



Foreign investors viewpoint on the shadow economy in Latvia

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Definition of the shadow economy

«Activities that are productive and legal, but are deliberately concealed from public authorities to avoid payment of taxes or compliance with regulations».

- Organisation for Economic Co-operation and Development

Measuring the Non-Observed Economy – a Handbook (OECD-IMF-ILO-CIS Stat, 2002).

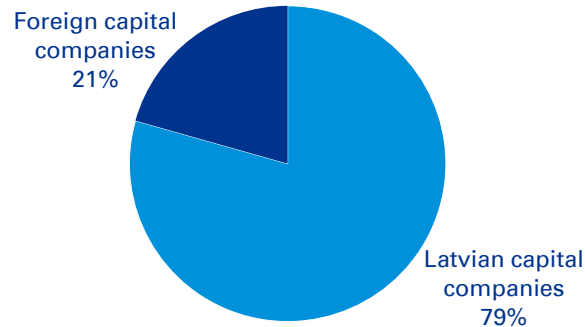


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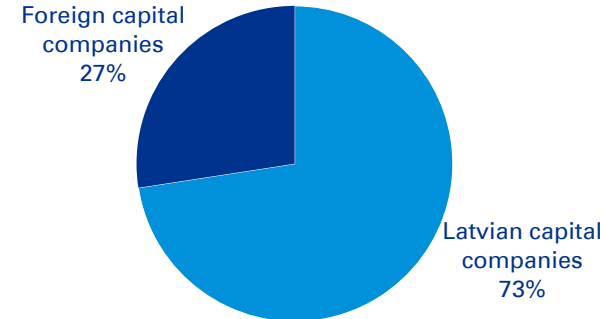


Companies with foreign capital in Latvia

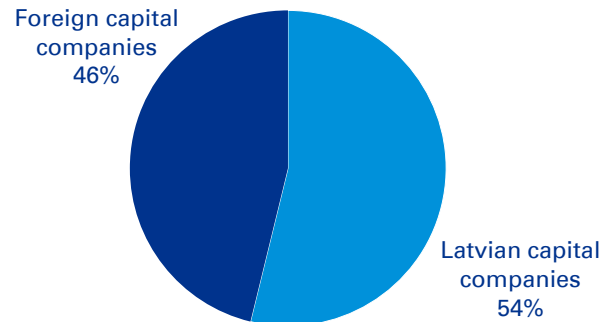
Number of companies (2014)



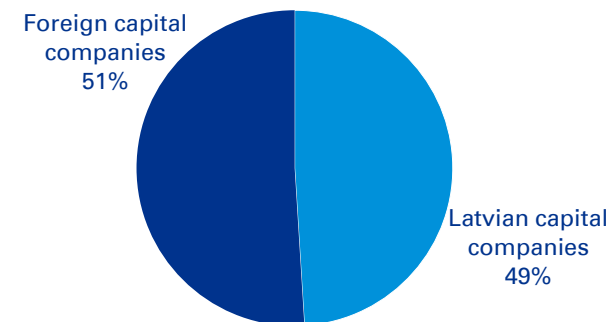
Number of employees (2014)



Total revenue (2014)



Total taxes (2014)



Dataset consists of ~22 000 companies in Latvia with revenue above 145 000 EUR in 2014, which represent 98.4% of all revenue (53 billion EUR) and employ 540 thousand people. Source: Firmas.lv

Main causes of the shadow economy in Latvia

Weak controls and enforcement

Corruption and political games

No visible benefits/stimuli to pay taxes

High income tax and social disparity

Culture



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Main causes of the shadow economy in Latvia

Weak controls and enforcement

«Nobody is sitting in jail for cheating on taxes, if so, others would reflect about what they are doing, even prominent examples are just “under investigation” without any negative effect on those individuals, they are still getting more influence on political decisions.»

- Transport, logistics and freight company

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Main causes of the shadow economy in Latvia

Corruption and political games

«There is no consistency from the government about the tax policy, lack of clarity and lack of predictability.»

- Finance and banking company

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Main causes of the shadow economy in Latvia

No visible benefits/stimuli to pay taxes

«[..]somehow taxation feeds the grey economy too. People do not feel they get anything in return for their tax payments, therefore it feels that the outcome is the same whether you pay taxes or not.»

