikoloska, 2018: 194)

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14 With this in mind, a distinction should be made between these two participants in the gray economy and measures to combat the gray economy, ie adjusted so that lower purchasing power groups are not put in an even worse position.

15 Tax morale is defined as the readiness of the taxpayer to settle his tax obligations in full and on time, which significantly affects the level of the gray economy.

Crime is more and more organized, and the manifestations of the gray economy are more and more subtle, while the sources of this phenomenon are complex and it is difficult to clearly distinguish them. Nevertheless, the gray economy appears as the basis that feeds economic torts. In order to understand the phenomenon, we need to single it out and take a stand regarding it. In theory and practice, there are two types of evasion:

1) legal evasion

- change of place of fictitious residence (Monaco, Cyprus, Luxembourg,
- Liechtenstein);
- giving up the consumption of taxable products;
- finding a “hole in the law” (privatization from abroad, purchase of shares, etc.)

2) illegal evasion

- tax evasion;
- smuggling;
- illicit trade;
- undeclared work.

In the Republic of Serbia, it is almost common practice to perform various business and financial transactions without paying taxes, while avoiding those taxes that are most important for the state.

Practice shows that we have a situation of hiring workers without official registration, where such workers are paid from daily markets, or unregistered funds, paid salaries to employees through youth and student cooperatives with minimal taxes, while the tax authorities are shown that salaries are not actually paid. Businesses in the construction sector are almost twice as likely to be in the informal economy as in the other services sector.

The possibility of tax evasion also exists from property income. Illegal construction is another important indicator that our construction industry is a generator for the informal economy. The exact number of illegally built facilities in Serbia has never been determined. The existence of a large number of buildings that are not taxed is a clear message that the state tolerates the gray economy.

Rich multinational companies are involved in the gray economy in order to avoid taxes and other costs, but also small companies that could not bear the costs of doing business in the formal economy. This modern

form works by forming more flexible and specialized production units, some of which remain unregulated, while employing an increasing number of non-standard workers in various places and locations. As a rule, these part-time workers are not employed in the gray zone, but flexible forms of work such as temporary and occasional jobs, the so-called leasing, are often abused.

From the tax point of view, the gray economy represents the value of taxable activities and rights for which no tax has been paid, and which are taxable according to the law. Tax evasion is the difference between the tax liabilities of the taxpayer under applicable regulations and the reported tax liabilities. All the listed forms, as well as the functioning of both sectors within the informal economy were observed within our country and our experience. We strive, wherever possible, to always point out our specific traditions and all other circumstances that create a favorable climate for the emergence of various forms of gray economy.

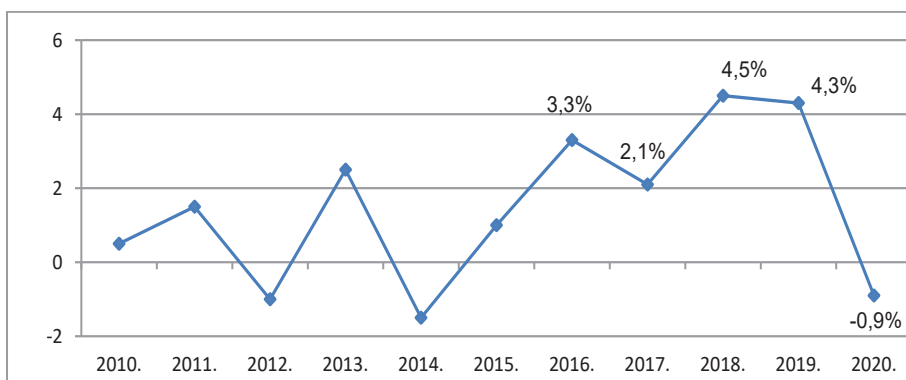
### **Determination of the Gray Economy as Determinants of Economic Security**

In this scientific article, we could not even list all the forms of informal, i.e. gray economy. They range from shopping abroad or benign smuggling to buying and selling human organs. The phenomenon continues to manifest itself from the sale in the shadow of old and new types of weapons, the purchase and sale of new technologies, the sale of individual companies to the suffocation of entire branches in individual countries and the emergence of new forms of economic destruction. on the economic security of a country. Shadow economy also raises a number of very complex theoretical questions. In one possible and possibly wider edition, we will present them in detail, given that we are in the process of further research on all these issues of the informal economy as a determinant of economic security. Research in our country on the topic of the gray economy and its impact on economic security is not reliable enough, does not include enough criteria and therefore it is desirable that the assessments are not made lightly.

