

Tax Evasion in Transition: Outcome of an Institutional Clash?
- Testing Feige's Conjecture -

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Abstract-*

A field survey of households was conducted in Tirana, Albania in 2000. A response rate of 89.3% yielded 1.340 valid questionnaires, allowing us to test Feige's (1997) conjecture that more tax evasion will be observed, when formal and informal institutions clash. Respondents' attitudes towards formal and informal institutions were obtained by applying factor analysis to the responses to a series of attitudinal questions. The results of the analysis support Feige's conjecture. An important implication is that when studying tax evasion one should take country specific institutions (and their interaction) into account.

JEL codes: H26, O5, O17

Key Words: tax evasion, transition, formal and informal institutions

* Comments by Arthur Schram and Jelle Visser are gratefully acknowledged.

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1. INTRODUCTION

Studies in developed and developing countries have shown that the underground economy has a significant impact on the economy as a whole (see Loyaza, 1996; Bhattacharyya, 1999; Giles, 1999a, Tanzi, 1999). Nevertheless, this phenomenon was neglected in previously socialist countries, in the first years of transition. There has been some discussion about whether this neglect was due to a perceived unimportance of the underground economy or it was conveniently disregarded by governments due to its tremendous effect as an absorber of poverty and social chaos (Kesner-Skreb, 1997). However this may be, a recent rise in the interest of researchers and policy makers is noticeable.

This paper represents a demonstration of this growing interest. Its main focus is on the institutional analysis of tax evasion in transition countries. One motivation is the scarcity of research in this field. The complexity of factors involved in the transformation process of these countries makes the study of such an important phenomenon not only a challenge but also a necessity. As reported in Gërzhani (2002), the magnitude of the underground economy in transition countries is significantly larger than in developed countries. The consequences are not only economic, but also social, institutional and political. Moreover, it is time that the analysis of the underground economy outside of the developed world is not only based on development economics but also on institutional economics. In other words, if one wants to study the underground economy in these countries, one needs to take account of institutional aspects in a systematic way. This paper presents an empirical analysis that does exactly that.

A specific country in transition is chosen for this study, to wit, Albania. Albania is an interesting country to study in this respect. It is the last country in Eastern Europe that opened itself up to democratic changes in the beginning of the 90s. While other Eastern European countries had in one way or another introduced slight changes with respect to private property as well as some moderate openness to international exchange of interests (already from the mid 50s), Albania, up to the beginning of transition, was in all aspects a completely isolated country.¹ As a result, when Albania entered the process of transition, it was struck not only by a deep crisis, but also by an institutional shock. Former institutions, established during four decades of communism, vanished before fundamental new institutions had time to develop. The gap between the two was filled by the emergence and rapid increase of the underground economy, which initially started as an emergency exit from the numerous problems of the formal sector, but later became an inevitable part of society. Radical institutional reform often creates a climate rife with noncompliant behavior (Feige, 1997:25).

The underground economy has many aspects (e.g., tax evasion, unrecorded economy, unregistered labor, illegal activities), which makes it impossible to analyze them all in one study. The focus of this paper is on tax evasion. There is an obvious macro-economic interest: a direct link to large budget deficits and hence to lower investments in public goods. Moreover, it allows one to study the decision-making process at the individual level. In addition, the study of tax evasion gives an indirect indication of individuals' involvement in the unregistered labor market. Finally, "the study of non-compliance in transition economies is likely to yield the most revealing view of the effective prevailing incentive structure, of the

¹ There is no quantitative evidence on the existence of tax evasion in Albania during communism. Nevertheless, as everywhere, there was an informal sector. Taxes could be evaded, for example, by not working in official employment or by selling privately grown agricultural products.

critical strategic behavior induced by that structure, and thus of the outcomes of policy changes” (Feige, 1997:25). Hence, individual tax compliance is the main focus of this paper, and the role of institutions in this individual decision is considered to be of crucial importance.

This research complements Feige’s (2002) recent macro-economic study, in which he estimates the average size of the Albanian unobserved economy at 65.4% or 48% of the total economy for the period 1989-2000, based on the electric consumption approach (ECM) or the currency ratio model (CDM), respectively. Our research provides a micro-economic underpinning for these large numbers.

