



CORRUPTION REPORTS 2016:  
**HIDDEN ECONOMY  
IN TURKEY**

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Southeast European Leadership for Development and Integrity (SELDI) is the largest indigenous anticorruption and good governance initiative of CSOs from Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Macedonia, Montenegro, Serbia and Turkey. SELDI currently includes partners from Romania and Moldova as well. SELDI contributes to a dynamic civil society in the region, capable of participating in public debate and influencing policy and decision-making process in the area of anticorruption and good governance. The initiative established a coalition for the development and endorsement of a regional CSO strategy and action agenda and carries out good governance monitoring. SELDI raises public awareness and advocates reformist policies through Regional Good Governance and Anti-Corruption Policy Forums.

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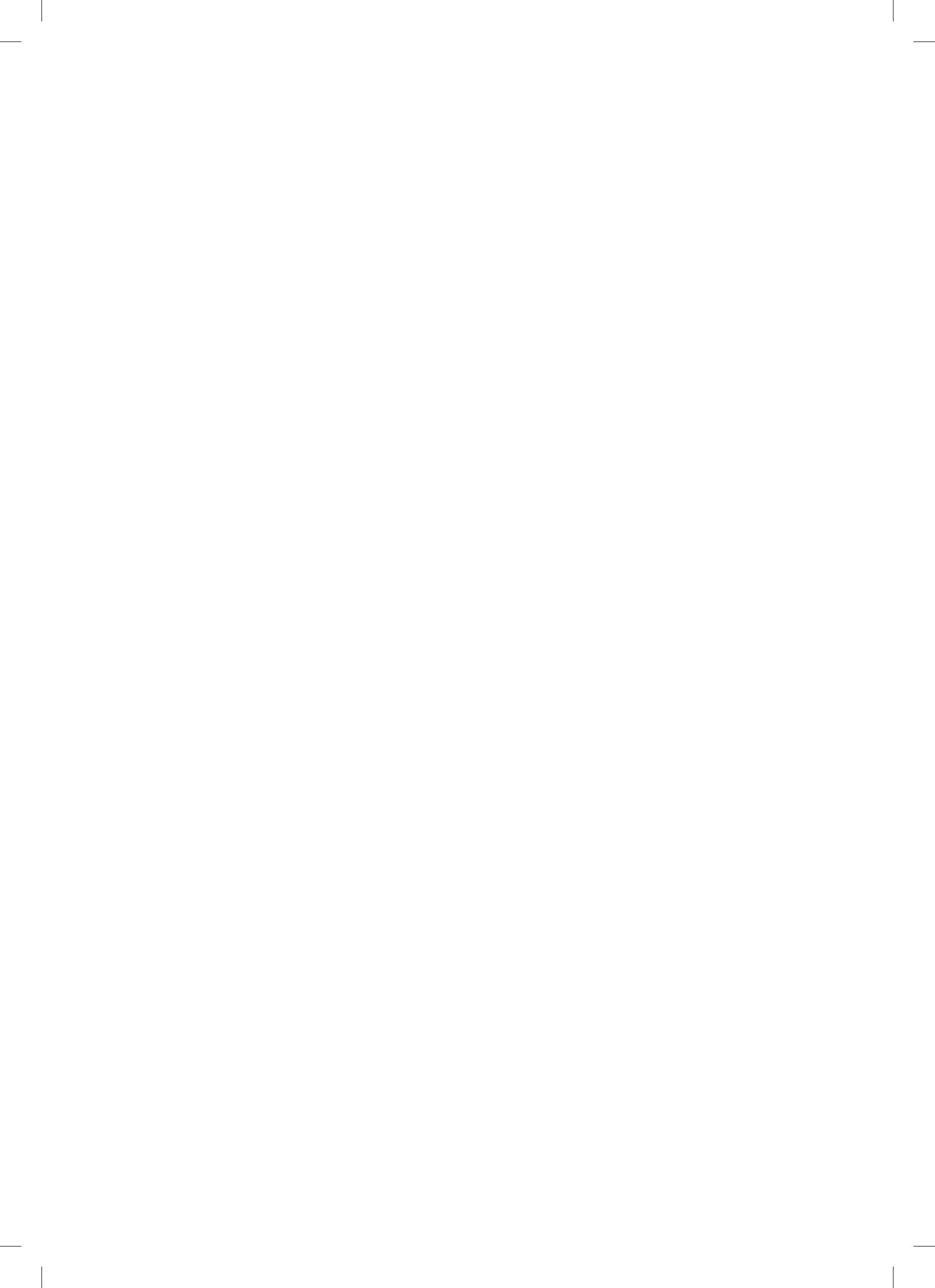
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## FOREWORD

This report is the product of the research conducted by TESEV within the scope of the network of Southeast European Leadership for Development and Integrity (SELDI). Comprised of 15 NGOs from the states of Montenegro, Bosnia-Herzegovina, Serbia, Albania, Macedonia, Kosovo, and Turkey, the SELDI network acts as a transnational research and collaboration platform for these NGOs. The main goal of the SELDI partnership, through empirical research and data-based assessments of corruption, is to understand and alleviate the problems of corruption and the lack of good governance which have become deep-rooted in Southeastern European states and Turkey.

In 2014, SELDI carried out a comprehensive assessment of corruption in Southeast Europe (SEE) covering the various aspects of the legal and institutional environments of nine countries, outlining the characteristics and challenges of state capture and measuring actual levels of corruption.<sup>1</sup> SELDI seeks to bridge analysis and policy design and to use it for civil society capacity building for good governance. As a follow-up to the recommendations of its 2014 analysis, the second phase of the SELDI partnership continued with capacity building projects, public awareness campaigns, and comprehensive analyses of regional corruption issues in 2014 – 2016. This report is the product of regional corruption assessment research and focuses on Turkey. It is the third report of the Corruption Reports 2016 that covers public perceptions of corruption, corruption challenges in the energy sector, and the state of hidden economy in Turkey.

Hidden economy is a complicated phenomenon, and not every activity in this realm equates to corruption. However, it causes vulnerabilities for workers and public sector and generates a grey area prone to corruption. Market and financial conditions lose reliability, social security and tax morale weaken undermining social welfare in general, and access to fair competition and concomitant rights are damaged. Furthermore, public revenue decreases, and rent seeking and corruption pressure proliferate when legal and financial monitoring lacks. This report discusses hidden economy from various angles by analyzing the root causes, repercussions, and current situation of hidden economy in Turkey, and offering ways to tackle it. It also draws attention to social embeddedness of the phenomena by shedding light onto the hidden economy - corruption nexus and other disadvantages.

The policy recommendations focus on key issues of monitoring, taxation, economic transformation, social security, and the role of local governance. It is argued that principles of good governance, such as, transparency, accountability, fiscal discipline, and architectural design of institutions that promotes participation, rule of law, and the right to equal opportunities are crucial to prevent hidden economy. Moreover, it is emphasized that civil society is an important actor in improving governance and tackling hidden economy and corruption. This report and overall SELDI project are part of civil society efforts in raising awareness on corruption and hidden economy, providing evidence that can be utilized in fighting against both.