The economic potential deprived of various types of destruction, even the gray economy, can be easily transformed into military power, and the economic wealth and ability to mobilize the resources necessary for the defense of the state. Constant economic growth, as well as gross

product growth is one of the basic factors of national security because the state provides its citizens with an optimal standard of living, and on the other hand the development perspective enables investment in those economic security instruments that prevent security threats. (Stajić, Milošević, 2017: 175) In this part, the intention is to consider the basic indicators of economic development and its impact on the economic security of the Republic of Serbia.

Macroeconomic and microeconomic factors are analyzed for several reasons, because they maintain the economic condition of the state and the individual. From the aspect of economic security, the most important macroeconomic indicator is the level of gross domestic product. Gross domestic product represents the value of final goods and services produced on the territory of one country in a certain period of time, usually one year. The stated parameter is extremely important because it shows whether the national economy is in crisis, development, and whether it is exposed to a possible recession or uncontrolled inflation.

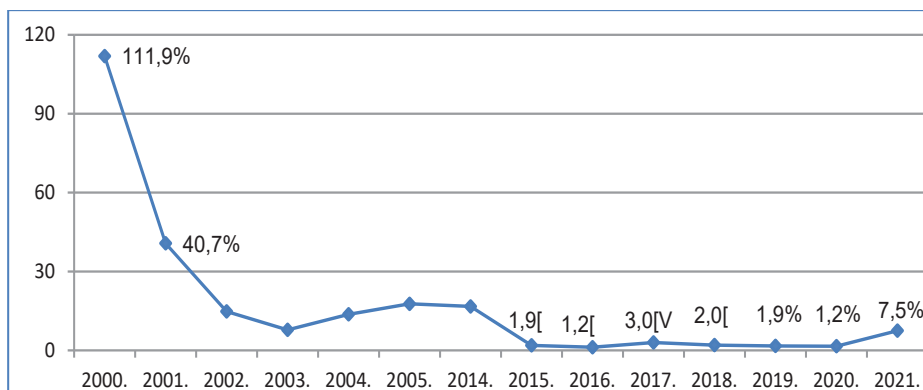


**Graph 1:** Gross domestic product trend of the Republic of Serbia 2010-2020

It is evident that the growth rate of gross domestic product in some years is above, and in some below the average rate, namely the maximum real growth rate of 4.5% was recorded in 2018, while a decline of -0.9% was recorded in 2020. (Republički zavod za statistiku, 2021) Negative impact on the budget of the Republic of Serbia, which is partly endangered by the emergence of the informal economy as a determinant, which negatively affects the efficiency of national security entities.

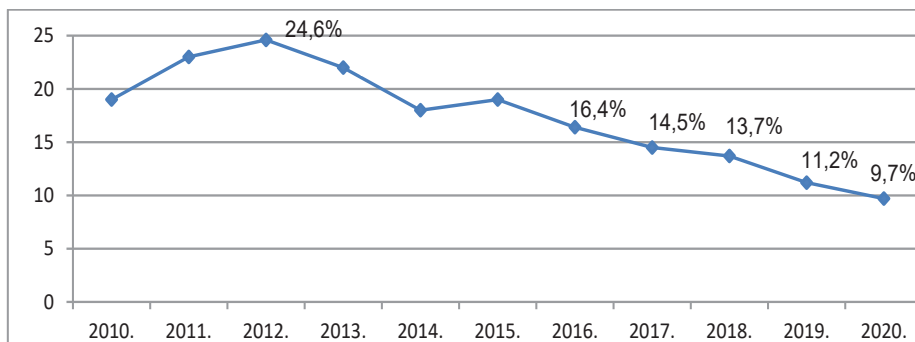
Economic stability is reflected in political stability, and on the other hand an efficient and developed national economy determines the state

budget, which is crucial for the functioning and development of the national security system, i.e. for the security of society and the state, but also for meeting the needs of citizens. Successful budget consolidation in the context of economic security requires great budgetary discipline and accountability.