- Energy company

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Main causes of the shadow economy in Latvia

High income tax and social disparity

«Tax policy, tax burden. If the burden was decreased, for example, the labour tax, it would make it easier for people to legalise their activities.»

- Wholesale and retail company

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Main causes of the shadow economy in Latvia

Culture

«We are a relatively young country and economy, so historically we probably simply do not have yet the culture of paying taxes. And then there are possibilities available due to the lack of control or insufficient control.»

- Wholesale and retail company

Problematic aspects of the shadow economy

'Envelope salaries'

**Public
procurement**

**Corruption,
bribery**

**Unrecorded sales/
illegal sale of
goods**

Problematic aspects of the shadow economy

'Envelope salaries'

«We do suffer from the lack of workforce and thus we also feel a big pressure on salaries. It is very difficult to fill up vacancies. In this critical situation, the fact that somebody is ready to pay 30 to 40 EUR more than I can (by way of avoiding taxes) makes a big difference! It is a real fight for people that is so difficult due to the shadow economy.»

- Wholesale and retail company

Public procurement

Corruption, bribery

Unrecorded sales/
illegal sale of
goods

Problematic aspects of the shadow economy

Public procurement

«The amount of tax paid is not taken into account when choosing applicants or winners of tenders, only the lowest price.»

- Finance and banking company

'Envelope salaries'

Corruption, bribery

Unrecorded sales/
illegal sale of
goods

Problematic aspects of the shadow economy

'Envelope salaries'

Public
procurement

Unrecorded sales/
illegal sale of
goods

Corruption, bribery

«Shadow economy – cash – bribery – corruption all go together.»

- **Finance and banking company**

Problematic aspects of the shadow economy

'Envelope salaries'