The following section briefly presents an institutional theory of tax evasion, focusing on Feige’s conjecture. Section 3 introduces the questionnaire, describes and analyzes the main tax evasion variables, and provides an analysis of the attitudinal statements used to test the conjecture. Section 4 provides a direct and indirect test of Feige’s conjecture. Section 5 concludes.

2. AN INSTITUTIONAL THEORY OF TAX EVASION: FEIGE’S CONJECTURE

The institutional approach defines institutions as the indispensable framework within which human interaction takes place, as the “rules of the game”, the humanly devised constraints that determine incentives and shape human interactions in all societies (North, 1990:3-4). Institutional theory distinguishes two types of institutions: formal and informal. Formal institutions include laws, tax regimes, and the explicit operating rules of organizations, while informal institutions comprise (cultural) norms and established conventions. Formal rules are only a small subset of the constraints that govern choices and human interaction, while informal constraints and conventions are so pervasive that one is often misled into underestimating their role and importance. (North, 1990).

This is especially relevant in the case of former communist countries. Due to the radical political and economic changes they have gone through in transition, many formal communist institutions (i.e., laws and regulations) have been destroyed. On the other hand, experience has shown that informal institutions (i.e., norms, relationships, rules of behavior) established during communism continue to shape behavior, attitudes and incentives in transition (Nelson et al., 1997). This creates a paradox in these countries, given that many efforts are made –and often successfully so- to introduce new formal institutions. Although North was the first to mention this paradox -“the outcomes of revolutionary changes will depend on the ongoing tension between informal constraints and the new formal rules” (North, 1990:91)- it was Feige who elaborated on it.

When formal and informal institutions clash, non-compliant behaviors proliferate, forming various underground economies (Feige, 1997:22). Due to essential contradictions between formal and informal institutions in former communist countries, he argues that “transition process had to deal with a legacy of noncompliant behaviors² involving protective and predatory activities”. Feige adds that formal institutions have indeed changed radically in the transition economies, but informal institutions much less so. This is to be expected because norms of behavior, conventions and self-imposed codes of conduct change very slowly according to North. In addition, North sees the major obstacle for Third World and transition

² When talking about noncompliant behavior, he refers to evasion, avoidance, circumvention, abuse, and/or corruption of institutional rules, which in other words comprise the underground economy.

economies in the fact that the belief system that has evolved as a result of the cumulative past experiences of the society has not equipped its members to confront and solve the problems (and formal institutions) they face today.

The remainder of this paper deals with testing Feige's conjecture empirically, using data from Albania. By focusing on one country, there is no cross-sectional variation in formal institutions. This is solved by considering individual attitudes towards formal institutions. The way the formal and informal institutions are operationalized in the data is discussed below.

3. THE SURVEY DATA

3.1. METHOD AND STRUCTURE

The analyses presented here are based on data collected from a field survey conducted by the author in the urban area of Tirana (the capital of Albania) in 2000. The method applied was the 'self-administered questionnaire' (a.k.a. 'drop-off survey').³ The survey sample consisted of 1,500 households living in Tirana. Their selection was random and based on a geographical framework. The main income earner of the household was asked to respond to the questions. The response rate of 89.3% gave 1,340 valid questionnaires returned. Gërxhani (2002) provides arguments for the method used and gives a detailed description of the survey and the data's representativeness, showing that the research method used is valid and reliable. The data contain information about the individuals' attributes and individuals' attitudes towards a series of statements presented to them, as well as sufficient information about income and taxes to derive estimates (where applicable) of the extent of personal income tax evasion, small business income tax evasion, and social and health insurance tax evasion. In order to test Feige's conjecture, I show that the attitudes measured are to a large extent related to formal and informal institutions. The predictors used to explain evasion include these individual attitudes towards formal and informal institutions as well as personal attributes. The attitudes will give an indication of the importance of the institutional setting in Albania in determining tax evasion behavior.

3.2. TAX EVASION VARIABLES

The data contain information related to the respondents' tax evasion. However, no direct question about tax evasion is asked in the questionnaire because of the sensitivity of this topic. Instead, various indirect questions are used as a basis for gathering information about tax evasion. For example, if the response to the question 'Does your employer (state or private) deduct your personal income tax from your monthly salary' is 'No', then this is one indication of tax evasion; or if the response to the question 'Please indicate who pays your tax on personal income or your tax on small business' is 'Nobody', then this is another indication of tax evasion.