**Graph 2:** Annual inflation rate in the Republic of Serbia 2000-2021

Despite the fact that the continuation of favorable movements of basic macroeconomic indicators of the crisis caused by the Covid virus is planned for 2021, it has led to significant changes and certainly influenced the implementation of the projected trend of gross national product and curbing inflation. The beginning of the new millennium was marked by an annual inflation rate of 111.9%, which was recorded in 2000, while in the period 2018-2020 inflation in the Republic of Serbia was at a stable level of 2%. (Graph 2)



**Graph 3:** Unemployment rate in the Republic of Serbia 2010-2020



The analysis of the gray economy as a determinant of economic security, in addition to macro-factors, includes a micro-level that is concentrated on the individual, and primarily deals with ensuring his existence. This level of analysis is usually referred to as internal economic security. It realizes its negative impact on human and national security through unemployment, poverty, low living standards, pronounced antisocial behavior, economic insecurity, lack of prospects.

The high unemployment rate<sup>16</sup> is also a great challenge from the aspect of economic security. This trend leads to an increase in certain forms of economic crime in society, as well as the gray economy, organizing outside official channels, or working illegally. Unemployment also has a negative effect on state social funds through allocations for this category of people. The unemployment trend in the Republic of Serbia (Graph 3) illustrates that in 2012 the highest number of unemployed persons was 24.6%, while the unemployment trend in 2020 was at a minimum level and amounted to 9.7%.

### **Institutional Reaction of the State**

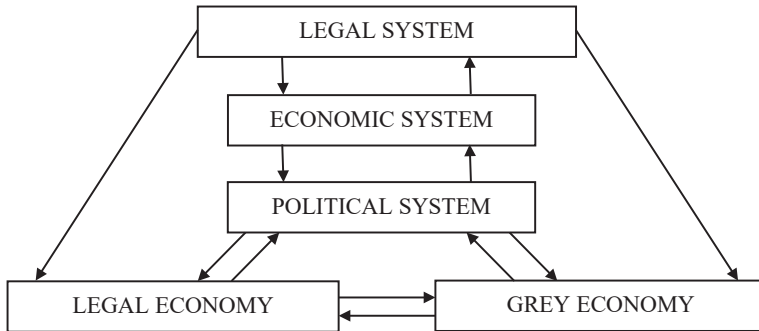
It is imperative that in this section we emphasize that we have rightly included the category of shadow economy with all its manifestations in this research and presentation in global security issues. Each country has an obligation to oppose the forms of shadow economy, in accordance with its capabilities and having in mind its institutions, legislation and sanctions that arise after identifying the phenomenon and entities that produced it, or participated in the practice of gray economy. The Program for the Suppression of the Gray Economy with the Action Plan for the Implementation of the Program for the Suppression of the Gray Economy for the period 2022-2025 was adopted by the Government of the Republic of Serbia. (Zakona o planskom sistemu Republike Srbije, Službeni glasnik RS, 2018)

Combating the gray economy depends on the institutional reaction, legal solutions and application of numerous regulations from various fields, including regulations governing the establishment and opera-

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<sup>16</sup> According to the Law on Employment and Insurance, Art. 2 p. 1. "Unemployment in the sense of this law is a person of 15 years of age capable and immediately ready to work, who has not established an employment relationship or otherwise exercised the right to work, and who is kept on the unemployment register and actively seeks employment."

tion of economic entities, labor relations, inspections, tax system, which also contributes to the European integration process. (Vlada Republike Srbije, Program za suzbijanje sive ekonomije 2022-2025, 2022)



**Figure 2:** *Gray economy as an 'element' of the social system*

**Tax Administration.** The tax system in all countries is subject to constant theoretical and political reviews, so in most countries significant changes in the tax system occur from time to time. The tax authorities of all EU member states must be connected to appropriate electronic systems for monitoring and controlling data, in order to detect and reduce tax evasion and fraud, and consequently reduce the size of the gray economy. At the same time, at the level of the European Union, there is a single electronic system for monitoring the movement of excise goods in real time, with the aim of facilitating the fight against tax evasion.

The Republic of Serbia deserves a modern tax administration that provides sustainable and predictable public finances, which is inconspicuous and ubiquitous and fully integrated into the natural environment of taxpayers. Through work with the modern Tax Administration, the fulfillment of tax obligations will be simplified for taxpayers, which, along with conducting an adequate tax policy, is a basic precondition for growing voluntary compliance with tax regulations, combating the gray economy and healthy economically secure economic development in Serbia.