Public
procurement

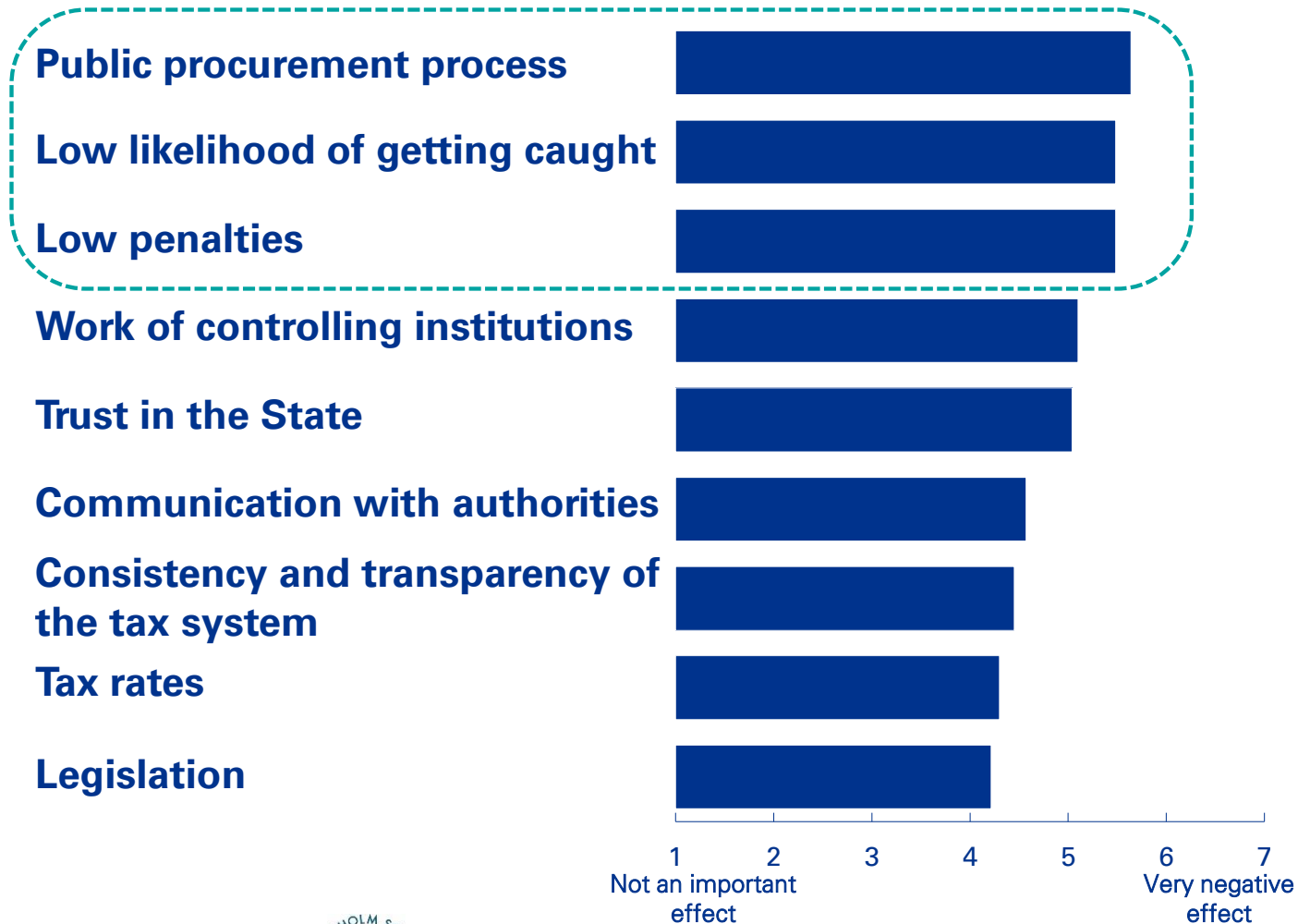
Corruption, bribery

Unrecorded sales/illegal sale of goods

«Although certain positive trends are observed and the legal market of cigarettes is stabilizing, the illegal market remains a very big problem. Due to cigarette smuggling, which amounts to 25% according to the latest Nielsen survey data on illicit trade in cigarettes in Latvia the national budget annually loses approximately 80 million EUR in revenues (excise and value added tax).»

- Manufacturers' association

Why is the shadow economy so big?



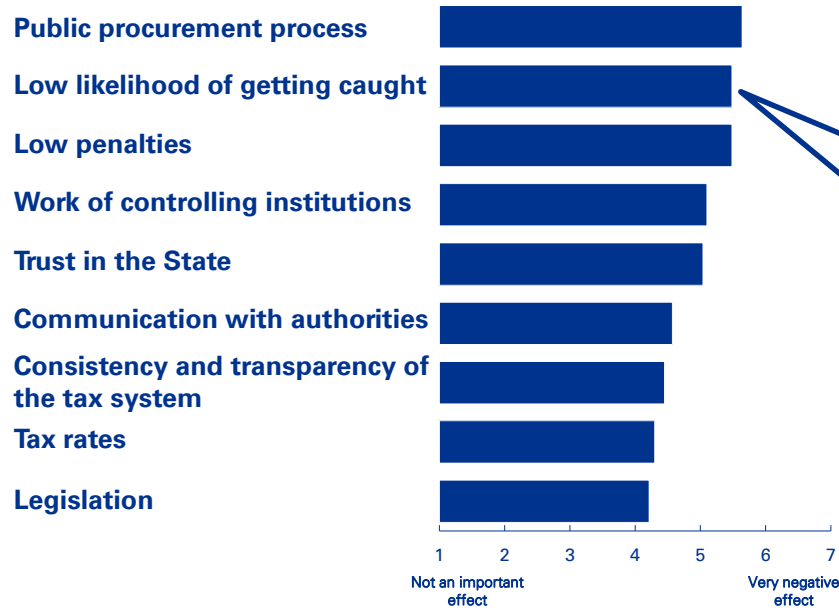
Public procurement process



«Most of the public scandals happen in this area. The press likes to take these examples. They make a lot of noise, but no one ever goes to jail.»

- Transport, logistics and freight company

Low likelihood of getting caught



«As long as nobody goes to jail for cheating on taxes, everybody thinks that no one will be caught.»

