



# Impact of the Shadow Economy on the Entrepreneurship in Latvia

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October 1, 2010



# Some common truths

- The global recession increased the number of enterprises who are either fully or partly in the shadow economy
- If the shadow economy is growing:
  - Less chances for the legal business – they lose market share;
  - The legal optimization of expenditures may turn into illegal.
- The increasing tax burden creates a risk of lower tax revenues.
- To find a way out of the crisis the State has to encourage creation of new enterprises, support the existing legal enterprises and create an environment supporting the transition of the “grey economy” into the legal sector.



# Impact of the Shadow Economy on the Legal Business

- Reduced turnover and profits
- Pressure to optimize expenditure (even transition into the “grey” economy)
- May squeeze the legal enterprises out of the market
- Fictitious enterprises, unregistered activities



# The Current Environment favours the “Grey” Business

Some possibilities of (illegal) optimization:

- “Envelope” wages,
- Illegal employment (up to 70% in cleaning services, high share also in construction)
- Full or partial tax evasion, undeclared incomes,
- “Double accounting”,
- Transactions in cash,
- Illegal production,
- Creation of off-shore companies,
- Falsification of documents.

The items above could refer to any industry!



# Status quo (1)

- LDDK signed an agreement with the Parliament on December 21, 2009 on cooperation to reduce the shadow economy

<http://www.lddk.lv/index.php?c=100&group=archive&p=1268&page=1>



- Plan for Reduction of Illegal Employment (MoW)
  - The Plan details the key problems, but the solutions are mainly directed at the complying entrepreneurs. A new burden for the legal business (?)
- Plan for Reduction of the Shadow Economy (MoF)
- Supporting measures for Microenterprises



# Status quo (2)

- Labour Law
  - The Employers' organization representing 50% of the employed in the industry or 60% of the turnover, have broader rights to set the minimum wage in the industry etc.
- Public Procurement Law
  - Now states that the enterprise has to pay wages of at least 70% of the industry average in order to get access to public contracts.



# Business Initiatives

- Creation of the Sustainability Index  
<http://www.ilgtspejasindekss.lv/indekss-2010/>
- Increasing role of the Employers' Organizations:
  - Possible general agreements within the industries
  - Exclusion of tax evaders from the industry associations



# Key Principles of Solutions

- More efficient control by the state institutions – cooperation, new technologies,
- Protection of legal goods and businesses,
- Cooperation/dialogue with the state institutions,
- Improved regulations regarding the general agreements in industries,
- Supportive tax legislation to increase production,
- Tax amnesty (transition to the legal sector with a possible amnesty regarding the previous wrongdoings)
- High quality public sector.





# Additional Caveats

- When eliminating the “grey” economy, don’t forget about the creation of the legal one. Otherwise, the situation will continue to worsen, higher unregistered unemployment etc.
- Foreign investors are not interested to invest in businesses, which are in the “grey” area,
- Banks are not interested to cooperate with businesses and provide loans if there are suspicions of “grey” activities.





**Thanks for your attention!**

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