**Customs Administration.** The Customs Administration is the executive body of the Government of the Republic of Serbia within the Ministry of Finance, which implements the customs policy. The role of this state body has historically changed over time from traditional to modern. In this context, the role is to maintain a lasting balance between core

tasks, fundraising and trade facilitation. (Ministarstvo finansija, Uprava carina Republike Srbije, Poslovna strategija 2020-2024, 2020) The Customs Service of the Republic of Serbia is one of the important institutional factors that on the one hand can contribute to the emergence of the gray economy, and on the other hand can successfully fight to reduce the gray economy and the black market. Today, her place and role are very different. Apart from being an important and unavoidable link in the chain of international trade, the modern customs service plays an extremely important role, both in the collection of customs duties, value added tax, excise duties, and in the system of economic security.

The role of the Customs Service in suppressing illegal economic flows inherited from the authoritarian past and the time of application of the international embargo is very important. In terms of creating normative settings for better functioning of the customs service, a significant step forward is the adoption of a new customs law as well as the Business Development Strategy of the Customs Administration 2020-2024.

**Table 1:** *Illegal intake of oil, cigarettes and tobacco detected by the Customs Administration of the Republic of Serbia in the 2013-2021 period*

Excise products	Oil (l)	Cigarettes (pcs)	Tobacco (kg)
2013	/	3.911.740	800
2014	/	6.977.289	4.207
2015	58.828	2.436.445	4.386
2016	49.274	15.288.450	951
2017	33.033	16.270.260	998
2018	254.201	1.095.334	1.394
2019	33.938	4.312.018	419
2020	221.955	4.189.300	15.344
2021	320.903	1.038.571	3.233

**Source:** *Act no. 148-III-650-03-8 4/2022 , 2022, Belgrade Customs Administration*

**Table 2:** *Illegal entry of foreign currency detected by the Customs Administration of the Republic of Serbia in the 2013-2021 period*

Sanctions	2013	2014	2015	2016	2017	2018	2019	2020	2021
Foreign exchange offenses (€)	2.753.520	2.730.694	4.711.638	3.732.734	4.435.494	2.914.075	3.082.044	7.448.735	3.639.854

**Source:** *Act no. 148-III-650-03-8 4/2022, 2022, Belgrade Customs Administration*

Ministry of Interior. As the informal economy is a complex phenomenon in itself, multidisciplinary knowledge and observation from different angles are needed to combat it. In this part, the emphasis is primarily on the function of protection and preservation of the legal economy by the Ministry of Internal Affairs of the Republic of Serbia, and the basis for taking measures is criminal protection provided in the Criminal Code of the Republic of Serbia in the group of crimes against the economy. The basic form of the fight against the reduction of the gray economy must be legal regulations that directly link the acquisition of property with legal income. This commitment stems from the projected Development Strategy of the Ministry of the Interior 2018-2023

**Table 3:** *Structure and number of crimes in the field of gray economy*

Year	Tax evasion Article 229	Smuggling Article 230	Illegal trade Article 243	Illegal production Article 242
2010	421	368	287	7
2011	275	205	240	10
2012	352	127	271	10
2013	257	75	356	25
2014	188	118	398	89
2015	186	138	562	88
2016	227	114	549	70
2017	308	135	412	84
2018	187	60	177	23
2019	36	6	29	9
2020	7	0	26	2
2021	25	1	14	3

**Source:** *Ministry of Internal Affairs of the Republic of Serbia*

The human and material resources used to combat criminal activities in this area affect the outcome of the police. The results are visible and significant, which can be determined by analyzing the statistical indicators in Table 3, but it is indisputable that greater investment in combating illegal activities related to organizing in the gray zone would cause extremely positive results. The efficiency of the work of the police in the fight against crime in the field of gray economy can be improved by better coordination with other state bodies engaged in the field of protection of legal economic flows.

Labor inspection. Inspections are a very important and indispensable link in the fight against the gray economy. Through the introduction of the e-Inspector system, which is currently in use in 36 inspections, the work of inspectors has been greatly facilitated and the efficiency of inspections has been improved. In one of the mentioned segments, on the basis of the Labor Law of the Republic of Serbia, (Službeni glasnik RS, 2015) it is envisaged that the labor inspection supervises the application of that Law and other regulations on labor relations which regulate the rights, obligations and responsibilities of employees. Combating informal unemployment is the primary responsibility of the labor inspector, which is organized as a separate sector within the Ministry of Labor, Employment, Veterans' Affairs and Social Affairs. During 2020, the Contact Center of Republic Inspections started operating as a single point for receiving applications from citizens and the economy related to all inspections. Greater efficiency and adequate resources directed to inspection practice can significantly contribute to the suppression of the gray economy, but they must also be complemented by measures related to the capacity and efficiency of misdemeanor courts.