The Albanian tax laws are similar to those in most western countries: individuals employed in the public or private sector are subject to tax on personal income; self-employed individuals with a small business are subject to tax on small business income; and all working individuals (including the self-employed), are subject to social and health insurance tax. Based on this tax

³ Appendix 1 gives the complete questionnaire.

liability, I distinguish three (overlapping) groups of respondents in the data set: (1) individuals employed in the public or private sector; (2) self-employed individuals with a small business; and (3) all working individuals (including the self-employed). For each of these groups (tax types), the survey gives four or five indications of evasion of the tax concerned. These are aggregated to obtain three main variables on tax evasion: ‘the extent of personal income tax evasion’ (PITE), ‘the extent of small business income tax evasion’ (BITE), and ‘the extent of social and health insurance tax evasion’ (ITE).⁴ These variables are used to describe a respondent’s evasion with respect to these three types of tax evasion. Table 1 summarizes the information obtained with respect to evasion variables.

Table 1: The extent of personal income, business income and insurance tax evasion

	PITE (personal)		BITE (business)		ITE (insurance)	
	# cases	%	# cases	%	# cases	%
No tax evasion at all	544	61.4	131	43.5	780	69.3
One indication of evasion	146	16.5	82	27.2	169	15.0
Two indications	76	8.6	46	15.3	105	9.3
Three indications	68	7.7	30	10.0	55	4.9
Four indications	43	4.9	12	4.0	16	1.4
Five indications	9	1.0	0	0	-	-
Total	886	100	301	100	1125	100
At least one indication	342	38.6	170	56.5	345	30.7

Table 1 shows that 38.6%, 56.5%, and 30.7% of the respondents concerned have at least one indication of personal income tax evasion, small business income tax evasion, and social and health insurance tax evasion, respectively.

Stressing that many individuals are liable to more than one type of tax, I can use the data for a first comparison of evasion of different taxes. Consider the respondents who (should) pay both personal income tax and insurance tax and those who (should) pay small business tax as well as insurance tax. For the former group, paired samples t-tests show that less evasion is observed for insurance tax (26.7% has at least one indication) than for personal income tax (38.5%) ($t=8.33$, $p<0.01$, $N=824$). For the latter group, less evasion is observed for insurance tax (44.4%) than for small business income tax (54.8%) ($t=3.32$, $p<0.01$, $N=239$). Comparing individuals who are supposed to pay (only) personal income tax with those liable to (only) small business income tax, independent samples t-tests reveal that the respondents employed in their own business evade more (54.2%) than the other respondents (38.5%). This result is significant at the 1% level ($t= - 4.39$).

⁴ For a detailed description of the construction of these tax evasion variables from the questionnaire, see Appendix 2.

Together, these results indicate that the evasion is highest for small business income tax and lowest for social and health insurance tax, with evasion of personal income tax in between these two.

3.3. ATTITUDES TOWARDS FORMAL AND INFORMAL INSTITUTIONS

In order to capture individuals' norms and 'rules of behavior' (i.e., informal institutions) towards tax evasion and their perception of laws and regulations (i.e., formal institutions), I included attitudinal statements in the questionnaire. For a detailed description of these statements and a frequency distribution of the responses to each statement, see question D.7 in Appendix 1.

Using factor analysis (*principal-component analysis*), I summarized the attitudes expressed in the responses to 13 (out of 19) statements in a limited number of underlying factors.⁵ Three factors explain 44.4% of the variance. When selecting these three factors, the final component matrix appears as in table 2, which gives the correlation coefficients between the 13 statements used and the three factors. The results show a clear distribution of statements across factors, with one possible exception, statement 6 'High corruption in Albania'.

Table 2: Component matrix of the three orthogonal rotated factors

	Factors		
	I	II	III
1. Appropriate tax system for Albania	.725		
3. Low taxes in Albania	.644		
4. Supported Albanian government	.652		
6. High corruption in Albania	-.417		.286
7. Tax mentality		-.220	.681
9. Political stability in Albania	.697		
10. Allowance to evade tax to max profit			.752
13. Efficient audit rules	.571		
14. Payment: more public goods		.752	
15. Non-payment of insurance: financially serious		.559	
16. Majority of Albanians no tax		.275	.558

⁵ The statements: 'I would pay taxes if my income were higher', 'I do not feel like paying taxes as long as the government cannot be trusted', and 'I would pay taxes if other people would pay taxes too' are not included in the analysis due to their conditional character. The statements 'I pay the taxes I am supposed to pay' and 'The average income of the majority of Albanians is low' are not included because they measure more than one theoretical dimension. The statement 'The moral attitude of Albanians towards taxes is low' was dropped because of its minimal input to the analysis.