- Transport, logistics and freight company

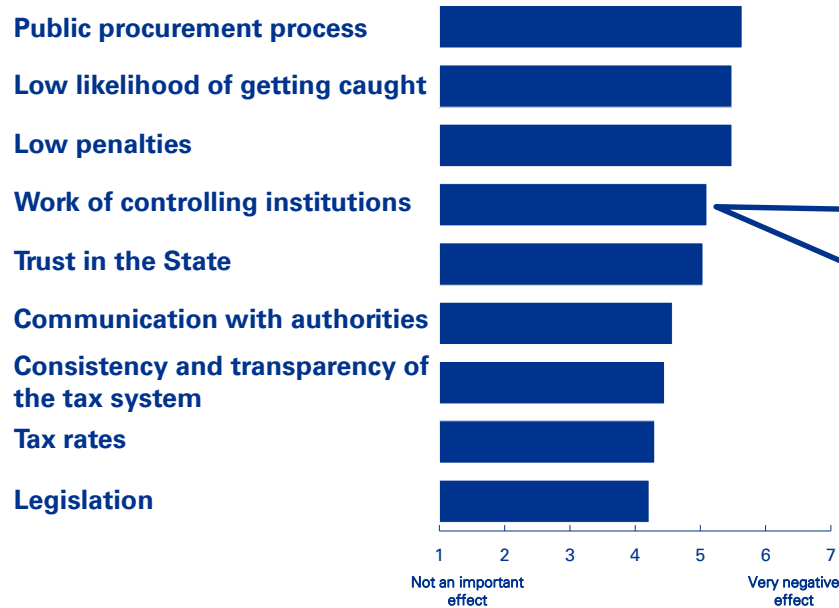
Low penalties



«Penalties do not really affect the shadow economy. You will not get results with penalties, which is same as with children, penalties will not get you anywhere. You have to work with rules, laws, economy.»

- Wholesale and retail company

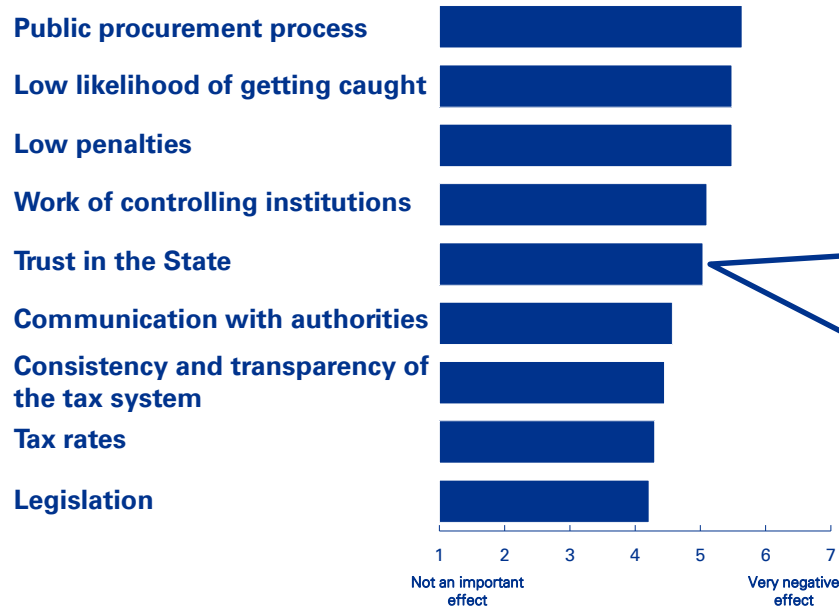
Work of controlling institutions



«Credibility is not high in general, very formalistic approach, no substantial control, acts like the police, when they should act more like consultants.»