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<sup>1</sup> SELDI. (2014). *Anti-Corruption Reloaded: Assessment of Southeast Europe*. Center for the Study of Democracy: Sofia.



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## HIDDEN ECONOMY IN TURKEY

SELDI network have proposed to prepare a hidden economy overview to contribute to understanding the hidden economy and tracing its links with corruption that are significant for both anti-corruption practices and increasing welfare in Southeastern Europe (SEE) countries. Anticorruption policies alone are unlikely to produce wide societal support, unless they are imbedded in economic reform and increase in prosperity. Therefore, a broadening of the anticorruption debate from sheer law enforcement towards more economic grounded rationale, such as addressing the nexus between corruption and hidden economy, is needed. According to the SELDI Hidden Economy Survey, the hidden sector occupies between a quarter and a third of the SEE economies.<sup>2</sup> Hidden employment remains highly present in SEE, creating risks of the exclusion of sizable shares of the workforce from the rule of law and placing the informally employed in a vulnerable position with respect to rent-seeking officials and to illegal business interests. This perpetuates the hidden economy – corruption vicious circle.<sup>3</sup>

Understanding the relationship between corruption and hidden economy is challenging as both are hard to measure phenomenon. Some argue that they are substitutes (Katsios 2006), while others claim that they are complements, or that this relationship is dependent on the institutional and/or economic state of countries (Schneider 2006). According to the SELDI report *Shadow Power*<sup>4</sup>, it is a broad concept encompassing undertakings varying from the fairly benign (where only minor regulations are circumvented) or even beneficial (e.g. self-subsistence economic activities) to the outright pernicious (e.g. the various criminal markets). The wide scope of the phenomenon has led to ambiguity on its definition, hence also resulting in different names – such as “non-observed”, “informal” and “black” economy. The involvement of corruption also varies along the continuum of hidden practices. Taking account of the complexity and multidimensional nature of this phenomenon, this chapter aims to provide an analysis of the concept of “hidden economy”, to shed light onto its scale in Turkey with particular reference to hidden employment, and to provide policy recommendations regarding the prevention of hidden economy.

### The Concept of Hidden Economy

In the era of globalization, governments and international organizations that design the new political/economic architecture of the world focus on governance quality, as the market reforms necessitate strong institutional capacity free from the hidden economy and corruption. To secure the reliability of markets and to boost the real and financial capital, for the governments, complementary to markets, good governance is required alongside trust and

2 SELDI. *Shadow Power: Assessment of Corruption and Hidden Economy in the Southeast Europe*. Accessed on 17 October 2016. [http://seldi.net/fileadmin/public/PDF/Publications/Shadow\\_Power/SHADOW\\_POWER\\_FINAL\\_2016.pdf](http://seldi.net/fileadmin/public/PDF/Publications/Shadow_Power/SHADOW_POWER_FINAL_2016.pdf)

3 Ibid.

4 Ibid.

other shared values. In an age of information and mobility, governments should create an environment of transparency, accountability, and fiscal discipline. In democratic regimes, the state can have legitimacy, only if it holds citizens' compliance and allegiance. Strengthening the collaboration between the state and the citizens is crucial for the reconciliation of democracy and international capitalism. This is why the fight against hidden economy and corruption has had an important place in the framework of good governance. Many academic studies on the issue in the last decade conclude that "the institutional architecture and governance quality seem to be key components in the size of the shadow economy" (B.Torgler, F. Schneider, A.Macintyre, 2011, p.490). In the literature, various terms, such as hidden economy, shadow economy, unofficial economy, undeclared work etc, are used in order to define economy that is running outside state monitoring totally or partially. The umbrella term of "non-observed" economy is used by international organizations such as OECD, ILO, and IMF; while "undeclared work" is the term used in the European Union (EU) documents.

### OECD Definition of "Non-observed" Economy<sup>5</sup>

This umbrella term for the non-observed economy covers five major areas:

1. Underground production: Activities that are productive and legal but are deliberately concealed from public authorities to avoid payment of taxes or compliance with regulations.
2. Illegal production: Productive activities that generate goods and services forbidden by law or that are unlawful when carried out by unauthorized procedures.
3. Informal sector production: Productive activities conducted by unincorporated enterprises in the household sector or other units that are unregistered and/or less than a specified size in terms of employment, and that have some market production.
4. Production of households for own-final use: Productive activities that result in goods or services consumed or capitalized by the households that produced them.
5. Statistical underground: Defined as all productive activities that should be accounted for in basic data collection programs, but are missed due to deficiencies in the statistical system.

The EU definition of undeclared work is "any paid activities that are lawful as regards their nature but not declared to public authorities, taking account of differences in the regulatory systems of the member states".<sup>6</sup> This definition excludes illegal products from the scope of "hidden economy". In academic studies, the terms mentioned above are used interchangeably, so it seems that there is not any definitive agreed-upon term. According to Schneider –Enste (2013), the economy is composed of official and unofficial segments;

<sup>5</sup> Source: *Measuring Non-Observed Economy-A Handbook*, OECD-IMF-ILO-CIS Stat., 2002

<sup>6</sup> European Commission Press Release Database.

and the unofficial economy is divided into 4 sectors:

1. Irregular sector where the output produced is legal but the production and distribution process is illegal
2. Informal sector where both the output produced and production/distribution process is legal
3. Criminal sector where both the output and production/distribution process is illegal
4. Self-sufficient economy (household sector)

According to this categorization, the irregular sector and criminal sector compose the shadow economy (hidden economy). However, in many of the reports on the hidden economy, the criminal sector is excluded from the research. By its very nature, measuring the hidden activities in the economy poses some difficulties. The main methods to measure the size of the hidden economy are as follows

- 1- Direct surveys/Audits: In this method, micro-surveys of informal sector and tax audits are used in order to estimate the size of the hidden economy. This method is extremely difficult in Turkey, because neither hidden sector participants nor tax auditors want to share the information they have.
- 2- Monetary measures: In this method, known monetary statistics such as currency in circulation and velocity of money are used to estimate the discrepancy between the official and unofficial (hidden) economy (e.g. Currency ratio/demand method, Transactions method).
- 3- Income/expenditure discrepancies in micro and GDP income/expenditure discrepancies in macro base can be used as indicators for the hidden economy. In national accounts GDP is calculated by incomes earned (wages, profits, interest, and rent incomes) and by expenditures (money spent by the income earners). With zero hidden economy, the two accounts must be identical. So the discrepancy between the two (expenditures exceeding income) can be used as a 'clue' that indicates the existence of the hidden economy.
- 4- Indirect non-monetary indicators/Measures Ranking Method: In this model, some proxies like electricity consumption are used to detect the hidden income. Another version of this approach is Expenditure-based Estimation Model. Assuming the same consumption (for any chosen item) behavior between reporting and non-reporting groups, the income of the latter group is estimated through its expenditures of the chosen item.
- 5- MIMIC (Latent variable models): MIMIC (Multiple Indicator Multiple Cause) is a common model where a latent variable is reflected by other variables. Although it is a controversial issue that MIMIC methodology is appropriate for the estimation of the hidden economy, this method has been used for many researches.