18. Morally obliged to pay taxes		.712	
19. Albanians are continuously informed about taxes and any problems are quickly clarified	.599		

Note: The complete statements used are presented in D.7, in Appendix 1.

The displayed selection is made for loadings > .2 or < -.2.

The result of factor analysis is a reduction of the 13 attitudinal variables into three main groupings. For each of these groupings, I calculate standardized factor scores for every individual in the sample. The variables summarize the respondent's answers to the statements in each factor/grouping. By carefully considering the statements combined in each factor and recalling that a high (low) score on an attitudinal question reflects (dis)agreement, one can try to interpret the underlying common attitude. This exercise yields the following grouping⁶ and interpretation:

I. Pessimism about formal institutions

1. The tax system in Albania is quite applicable to the economic situation in the country
3. Taxes are low in Albania
4. The Albanian government deserves to be supported
6. Corruption in Albania is high
9. Our country is characterized by political stability
13. Audit rules on tax compliance are efficiently and equally enforced by the relevant state institutions
19. The Albanian public is continuously informed about tax legislation and any problems are quickly clarified

Factor I: when the score value increases, individuals have a more *pessimistic view about formal institutions* in Albania. For example, they will disagree that 'The tax system in Albania is quite applicable to the economic situation in the country' or agree that 'Corruption in Albania is high'. The expected effect on the extent of tax evasion is positive: pessimism about formal institutions might make people evade more. Some hypotheses can be found in the literature about the relationship between the extent of tax evasion and some of the statements underlying this factor. For example, Friedman et al. (2000:27) report a positive relationship between the share of the unofficial economy and the ineffectiveness of institutions (including corruption). Schneider and Enste (2000) attribute higher tax evasion to a long-term decline of civic virtue and loyalty towards public institutions. Both imply a positive correlation between this factor and evasion.

⁶ The grouping was subjected to a reliability analysis. The estimated Cronbach's alfa coefficient was 0.625, 0.495, 0.437, respectively, indicating a good level of reliability.

II. Tax immorality

14. People should pay taxes because if they do, they will benefit from them (e.g. better roads, more parks, more schools, etc.)
15. Not paying social and health insurance today, would cause serious financial problems for me in the future (e.g. no pension benefits)
18. I think everyone is morally obliged to pay taxes

Factor II: when the score value increases, individuals demonstrate higher *tax immorality*. For example, they will disagree that ‘People should pay taxes because if they do, they will benefit from them (e.g. better roads, more parks, more schools, etc.), or that ‘I think everyone is morally obliged to pay taxes’. This means that if a high tax immorality is reported, more evasion is expected. Schneider and Enste (2000) attribute higher tax evasion to the decline of tax morale.

III. Positive tax experience

7. I (We) haven’t paid taxes in the past, so I do not find any reason for paying now
10. Anyone is allowed to evade taxes in order to maximize his/her profit
16. The majority of people in Albania do not pay taxes

Factor III: when the score value increases, individuals demonstrate a more *positive tax experience*. For example, they will disagree that ‘The majority of people in Albania do not pay taxes’ or that ‘I (We) haven’t paid taxes in the past, so I do not find any reason for paying now’. This is expected to be negatively correlated to tax evasion. Kesner-Skreb (1997) claims that spreading tax evasion is to a large extent determined by the number of people that already evade. In addition, Feige (1997) argues that the choice to comply or not is often conditioned by the institutional structure that prevailed in the pre-transition period.

Based on the underlying attitudes, I consider factor I, *Pessimism about formal institutions*, as a good representation of individuals’ perception of formal institutions. Factors II and III, *Tax immorality* and *Positive tax experience*, are much more related to norms, culture and customs, and hence are seen as representing informal institutions.