- Real estate company

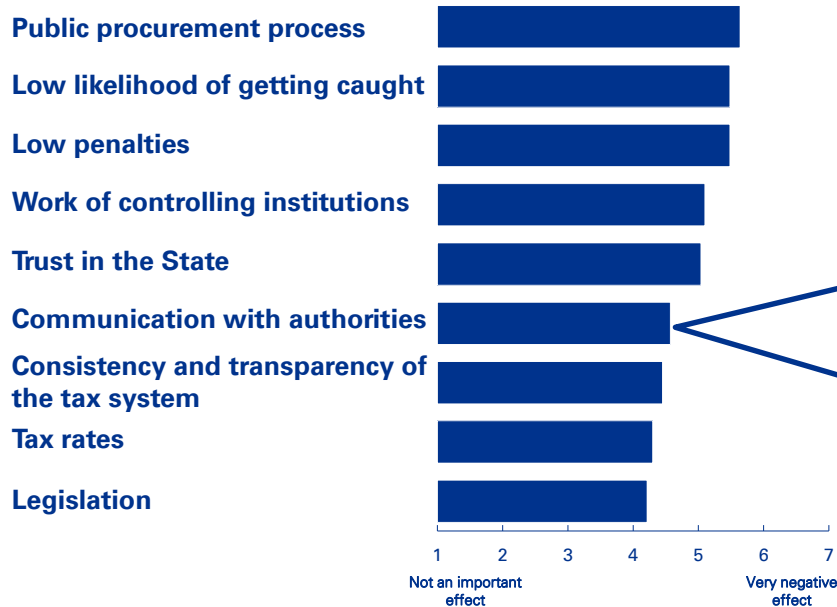
Trust in the State



«You pay taxes when you trust that in case something happens you will be supported by the State and get back what you have given, for example, medical insurance. Why pay taxes when the government wastes the revenue.»

- Energy company

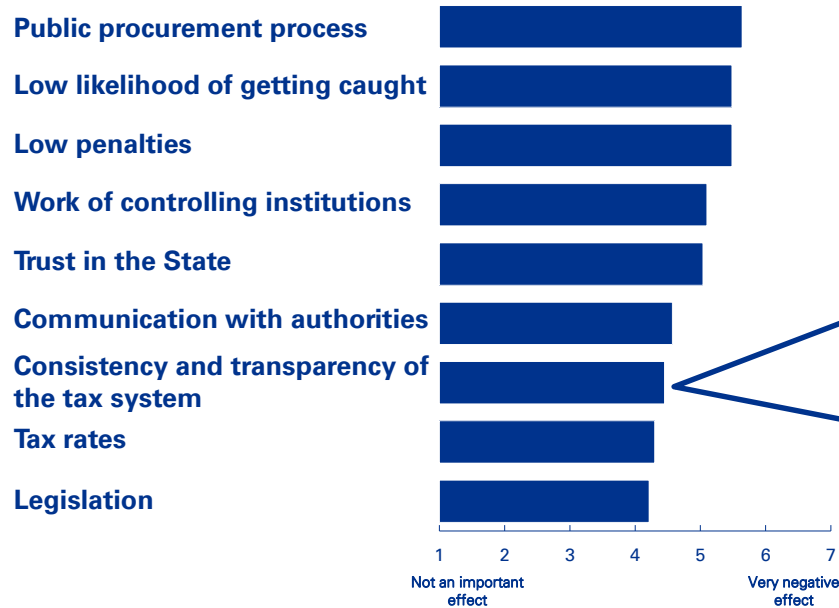
Communication with authorities



«This has a significant effect. If the State is helpful – it is very important, particularly for new companies. The more government explains and talks to companies and entrepreneurs the better result they will get.»

- Wholesale and retail company

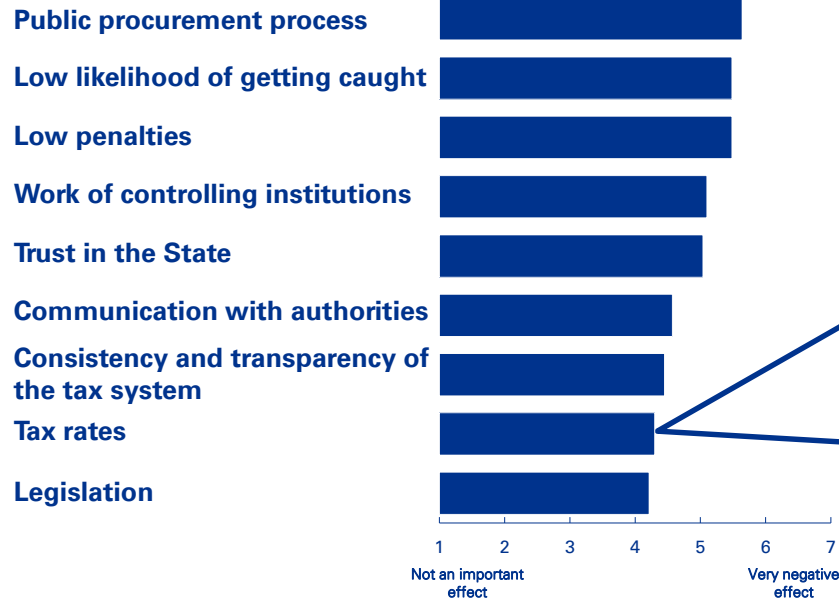
Consistency and transparency of the tax system