The most commonly used method of measurement is based on a combination of the (MIMIC) procedure and on the currency demand method, or, alternatively, the use of only the Currency Demand Method (Schneider and Williams, 2013). Some consider the Currency Demand Approach (CDA) as the most popular among indirect measurement methods. Nonetheless, it seems that the MIMIC method is considered as the most forthright, notwithstanding its shortcomings (Ardizzi et al., 2013). By using any of these methods, many empirical studies have found that the problem exists in the world by varying degrees depending on the economic /social development level of the country and the enforcement capacity of the state. In recent years, with the enlargement of the EU, the integration with the economies of new member states also enlarged the hidden economy; and fighting policies have gained importance. A European platform against “undeclared work” bringing together the European Commission, government authorities, and social partners in charge of combating undeclared work is on the agenda of the EU legislative procedure.

The EU integration process has certainly impacted the way Turkey pursued to enhance the formal economy. Turkey has adopted some policies designed around common policy targets to integrate into the EU markets. The fight against undeclared work has been on the agenda of the European Commission since 2007. It has launched initiatives and prepared action plans to prevent and sanction undeclared work with the aim of enhancing cooperation at the EU level. Accordingly, in Turkey, the action plans called “The Action Plan of Strategy for Fight against the Informal Economy” have been prepared for every two years, since 2008-2010.

## Overview of the Hidden Economy

The main source of the hidden economy is illicit and undeclared work. The output produced is bought and sold without registration; and this chain continues from the production process to the retail sales. Especially in non-corporate sector, these activities are extensive. Most of the time some segments are in corporate sector and some are not. Some spill-over effects may occur from the unregistered to the registered economies and to the entire economy.

The reasons why people work illicitly can be explained in a multidisciplinary context. Sociological, socioeconomic, and cultural features play a role in the emergence of hidden economy. The administrative structure of the state is also an important factor in generating it, which ends up by creating a vicious circle. More unregistered work cause more revenue loss for the government, which in turn weakens the administrative capacity of the state. To break down this circle, the state authorities should be very determined. Any tolerance towards the hidden economy makes it even larger since the firms working in the official sector face unfair competition and have an incentive to hide their activities. The hidden economy is harmful for workers, businesses, and governments. It is to the detriment of pension rights and access to healthcare services for workers. In business, it means unfair competition for the regular companies. For governments, it causes lost tax and social security revenues. Governments implement policies to tackle the hidden economy, but the effectiveness of these policies varies depending on:

- 1- Whether it really poses a serious socio-economic problem for the country, or is seen as a kind of social safety valve to increase income and reduce unemployment.

- 2- Whether governments are searching for a potential source of budget revenue. When they are in need of fiscal discipline, especially during post-crisis austerity periods, they implement policies to effectively tackle the hidden economy.

Although the economic conjuncture gains importance for the success of combating the hidden economy, it is largely a structural phenomenon stemming from the socio-economic environment of the country, working conditions of the business sector, and the confidence between society and state. There needs to be a comprehensive and long-term plan to tackle the problem, as stated below:

“...short term measures for tackling the hidden economy are unlikely to produce tangible results. This calls for developing a concerted public-private platform for designing long-term measures for tackling hidden economy issues and for tracking progress continuously over time” (Monitoring the Hidden Economy in Macedonia: Trends in Policy Options)

The academic studies on the size of the hidden economy involve a high level of ambiguity in Turkey as in many other countries. The findings are very divergent, yet, they allow us to trace an overall trend. From 1960's (when data begins to be available) to the mid-1980's, it is in a decreasing trend; afterwards, it begins to rise, although in some years sharp decreases happen, until the beginning of the 2000's. After the 2000's, the trend moves downward from 32.1 % to 27.8 % (over the last 15 years) (Table 1). Between 2008 and 2009, the slight increase may be attributed to the economic crisis

**TABLE 1: SIZE OF THE HIDDEN ECONOMY IN TURKEY**

% of GDP	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Turkey	32.7	32.1	32.8	32.4	32.2	31.5	30.7	30.4	29.1	28.4	28.9	28.3	27.7	27.2	26.5	27.2	27.8

Source: OECD and Friedrich Schneider, 2015

In Turkey, the issue has faced politicians and academics extensively after the 2000's. In the era of globalization, to curb the share of the hidden economy some measures have been taken, and the existent ones have been reinforced. The most important developments can be summarized as follows:

- 1- A law has been issued (notification) in order to reduce the undeclared work. It delegates the banks and public institutions to control the companies' legal employment declaration when they become a customer to their services.<sup>7</sup>

<sup>7</sup> Sosyal Güvenlik Kurumu'ndan: Bankalar ve kamu idareleri tarafından yapılacak olan sigortalılık kontrolü ile kurum ve kuruluşlardan alınacak bilgi ve belgelere dair tebliğ (10.06.2014). (Social Security Institution: Disclosure regarding the information and documents to be provided by institutions and organizations regarding insurance control by banks and public administrations.)

- 2- The auditing mechanisms are renewed technologically. For example, a new risk analysis program is added to the module in order to depict the fake receipts. The banks also use a similar module when they investigate their credit customers. The monitoring capacity of state increased owing to the automatization of some public and private (especially banking) services. Revenue Administration, Tax Inspection Board, Social Security Institution, using various e-state tools, have had the opportunities to monitor the economy on one hand and the banks and the Central Bank on the other. For the companies to integrate the fiscal and financial network, it is necessary to have regular work and employment activities. A consulted bank credit analyst confirmed that in recent years, the SME's that compose a large majority of enterprises in Turkey have to be more organized in order to be integrated to the financial sector.
- 3- "The Action Plan of Strategy for Fight against the Informal Economy" prepared within the framework of 10th Development Plan (2014-2018) is issued. Also a program called "Program for Reducing Informal Economy" was launched for more effective implementation of the action plan.

### The Action Plan, Strategy for Fight against the Informal Economy, and the Program for Reducing Informal Economy:

The Program targets are:

- Reducing the ratio of informal economy to GDP by five percentage points
- Reducing the informal employment rate in non-agricultural sectors by five percentage points

**TABLE 2: TARGETS OF THE ACTION PLAN OF STRATEGY FOR FIGHT AGAINST THE INFORMAL ECONOMY**

	Current situation	2014	2015	2016	2017	2018
The ratio of informal economy to GDP	26.5%	26%	25%	24%	23%	21.5%
The ratio of informal employment to total employment in non-agricultural sector	22%	22%	20%	19%	18%	17%
Number of registered tax payers	4.9 Million	5 Million	5.1 Million	5.2 Million	5.3 Million	5.4 Million

Source: 10th Development Plan, the Action Plan of Strategy for Fight against the Informal Economy, Presidency of Tax Administration, January, 2015

This plan envisages to reduce the hidden economy from 26.5 % to 21.5%, the ratio of informal employment to total employment in non-agricultural sector economy from 22 % to 17 %, and to increase the number of registered tax payers from 4,9 million to 5,4 million within five years (between 2014- the year the program was prepared to 2018). Nevertheless, the plan targets do not cover agricultural sector, where the hidden employment mostly exists.