4. RESULTS

Now that I have data on tax evasion and attitudes towards formal and informal institutions in Albania, I can empirically test Feige’s conjecture. I do so in two ways. First, I construct a variable that captures the clash directly and test the effect of this variable on tax evasion. Second, I consider the three cornerstones underlying the conjecture: the relationships between (1) personal attributes and attitudes, (2) attitudes and evasion, and (3) evasion and personal attributes.

4.1. A DIRECT TEST OF FEIGE'S CONJECTURE

In order to test Feige's conjecture directly, a variable that captures the clash between formal and informal institutions is needed. I construct such a variable using the factors derived in the previous section. Consider a variable 'noclash', defined as the product of the score on factor I and the score on factor II.⁷ An individual with a high score on the variable 'noclash' combines either pessimism about formal institutions with tax immorality or optimism with morality. A negative score is an indication of a clash between attitudes towards formal institutions (factor I) and informal institutions (factor II).

For the direct test of Feige's conjecture, I will use the variable $\text{clash} \equiv -\text{noclash}$, because of the intuitive interpretation that a higher value for this variable is an indication of a stronger clash between both types of institutions. Feige's conjecture is now testable, because it implies that this variable will have a positive impact on tax evasion.

The choice variables I want to explain are: the extent of personal income tax evasion (*PITE*), the extent of small business income tax evasion (*BITE*) and the extent of insurance tax evasion (*ITE*). Given the ordinal nature of the dependent variables, I use ordered probit for all regressions testing the effect of independent variables on tax evasion.⁸ Table 3 presents the results. For each type of tax, two regressions were run: one including the factors I and II as independent variables and one without these first order effects. Both regressions include a dummy variable 'missing' that indicates missing data on the at least one factor score. This variable is included in order to test for a possible selection effect in the responses to the attitudinal questions.

Table 3: A direct test of Feige's conjecture

Dependent Independent	PITE		BITE		ITE	
Pessimism about formal institutions		.02 (.71)		-.18 (.01)*		-.01 (.88)
Tax immorality		.22 (.00)*		.09 (.22)		.18 (.00)*
Clash	.10 (.02)*	.10 (.02)*	.15 (.04)*	.13 (.08)**	.05 (.24)	.05 (.22)
Missing	.16 (.13)	.17 (.11)	.03 (.83)	.03 (.86)	.10 (.29)	.11 (.25)
# observations	886		301		1125	

(*) indicates statistical significance at the 5% level; (**) indicates statistical significance at the 10% level.

Note: Numbers represent the regression coefficient; p-values in parentheses.

The Ordered Probit regression was run in the statistical program STATA.

⁷ For the construction of this variable, I prefer to use factor II (tax immorality) to represent the attitudes towards informal institutions (as opposed to factor III), because its reliability, as measured by Cronbach's alfa (see footnote 6), is higher.

⁸ As a robustness check, I defined binary variables distinguishing between 'no indication of tax evasion' and 'at least one indication of tax evasion'. Replacing PITE, BITE and ITE by these variables and using logit regression, I redid the tests described in this paper. No important differences in conclusions were reached.

The results show support for Feige’s conjecture. The coefficient for ‘clash’ is positive in all cases and statistically significant for PITE and BITE. As far as I know, this is the first empirical support for this conjecture. The results also show that when business people report to be optimistic about the formal institutions in Albania, they evade significantly more. This counterintuitive result may be related to the fact that some (successful) business people may express optimism about formal institutions because they know how to use them to their own benefit (e.g., through bribing). This is where informal institutions may play an important role. More discussion will follow. On the other hand, the relationship between tax immorality and evasion is positive in all cases and statistically significant for PITE and ITE.

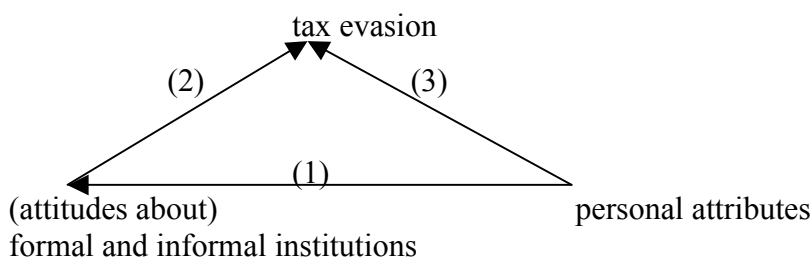
4.2. AN INDIRECT TEST OF FEIGE’S CONJECTURE

The conjecture is based on three building blocks:

- (1) Individuals’ attitudes towards formal and informal institutions; and the determinants thereof.
- (2) Individual tax evasion, as determined by their attitudes towards institutions.
- (3) Individual tax evasion and the determinants thereof.