«The tax system is far too complicated, even those who should apply it do not seem to have a solid knowledge; it may be the case that three employees of the State Revenue Service will give you three different opinions.»

- Transport, logistics and freight company

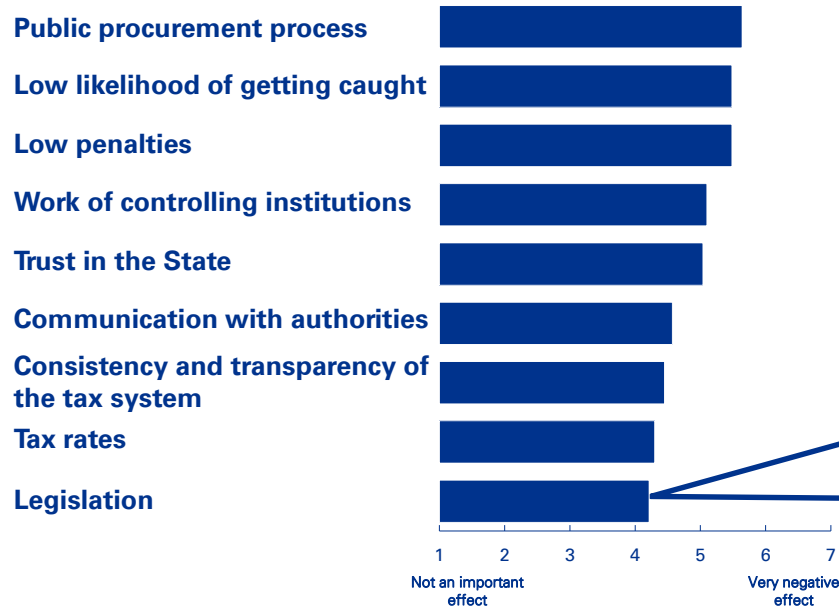
Tax rates



«Salary taxes are too high both for the employee and the employer. Unfair system, especially for low wages. In many other countries salary tax on lower wages is low percentagewise due to deductibles/tax allowances, which are practically non-existent in Latvia by comparison.»

- Energy company

Legislation



«Legislation is not the problem, the problem is the enforcement and the collecting system.»
- Real estate company

Foreign investors' suggestions

Improve enforcement by increasing professional qualification of public officials

«Implement a service standard in the State Revenue Service whereby every public servant is considered to be a service provider and is required to act accordingly. There are some good examples like CSDD.»

- Finance and banking company



Foreign investors' suggestions

Focus reviews on the black list and increase scale and speed of punishment for working in the shadow economy

«Identification of priorities and stop wasting resources fighting small violations of tax payments e.g. hairdressers or shoemakers.»