Performance Indicators of the Plan are:

- Ratio of informal economy to GDP
- Ratio of informal employment in non-agricultural sectors to employment in non-agricultural sectors
- Number of informal employees detected via audits
- Annual rate of change in the number of audits
- Amount of tax base differences detected via audits
- Level of satisfaction with public services

The first three of the indicators are about hidden economy directly; the rest is rather on tax evasion. The activities in the hidden economy cause tax evasion, but every tax evasion case does not necessarily stem from the hidden economy. Firms operating in official sector can evade taxes by many other ways such as invoicing the sells with a lower VAT rate.

### The Estimated Size of the Unofficial Economy in Turkey based on Some Recent Researches

As noted before, regarding the measurement issues, there is not an agreement among the researchers who are interested in hidden economy in Turkey as in many other countries. Depending on the methods and periods undertaken, the results show a great degree of divergence. The estimated size of the hidden economy ranges from 3.6 % 27.4 % depending on the time period chosen and the methodology used. The list below summarizes the results of various studies:

- 1- F. Ögünç & G.Yılmaz (2000), using the currency-demand method, estimated the underground (unofficial) economy for the 1971-99 period. It was relatively low between the years of 1971 and 1986 and began to rise afterwards, then reached its utmost value as 22.1 % in 1995.
- 2- N. Davutyan (2008) estimated that “the true disposable income” of the informal sector members was 21% larger than the officially reported income by using the household income-expenditure surveys (the discrepancy between spending and reported income reflects the unreported income).
- 3- F. Halicioğlu and R. Dellanno (2009) reported that “Under the currency demand approach, the size of the undeclared economy in 1987 was measured as 10.7% of the official GDP; and then it reached its peak in 2004 with a figure of 27.4%. In 2007, the size of the undeclared economy was estimated as 18.9% of the official GDP”.
- 4- Ö. Yıldız (2013), by using the ‘currency demand method’, estimated that “The ratio of black economy to real GDP is between 3.6 % and 4.5% in the selected period (2001- 2012)”.

### Historical Trends in Turkey: Historical and Economic Developments Determining the Hidden Economy Trends

Economic development amounts to a transformation in the structure of the economy, meaning that the ratio of agricultural products in GDP diminishes, but that doesn't necessarily lead to proportionate reduction in agricultural employment. Hence, it results in low labor productivity in agricultural sector. The labor force with low productivity is forced to migrate to urban areas, which has brought about great potential for unofficial/unregistered jobs. This movement continued over the last decades. Moreover, the recent immense immigration to Turkey brought out the same results.

When Scheineder's definition is used, informal economy is included in the unofficial sector, but is not considered as hidden economy since it is legally kept outside the registration duties. The people working in small business and artisan/handicraft sector are self-employed to a great extent. These jobs tend to disappear as the big companies dominate the market. In many studies, this trend is approved for the sake of development because they are unproductive (R. La Porta, A. Shleifer; 2008). This dual structure resist in many developing countries due to socio-economic conditions such as rural-urban migration, low degree of human capital etc. In Turkey, after 1980's, with the liberalization of the economy, the volume of internal and external trade increased (so did the profits and interest income) due to removal of controls on trade, foreign exchange, and prices. Some significant proportion of commodities were bought and sold without invoice from the production level to the retail sale; and the chain of non-registration affected the whole economy. In 1986, when the VAT was introduced to the tax system, this mechanism was intended to be prevented through a control mechanism within buyers and sellers. Nonetheless, due to great amount of exemptions and deductions, this goal could not be achieved.

Over the 1990's, the economy experienced severe crisis resulting from policies implemented without prudence and consistency. Both budget deficits creating government demand for savings, and capital inflows induced by financial liberalization caused the interest rates to hike, and the Turkish currency to be overvalued. This conjuncture brought about considerable financial speculation. The firms could gain considerable amounts of speculative money by hiding their taxable income. The enlarging hidden economy posed serious problems for policy makers for it became difficult to implement an appropriate tax policy since the base to be taxed was hidden. When the trend of the 'tax to GDP ratio' in Turkey is examined, it turns out that Turkey had a ratio of 24.2 compared with the OECD average of 34.2% for the year of 2000. In 2014, the tax to GDP ratio is 28.7 % in Turkey, while the OECD average is 34.4 per cent. Moreover, in Turkey, only 14 % of tax revenue comes from taxes on personal income, profits and gains (OECD Revenue Statistics, 2015). When Turkey and some other European countries are compared with regards to the hidden economy, ten percentage point difference in the shares of hidden economy between Turkey and the European countries continues to exist despite the decreasing trend on both sides. As is shown in Table 3, the average size of the shadow economy in the 28 EU countries was 22.6 per cent in 2003; and it decreased to 18.6 per cent (of official GDP) in 2014.



TABLE 3: HIDDEN ECONOMY IN TURKEY AND IN EUROPEAN COUNTRIES

As % of GDP	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Turkey	32.2	31.5	30.7	30.4	29.1	28.4	28.9	28.3	27.7	27.2	26.5	27.2
31 European Countries*	22.4	22.1	21.6	20.9	20.1	19.4	19.9	19.7	19.3	19.0	18.5	18.3

\*EU Countries plus Turkey, Norway and Switzerland. Source: F. Schneider K. Raczkowski B. Mróz, (2015) p.45

### Efficiency and Effectiveness of Applied Policies

The performance measurements that are mostly used are efficiency and effectiveness for evaluating the performance of government policies. Efficiency means to obtain the greatest output by using the lowest amount of inputs. Effectiveness is the ability to meet the targets. In our context, the output is defined and relatively easy to measure (to make the operations in the economy official and declared), but it is not very easy to define and measure the inputs (policy tools, administrative costs etc.) However, if the policy targets have already been revealed, the effectiveness of the policies by comparing them with the results can be measured. Therefore, it is preferable to use 'the effectiveness' of the policies implemented to combat the hidden economy to evaluate the performance of the government.

The plan published in 2014 projected the ratio of informal economy to GDP as 25 % and the ratio of informal employment to total employment as 20 % for the year of 2015 (Table 2). Nonetheless, the realized figures of 2015 showed us higher ratios: 27.8 % (Table 1) and 21.4 % (Table 4) respectively. For the time being, the policies do not seem very effective as the results fall short of the targets. In the forthcoming years, we will have the data for assessing the realization of the plan targets for the years of 2016, 2017, and 2018.

### SELDI Hidden Employment Survey Results

There are various studies of hidden employment, yet there were no recent comparable data for Western Balkans. SELDI fills this gap by a set of national representative surveys in nine countries and a sample of 9340 people<sup>8</sup>. The SELDI survey results allow us to analyze the hidden employment environment in Turkey. (The results are consistent with the statistical data.)