**Table 4.** Overview of the overall results of the inspection of 'illegal' work on the territory of the Republic of Serbia in the 2007-2021 period

Year	Total number of inspections	Number of persons covered by supervision	Number of persons caught working 'illegally'
2007	48.255	268.682	10.448
2008	42.595	306.416	9.054
2009	40.222	357.498	5.734
2010	37.747	558.536	5.228
2011	33.920	503.613	5.744

Year	Total number of inspections	Number of persons covered by supervision	Number of persons caught working 'illegally'
2017	53 424	510 725	22 411
2018	70 122	629 834	17 026
2019	77 806	658 744	12 938
2020	62 475	546 702	5 951
2021	63.670	426.023	5.261

*Source: Report on the work of the Labor Inspectorate for 2021*

According to labor inspectors, undeclared work is most common in trade, construction, industry and catering. In some activities, it has been noticed that the number of workers engaged in illegal activities in the same periods increases every year, which is especially characteristic for catering and construction.

## Conclusion

Increasing attention is being paid to the segment of economic security, frequently referred to as a condition for the stability of the national economy. The emergence of various forms of economic crime, and thus the informal business system, has led to security becoming a major issue for many countries, and legal regulations and institutions are increasingly required to contribute to the goals of economic security. This scientific paper analyzes the basic economic factors and conditions that affect or may affect economic security. The paper also deals with the theoretical analysis of problematic economic and political aspects of the gray economy as a determinant of economic security.

In order to better understand the phenomenon of the gray or - as it is more subtly called - hidden economy, it is necessary to acquire basic knowledge about the scope and development of this phenomenon, as well as the motives for direct involvement of people in illegal economic flows. We analyzed the causes of the gray economy using, where possible and appropriate, elementary theoretical analysis, comparative statistics and views on the functioning of institutions, which is also the result of research.

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## Siva ekonomija kao determinanta ekonomske bezbednosti – pogled iz Srbije

**Apstrakt:** Sa novim tektonskim geopolitičkim promenama, zaoštavanjem globalne ekonomske krize, posledicama civilizacijske pandemije, poremećajem na energetsom tržištu i ekonomija Republike Srbije ušla je na početku novom milenijumu u turbulentno razdoblje razvoja. Praćenje i izučavanje neformalnih, sivih paralelnih skrivenih ekonomskih odnosa u domicilnoj ekonomiji i dalje privlači neumanjenim intenzitetom pažnju ekonomista, pravnika, sociologa, kriminologa i naučnih radnika iz drugih društvenih nauka, koji pokušavaju da odrede njene glavne karakteristike, uzroke, te da kvantifikuju njene razmere i društveno-ekonomske posledice na ekonomsku bezbednost. Jedan od elemenata politike nacionalne bezbednosti jeste i ekonomska bezbednost. Realizovati ciljeve ekonomske bezbednosti moguće je ako ekonomski system zemlje ostvaruje svoju funkciju u potpunosti, uz odsustvo bilo kog oblika ugrožavanja ekonomskog potencijala nacionalne ekonomije. U tom smislu začajna je uloga države.

U nedostatku finansijske aktivnosti države ekonomska bezbednost zemlje bi bila ugrožena, što povratno ima za posledicu ugrožavanje celokupnog ekonomskog Sistema, a time i države u celini. U ovom naučnom prilogu primarni cilj je pružiti analizu duboke ukorenjenosti dualne ekonomije u savremeno ekonomsko tkivo, a ujedno preispitati međusobni odnos mera instrumenata za njeno smanjenje sa jedne strane i moguće delovanje kao factor njenog multiplikovanja sa druge strane.

Izvedeni zaključci delovanja ovako suprostavljenih degenerativnih sila mogu biti značajni sa stanovšta kreiranja i vođenja ekonomske, socijalne politike, kao i mera usmerenih na smanjenu obima sive ekonomije. Način istraživanja sadrži izbor i primenu naučnih metoda, izbora podataka i obuhvat istraživanja.

**Ključne reči:** siva ekonomija, ekonomska bezbednost, destrukcije, kriminal, bezbednost