- Manufacturing company



Foreign investors' suggestions

Agree on the core principles and stay consistent

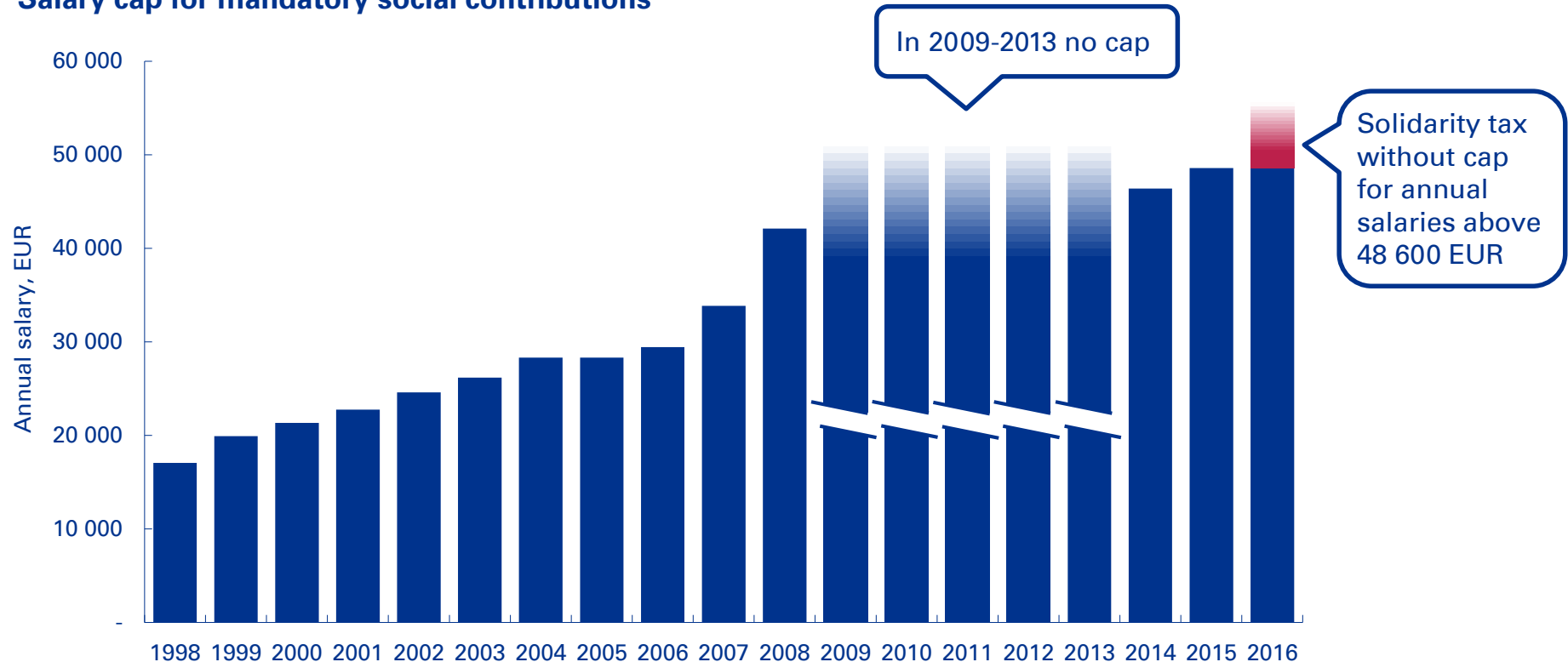
«The government should clearly communicate the strategy to fight the shadow economy.»

- Professional and assurance and advisory services company



Change in salary cap for social contribution tax

Salary cap for mandatory social contributions



Foreign investors' suggestions

Lower the tax burden on labour force and the proportion of taxes paid by low income earners

«In the long run, gradually decrease payroll taxes, allowing businesses to move from the shadow economy to the white economy.»

- Real estate company



Foreign investors' suggestions

Simplify the tax burden for small and micro companies

«Lower the administrative burden for small entities, but as this creates an opportunity for the shadow economy in the small and medium sector, prosecution of the small companies should also be improved.»

- Professional assurance and advisory company



Foreign investors' suggestions

The State should create incentives to pay taxes

«Older generation – they receive miserable pensions, their children see it and are not very motivated to pay any taxes and decide better to save themselves.»

- Technology and communications company



Foreign investors' suggestions

Increase the use of electronic documents between tax payers and public institutions

«More electronic solutions should be considered - how you pay taxes, report to financial institutions. The more automatic, the better it is, because it means you can also detect problems more easily.»

- Finance and banking company



Foreign investors' suggestions

Improve education of youth

«Tackle the moral issues. Look at different levels of the society from different perspectives. Consider age, gender, education, nationality.»

- Finance and banking company



Foreign investors' suggestions

Improve the quality of PR campaigns on paying taxes

«Educate people about the principles and have a common understanding. If you pay – you will receive public services. For example in healthcare, those who do not pay taxes would be last in the queue, just to show consequences.»

- Service company



Foreign investors' suggestions

Take cash out of system

«Remove cash from the system and you will solve the grey economy.»
- **Real estate company**





Contacts

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