1- 40.7 % of the interviewed people reported that they had no written contract with their employer. If we exclude self-employed and business owners, this ratio rises up to 50.7 %. Almost half of the employees are working without a written contract. The written contract is about employee rights which are enacted in the labor law. Any contract for more than one year must be written according to the law. Every employee having a written contract should be reported to the social security system, but not vice-versa.

<sup>8</sup> Sample sizes are as follows: Albania (1050), Bosnia and Herzegovina (1007), Bulgaria (1008), Macedonia (1001), Croatia (955), Kosovo (1000), Serbia (1061), Montenegro (1040) and Turkey (1219). Field research was conducted January – February 2016 by professional interviewers. More details on methodology applied are available on request from SELDI secretariat.

- 2- 55.6 % of the interviewed people reported that their actual remuneration was higher than the one written in their contract; and 41.3 % reported that the minimum gross wage was the basis for their social security payments on their main job, despite the fact that their actual remuneration was higher. This shows that besides unreported income, there is a problem of under-reported income in the system. An interviewed social security inspector stated that this practice was widely used by many of the employers in order to reduce the social security premiums (as a percentage of employee's gross earnings). This damages the long term benefits of the employee. As of 2016 minimum gross wage is 1647.00 TL in Turkey; and after deducting the fiscal and parafiscal obligations net minimum wage remains to be 1300.99 TL (if the worker is single and has no children). As the employer pays 15.5 per cent of social security contributions and 2 per cent of unemployment security contribution, the cost to the employer becomes 1935.28 TL (per month). The business class has been making pressure on government to reduce the employers' premium rate or subsidize the employers' contribution. Employed people have, to a large extent, social security along with their jobs (65.6 %). Some people who don't work or have a part-time work can have social security by paying their premiums themselves. Only 10.4 % of the interviewed people do not have social insurance (the share of population covered by social security is revealed as 16.26 per cent by Social Security Institution as of 2014).
- 3- As to the question regarding the basis of social security payments on the main job, 48.6 % (28.3 + 20.3) of the respondents answered that their actual remuneration and the one written in the contract was the same. 28.3 % of them correspond to those whose actual remuneration equals to minimum salary base, and 20.3 % to the ones whose actual remuneration equals to higher salary basis. The true ratio of employers who are paid minimum income is difficult to depict since the contracts do not reflect the reality. In this survey, this ratio is found as 28.3 % which is lower than the ratio stated by the Minister of Labor and Social Security as 40.4 % in 2014. 41.3 % of the respondents are those whose social security payments are made on minimum salary base, despite the fact that their actual remuneration is higher. This result reveals the under-reporting problem that we remarked before.
- 4- Regarding health insurance, 63.9 % of the respondents are those whose health insurance is paid by their employers. 21.4 % of the respondents are paying their health insurance premiums themselves. Only 7.7 % do not have health insurance.

According to survey results, the number of people who have health insurance through the employer is larger than the number of people who have a written contract with their employer. This may occur, if the contract is made for short term. According to the law, the contracts for short term jobs may not be written, but those who have these contracts are nevertheless eligible for the general health insurance. The employer should pay the premiums as long as the person is employed.

## Hidden Employment in Turkey

Hidden employment may occur in three forms<sup>9</sup>: 1. The employees are not reported at all 2. They are reported, but hours worked are underreported 3. Their earnings are under-reported.

**TABLE 4: RATIO OF EMPLOYMENT WITHOUT SOCIAL SECURITY REGISTRATION IN TOTAL EMPLOYMENT**

	Total	Agricultural sector	Non-agricultural sector
2015 (June)	34.6 (-1.8)	81.5	21.4
2012 (March)	37.5 (-3.8)	81.8	23.9
2011 (March)	41.3 (-0.8)	82.6	27.7
2010 (January)	43 (+1.2)	85.3	29.7
2009 (January)	40.8 (-0.5)	83.7	28.6

Source: TUIK

Non-registration is much higher in agricultural sector than in non-agricultural sector. The ratio of employment without social security registration is 81.5 % in agricultural sector, whereas it is 21.4 % in non-agricultural sector (Table 5). Non-registered people are those who are not registered to any social security institution on their main job. In Turkey, labor force participation rate is 52.1 %, employment rate is 47.1 %, and unemployment rate is 9.7 % as of 2015. The level of unemployment is higher for women than for men and lower for people with higher education qualification than for people having lower degrees. Paradoxically, unemployment rate is the lowest for the illiterate.

When the employment by sectors is examined, it is observed that 22 % of employed people work in the agricultural sector where the non-registered labor ratio is the highest. In agricultural sector, employment is mainly in the form of unpaid family worker (Table5); and it is very likely to be non-registered. If the share of income produced in agricultural sector is compared with the share of labor force employed there, it is obvious that the productivity is low in this sector. Concerning the hidden employment, the related results are twofold: First, they live at subsistence level; and second they tend to migrate to the urban areas. As the people live almost at the subsistence level, the capacity to pay the social security contributions is low, and the probability of staying non-registered is high. Furthermore, as the people migrate to the urban areas, they work in marginal sectors which constitute the informal and irregular sector. Non-registration is also high among the self-employed people (60.4 %). They have typically handicraft and artisanal jobs. In non-agricultural sector this ratio is 51.1 %.

This high discrepancy between agricultural and non-agricultural sectors regarding hidden employment shows us that the problem is rather structural.

<sup>9</sup> "Hidden employment" is the term used for the persons working without social security registration. In Turkey the ratio of people working without social security registration is 34.6% as of June 2015. As is shown in Table 4, there is a decreasing trend in hidden employment from 2009 onwards except for the year of 2010.

As the agricultural employment shrinks and the sector modernizes, the registration status of labor employed in this sector is expected to be positive. Since the corporate sectors in industry and services have the capacity to absorb the labor force released from non-incorporate agricultural sector, this transformation will reduce the hidden employment. It is also observed that the non-registered employment is closely related to the educational level of the working population. While for the university graduates, the rate of non-registered labor is 15.8 %, it increases as the educational level decreases (30 % for high school level, 47.46 % for primary school level, and 89.70 % for the illiterate). Education seems significant to have regular employment. Geographical regions determine non-registered employment. Northeastern, Eastern, and Southeastern regions of Turkey exhibit rates over 40 %, while it is around 20 % in İstanbul, Ankara and İzmir. Another factor that is relevant to the non-registered employment is age. For the 15-19 and 55+ age groups, this rate is over 60 %; while for the 30-34 age group, it is lowest (22.35 %).<sup>10</sup>

**TABLE 5: EMPLOYMENT BY STATUS IN SOCIAL SECURITY REGISTRATION, JUNE 2014-2015**

Employment status	Employment		Unregistered <sup>(1)</sup>		Unregistered (%)	
	2014	2015	2014	2015	2014	2015
Total	26,586	27,261	9,675	9,438	36.4	34.6
Regular or casual employee	17,384	18,018	3,565	3,430	20.5	19.0
Employer	1,168	1,214	170	143	14.6	11.8
Self employed	4,573	4,552	2,813	2,749	61.5	60.4
Unpaid family worker	3,462	3,477	3,126	3,116	90.3	89.6
Agriculture	5,937	5,998	4,966	4,890	83.6	81.5
Regular or casual employee	668	731	568	554	85.0	75.8
Employer	52	55	28	25	53.8	45.5
Self employed <sup>11</sup>	2,253	2,293	1,623	1,594	72.0	69.5
Unpaid family worker	2,963	2,918	2,748	2,716	92.7	93.1
Non-agricultural	20,650	21,263	4,708	4,549	22.8	21.4
Regular or casual employee	16,716	17,287	2,998	2,876	17.9	16.6
Employer	1,115	1,159	143	118	12.8	10.2
Self employed <sup>1</sup>	2,321	2,259	1,190	1,155	51.3	51.1
Unpaid family worker	498	559	379	400	76.1	71.6

Source: TUIK

<sup>10</sup> [http://www.sgk.gov.tr/wps/portal/tr/sigortalilik/kayitdisi\\_istihdam/kayitdisi\\_istihdam\\_oranlari!/ut/p/b1/jZJJcqNAEEXP4gPYVDGz](http://www.sgk.gov.tr/wps/portal/tr/sigortalilik/kayitdisi_istihdam/kayitdisi_istihdam_oranlari!/ut/p/b1/jZJJcqNAEEXP4gPYVDGz)

<sup>11</sup> In Turkey self-employment is an employment status denoting the people working in their own works without employing regular employee.

Another issue to be raised concerning hidden employment is the huge gender gap (Table 6). The ratio of non-registered labor force is 28.7 % for men, whereas it is 48.1 % for women. In agriculture sector, this ratio is 70.5 % and 93.8 % respectively. The reasons are related to the women's employment status. The women's labor force participation rate is very low (32.3 % as of 2015) in Turkey relative to OECD countries. When they participate, they are likely to be employed in part-time positions. According to the law, the part-time workers can benefit from the social security services by completing the premium payments themselves. The working conditions which are not very favorable for low or medium level educated employees are even worse for women. The social security system in Turkey is Bismarkian, meaning that the working status of man provides his family with social assurance. In this respect, on one hand being registered is important in Turkey since it impacts the whole family, and on the other hand, this situation may dissuade the family members from registering to the system.

Social security services include both pension and health services. In 2008, Social Security and General Health Insurance Law came into effect and aimed to take the whole population under coverage of general health insurance. Those who are not under social security coverage are obliged to pay their health assurance premiums, if they do not pass the means test. The income limit to be eligible by this test is so low that (one third of minimum income) only the people with lowest income can benefit. If they are not under employment contracts or do not have voluntary insurance, people cannot benefit from the public health services. Consequently, to be registered is extremely important for the employed people otherwise they might pay high prices for healthcare. Under these conditions, some people, especially those with insufficient education, accept working with a salary which is under minimum income in order to obtain social security services. This practice causes over-reporting, just the inverse of under-reporting we have evaluated in the previous part. Although the firms declare the minimum income officially, the employee is paid lower. Another problem that is encountered is the fake firms established with fraudulent documents to claim assurance rights to their so-called employees.<sup>12</sup>

The most affected economic sectors are tourism (small hotels and restaurants), transportation, construction (building inspection companies), and private courses for supplementary education. According to the law, all the full-time employees must have a written contract and social security registration. In part-time jobs, health insurance is paid by the employee. In some situations the employee may prefer not be registered officially, and apply for the means test, but this is risky for the employer. If he/she is detected by the social security inspectors, the previous debts are taken with their interest payments and a penalty is paid by the employer. To fight against these illegal practices, the number of auditors and auditing standards must be raised.

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12 Source: a consulted officer from Social Security Institution.

TABLE 6: EMPLOYMENT STATUS BY GENDER

Employment	Male					Female					
	Unregistered <sup>(1)</sup>			Unregistered (%)		Employment		Unregistered <sup>(1)</sup>		Unregistered (%)	
	2015	2014	2015	2014	2015	2014	2015	2014	2015	2014	2015
Total	18,900	5,642	5,417	30.3	28.7	7,946	8,361	4,032	4,022	50.7	48.1
Regular or casual employee	13,028	2,472	2,380	19.4	18.3	4,663	4,989	1,093	1,050	23.4	21.0
Employer	1,113	159	134	14.8	12.0	93	101	11	9	11.8	8.9
Self employed	3,798	2,199	2,106	56.7	55.5	698	754	614	643	88.0	85.3
Unpaid family worker	961	812	796	83.8	82.8	2,493	2,517	2,314	2,320	92.8	92.2
Agriculture	3,155	2,315	2,223	73.9	70.5	2,805	2,842	2,651	2,666	94.5	93.8
Regular or casual employee	444	332	313	80.4	70.5	256	287	236	241	92.2	84.0
Employer	51	25	22	50.0	43.1	3	5	2	3	66.7	60.0
Self employed	1,999	1,348	1,313	68.5	65.7	284	294	275	282	96.8	95.9
Unpaid family worker	661	610	575	87.0	87.0	2,263	2,257	2,138	2,141	94.5	94.9
Non-agricultural	15,745	3,327	3,193	21.5	20.3	5,141	5,518	1,382	1,355	26.9	24.6
Regular or casual employee	12,584	2,141	2,068	17.4	16.4	4,407	4,703	857	809	19.4	17.2
Employer	1,063	134	112	13.1	10.5	90	96	9	6	10.0	6.3
Self employed	1,799	850	794	44.6	44.1	413	459	339	361	82.1	78.6
Unpaid family worker	299	202	220	75.4	73.6	230	260	177	180	77.0	69.2

## Tax Compliance and Tax Avoidance

The official economy in Turkey is operated by big businesses and large holding groups etc. They are to a large extent open to international transactions in real and financial terms. They are generally regular in their work and employment activities. However, this does not amount to say that they bear a considerable amount of tax burden. They may benefit from deductions and exemptions which are called 'tax expenditure' in varying degrees according to the sector and geographic area that they perform. They utilize highly developed tax planning techniques to avoid taxes and minimize their tax burden in a legal framework.

In Turkey a large majority of companies are micro, small or medium sized, and employ more than two third of labor force. The problem concerning the hidden economy is related to micro and small-scale business sector, which compose the unofficial economy, mainly the informal and irregular segments. In small-scale business sector, tax evasion stemming from underreporting of income is one of the reasons for the insufficient income tax base. The Income Tax Law causes tax base to shrink due to exemptions and deductions, withholding tax (especially for agricultural income) and tax avoidance possibilities. Tax potential is low for the activities carried out in informal sector where some taxpayers earning business income are exempted from tax obligations under certain

conditions. Small businesses of artisanal and handicraft activities are either totally exempted from paying tax, or are subject to lump-sum tax. According to the law, they are obliged to document their sales with invoice. However, as they do not have to book their accounts, this obligation is not generally fulfilled and creates loopholes for the regular/ official economy. The taxpayers tend to hide their earnings partially or totally. They evade some of their tax obligations. There is a grey area between the informal and irregular sectors.

Another reason of the large erosion in income taxes is lack of sufficient investigation. As of December 2015, the number of tax auditors employed by Tax Auditing Service is 9.205 (this number is 0.6 for 1000 habitants in Turkey, while it is 1.3 in France and 1.5 in England). As is seen in Table 7, the number of taxpayers investigated over the number of registered taxpayers (the investigation ratio) is very low. It is a motivating factor for the taxpayers to underreport/over report their accounts in order to minimize their tax burden. If we take into account the unregistered tax payers -for which the data do not exist- we can figure out that the riskiness of operating in hidden economy is not very high to deter the firms.

**TABLE 7: TAX INVESTIGATION OF TAX PAYERS IN TURKEY**

Years	# tax payers*	# taxpayers investigated	Investigation ratio
2013	2,460,281	71,352	2.90%
2014	2,472,658	55,284	2.24%
2015	2,527,084	58,676	2.32%

\* Income and corporate tax

Source: VDK Faaliyet Raporu 2015 Table 19

**TABLE 8: TAX INVESTIGATION RESULTS WITH REGARD TO TAX TYPE**

Tax type	Base Difference	Tax Amount to Reinvestigate	Penalty
Corporate tax	5,721,126,30	882,807,654	1,539,588,634
Corporate tax(transitory)	8,247,413,332	688,885,406	988,481,872
Income tax	477,830,515	146,704,285	267,338,801
Income tax(transitory)	728,880,855	59,758,994	83,018,947
VAT	7,277,771,008	5,227,813,584	11,601,867,902
Bank and Insurance Tran. tax	3,060,606,206	155,262,020	185,344,151
Excise tax	361,759,435	1,261,294,944	2,584,748,238
Stamp duty	11,158,719,400	46,451,701	48,127,689
Income tax (withhold)	3,594,105,473	418,115,608	475,060,192
Corporate tax (withhold)	570,998,366	63,369,042	92,038,347
Other taxes	5,550,770,223	853,536,745	977,467,856
Total	46,749,981,122	9,803,999,983	18,843,082,627

Source:VDK Activity Report 2015 Table20.

The tax investigation results (Table 8) indicate that the difference between the true base and declared base is approximately 46, 7 billion TL and total tax to reinvestigate amounts to 9, 8 billion TL. Total penalty that should be paid by the tax evaders is 18, 8 billion TL. The biggest difference between the declared base and true base is in VAT (Value Added Tax) followed by corporate tax. We don't have enough information about the investigation results. However, what we know is that, since the taxpayers do not feel confidence to the tax authorities, it is not very likely that they change their attitudes. In Turkey it is very often that a tax amnesty law is enacted and enables the taxpayers to restructure their previous tax debts (the latest one is Law number 6552, September 11, 2014). Debt is rescheduled after the default interests and penalties are cut, within the scope of this law. The amnesties, thus, create a negative effect since those who dutifully abide to law feel that the evaders gain more. From the citizens' perspective, as well, paying tax is something to be avoided. The citizens generally prefer not to receive fiscal receipts, if they have the opportunity to pay lower for the product they bought. Tax compliance is not a typical citizen behavior. That is why the indirect taxes are preferred preponderantly by politicians. People prefer staying hidden in order to avoid paying taxes and contributions due to:

- Highly complex tax laws and regulative procedures
- Poor confidence (poor quality of government programs, ineffective bureaucracy, privileged groups etc.): Some people feel that the money given to government is wasted.
- Free-rider psychology: Some people think that it is more "rational" not to pay for public services.
- Poor enforcement capacity: People think that being detected is of low probability; and that if they are detected, penalties will be low.
- Not very high satisfaction level for public services (the citizens' satisfaction level for certain public services is as follows: Social security (58.7 %), Health (72.3 %), Education (59 %), and Judiciary services (50.4 %).<sup>13</sup>

## Business Environment

In OECD Country Survey Report, Turkey's business sector is defined as "highly segmented, ranging from a myriad of micro, informal, low productivity firms to a small core of modern, high-productivity enterprises". Five types of firms are distinguished according to their size and institutionalization level. Their qualities regarding human/physical capital and management, their openness to world product and capital markets, their access to labor market also differ. These types are<sup>14</sup>:

- 1- Micro-enterprises (which represent about 45% of total business sector employment outside agriculture)
- 2- Small-and-medium sized businesses (about 35% of employment)

<sup>13</sup> National life satisfaction surveys by TUIK for 2015

<sup>14</sup> [http://www.oecd.org/eco/surveys/Overview\\_Turkey\\_2014.pdf](http://www.oecd.org/eco/surveys/Overview_Turkey_2014.pdf)



- 3- Large family firms (about 15% of employment)
- 4- Institutionalized corporations listed on the stock exchange (no more than 3% of employment)
- 5- "Skilled Stars" (sophisticated start-ups representing less than 1% of employment)

The first two types (SME's) potentially operate in the hidden economy. The large and incorporated firms generally meet the conditions of operating regularly. SME's constitute 99.8% of the total number of enterprises, employ 74.2 % of all employees, and produce 52.8 % of total value added (at factor cost). Especially, the micro size firms (1-5 employees) constitute the segment where the hidden employment is highest among all segments (approximately 70 % their employment is not registered). Hidden employment diminishes as the firm size grows. The productivity difference among these small and large sized firms is enormous. Productivity (as measured by the value added per person employed) is lower in SME's. They mostly use low level technology. Turkey has the biggest labor productivity gap between the largest and smallest enterprise size class among OECD countries (2010, OECD).

It is fair to say that there is a negative correlation between the productivity and regularity of firms. For low-productive and unincorporated small-sized firms, it is said to be difficult to satisfy the regularity conditions. Micro-sized and some small firms are legally exempted from income tax duties; and they compose the informal sector as is defined by Schneider: "The sector where both the output produced and production and distribution process is legal. The informal sector is predominant in developing countries where small firms produce a large proportion of economic added value" (Schneider – Enste (2013) p.12). In less developed countries informal activities are deeply engrained in society. There are socio-economic and political reasons for that situation:

- 1- In informal sector, the productivity is generally lower than in the formal sector. Many of the activities would not be carried out, if they were fully declared and taxed.
- 2- Small firms can better conceal their activities, so they tend to stay small.
- 3- The government collects the majority of taxes from sales taxes which are easy to collect administratively.

The people working in small business and artisan/handicraft sector are mostly the self-employed people. They are exempted from many of the legal procedures that are necessary for the official sector. As the boundary between irregular sector and informal sector is not very clear in Turkey, as in other developing countries, there is transitivity between the two. Despite some protective measures for the SME's, "they are trapped in informality or semi-informality as they are unable to cope with formal sector regulations" (W. Leibfritz, Reducing Undeclared Work in Turkey, 2009). The dual structure of the economy creates dissatisfaction with the laws and procedures. In this regard, small and large businesses show differences. Since the large business

groups work regularly, they do not have significant problems concerning the laws and procedures regulating economy in a way to restrain the hidden economy. The tax consultants and auditing firms that they work together minimize the problems they might face. Concerning the small business environment, dissatisfaction with the enforcement of laws is observed. Staying regular in an environment where the irregularities are the norm is pronounced as the main difficulty. The firms obeying the laws demand the tax authority (Tax Inspection Board) to increase monitoring the law breaking firms. As these firms take the advantage of being hidden while increasing their market share by cutting prices unfairly and being flexible to enter or exit the market. Consequently, they pose a threat for law-abiding firms. Another issue creating dissatisfaction with the laws in Turkey is the amnesty laws issued very often for tax and/or social security liabilities. The firms that fulfill their obligations properly regard themselves as punished by these amnesties and are inclined to hide or circumvent their obligations.

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## CONCLUSIONS AND POLICY RECOMMENDATIONS

The fight against hidden economy as part of good governance has gained importance in recent years to improve the relationship between states and markets. There is no agreement on the definition of the hidden economy and on the estimation methods of its size. However, the official statistics reveal that there nearly exists 10 % point discrepancy between Turkey and European countries regarding the share of hidden economy in GDP. These rates are approximately 28 % and 18 % respectively. The non-registration rate in agricultural sector is very high in Turkey. In agricultural sector, especially unpaid family member as an employment status is widespread causing high non-registration rate in the system. As people migrate to urban areas as surplus labor, they enlarge the informal and irregular sectors. There is a considerable gender, education, and age gap between those who are employed as regularly registered and those who are not. Women are more likely to be employed in hidden economy as their employment status is inferior to men. Furthermore, insufficiently educated people and young laborers named child labor potentially constitute part of hidden employment.

Informal sector and irregular sector cannot be clearly separated from each other. In Turkey, a majority of firms are micro and small sized firms. Some are exempted legally from paying taxes or subject to lump-sum taxes. This harms the invoicing mechanism in the economy and compounds the hidden economy. In the long run, the transformation of economy from agricultural to industrial structure and from unincorporated to incorporate sector will enhance the regular economy. As the (financial, product and labor) markets in Turkey are being integrated to the world markets, the firms are expected to build their capacity to work in tandem with regulations. Also the SME's that are widespread in Turkish economy should promote integration into the regular economy. In the short run, it is possible to combat the hidden economy by improving the monitoring capacity of state and developing its enforcement capacity. The monitoring mechanisms applied by the state authorities are written in detail in the "Tax Procedural Law" (the rules to be followed and the penalties to be imposed in case of illegal declaration or any violation of laws are set forth in this law) but the problem is that it is subject to frequent changes by directives and by-laws issued by the executive branch (Ministry of Finance). In this manner, the parliament that represents the civil society is excluded from the process and little remains to be done for the civil society to monitor the economy.

As to strengthening the collaboration between the state and the citizens, the state must quit the habit of forming and dominating the society. Within this paternalistic approach, the initiative to induce the people to act in the official economy must come from the state. This can take two forms: reward (the citizens are awarded when they stay in official economy) and punishment (any transaction without declaration must have immediate negative effects for the actors). However, this perspective, which puts the state in a paternalistic

place vis-a-vis the society, does not comply with the principles of democratic society. Instead, the state as an agency for providing the public needs must convince the citizens that every single tax is spent for welfare gains, and the tax-payers should know that there will be equality before the law and some will not be discriminated by the modification of the laws. In this context, the immediate remedy is to make the legal procedure more foreseeable and abolish tax amnesties immediately. Tolerating the firms working without abiding by the rules weakens the fight against the hidden economy.

In Turkey, the two crucial ministries in fighting against the hidden economy are 'Ministry of Finance' and 'Ministry of Labor and Social Security'. The tasks of the 'Ministry of Finance' in this regard are twofold: Tax auditing and inspection on one hand, and tax investigation on the other. The first one, undertaken by Revenue Administration, aims to educate the tax payers (especially those who are to declare their taxable income) and inform them about the necessary procedures to avoid irregularities. The second task is aimed to detect the illegal operations by tax investigation, which is undertaken by "Tax Inspection Board". In recent years, tax auditing and inspection mechanisms are highly improved through IT facilities. For example, by a recent declaration, the firms are obliged to use new generation POS devices that are said to provide direct connection between the firm and the tax authority. By using technology, monitoring mechanisms can be developed provided that the share of companies using this technology has risen enough. Furthermore, Revenue Administration is applying various new technologies online, but the micro sized firms might face difficulties in getting benefit from these services. An immediate measure is to extend the usage of technology, without further complicating existing procedures, to cover all the sectors of the economy, especially small firms. As to the second duty, there are some problems due to insufficient number of state officials. The number of tax inspectors and the budget share for this function must be immediately increased to a sufficient level to ensure that the inspection system is deterrent enough. Hence, regular firms would not be threatened by irregular ones; and the entire body of economy would become more equitable and efficient.

The task of fighting against the hidden work and undeclared employment is undertaken by the Social Security Institution which is an affiliated institution of 'Ministry of Labor and Social Security'. The inspectors working for this institution, albeit sufficient in quantity, have a wide range of duties from guiding to companies to the inspection and investigation on the related matters. What is to be improved about this institution is reorganization of its functions. Guiding, inspection, and investigation are to be done separately by their own staff and budgets. Some of these duties may be devoted to local administrations. As the public administration in Turkey is highly centralized, the role of local administrations is limited in monitoring the economy. In metropolitan cities, there are a considerable number of people who are working in the marginal sector (street vendors, peddlers etc.). They barely access to official economy due to their education level and social status. The local governments should provide them with vocational training instead of fighting them by the local security forces (zabita). In recent years, a large percentage of local governments perform this function, and we need to conduct further research to evaluate their performance results. In the light of these, policy recommendations are:

- ❖ Improving the monitoring capacity of state and developing its enforcement capacity are crucial to combat the hidden economy in the short run.
- ❖ The transformation of economy from agricultural to industrial structure and from unincorporated to incorporate sector should be ensured to enhance the regular economy in the long run.
- ❖ The state as an agency for providing the public needs should convince the citizens that every single tax is spent for welfare gains. The taxpayers should be informed that there will be equality before the law and some will not be discriminated by the modification of the laws. In this context, the immediate remedy is to make the legal procedure more foreseeable and abolish tax amnesties immediately
- ❖ Technological developments should be integrated into monitoring mechanisms.
- ❖ The number of tax inspectors and the budget share for this function must be immediately increased to ensure that the inspection system is deterrent enough.
- ❖ As to the Social Security Institution, its functions should be reorganized. Guiding, inspection, and investigation should be conducted separately by their own staff and budgets. In fact, some of these duties may be devoted to local administrations to ensure efficiency.
- ❖ Since Turkey has a highly centralized governance structure, local administrations have limited role in monitoring the economy. However, in metropolitan cities where economic actors and activities are dense, local governments can and should play a role in the monitoring and management of economic activities. More specifically, these institutions should provide those working in the marginal sector with vocational training instead of fighting them to ensure inclusion into formal economy.

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