(3) might be considered to be the result of (1) and (2), but there may also be determinants of tax evasion not related to institutions. This is summarized in the following diagram, which is denoted by ‘Feige’s conjectural triangle’.

Figure 1: Feige’s conjectural triangle



In Gërzhani (2002), I provide detailed regression results that estimate the three legs of this triangle. These results enable me to draw indirect conclusions on the conjecture itself. Gender affects attitudes: males are more optimistic about formal institutions, but they are characterized by more negative scores with respect to informal institutions than females. This clash between the two types of institutions (relative to females) is expected to yield more evasion by males, which is indeed observed.

Highly educated people think more positively about formal institutions than uneducated people; in addition, highly educated people are characterized by more positive scores towards informal institutions than less educated people. The two institutions are compatible, therefore, according to Feige’s conjecture, highly educated people are expected to evade less. This is supported by the data.

Main income earners of large families have more negative attitudes towards formal institutions and are also characterized (on balance) by negative scores with respect to informal institutions. The two institutions are compatible, hence less evasion is expected from the respondents of large households, as the data show.

People of rural origin think positively about formal institutions, but negatively about informal institutions. This clash makes us expect more evasion by respondents with a rural origin, which is supported by the data.

Finally, I find that when small business people report to be optimistic about the formal institutions in Albania, they evade significantly more (table 3). My interpretation is again related to Feige's hypothesis. It was speculated above that the self-employed respondents may report to be satisfied with the formal institutions because they know how to efficiently use them to their own benefit, for example, through bribery and corruption. If this is the case, the result with respect to formal institutions also measures the 'informal use' of these institutions for this group. This explanation makes sense given the low score the self-employed individuals have on the informal institutions (factor III). The consequence is a higher level of tax evasion than would have been observed otherwise. Admittedly, this reasoning is speculative. It is a possible interpretation of a counterintuitive result that is in line with Feige's conjecture, however.

All in all, I also find some indirect empirical support for Feige's assertion. Using experimental data, Gërzhani and Schram (2001) find more evidence along this line. They conclude that different levels of tax evasion in Albania and the Netherlands are not attributable to different tax norms and attitudes, but to different formal institutions and their 'informal use' by individuals.

5. CONCLUSION

This paper analyzes the data from a household survey in Tirana. The core is an empirical test of Feige's conjecture that when formal and informal institutions are in conflict, more tax evasion is observed. The data allow me to undertake this test at the micro-level. Using regression analysis, I was able to test this conjecture directly and indirectly. I use responses to attitudinal questions, summarized through factor analysis, to find instruments describing individuals' attitudes towards both types of institutions. The direct test uses a proxy for the clash discussed by Feige. The indirect test is based on regression results provided elsewhere, which estimate the three legs of Feige's conjectural triangle.

The empirical evidence provided in this paper to a large extent supports Feige's conjecture. The proxy capturing the clash directly has the expected sign and is statistically significant in two out of three cases. In addition, evidence that gender, education, family size and migration influence the respondents' attitudes towards formal and informal institutions, and consequently their decision to evade taxes, is consistent with the model of thought underlying the conjecture.

The conclusion is that when the institutional component is included in the analyses in the way implied by Feige, it turns out to be as important as his conjecture suggests. Whenever the formal and informal institutions are in conflict, tax evasion is observed. When the two are studied separately, the results can be ambiguous. Hence, for the study of noncompliant activities, one should consider both types of institutions simultaneously for a better understanding of these phenomena. Unfortunately, most of the existing literature fails to do

so. This is especially interesting when one considers the implications for the study of tax evasion in general. This paper was only concerned with Albania. Many studies on tax evasion cover a variety of countries or implicitly assume that the results are more or less general. What I have shown is that the assumed generality is probably dependent on the extent to which a study takes country specific institutions (and their interaction) into account. Institutions vary across countries (especially when comparing developed and less developed countries) and should be considered when studying tax evasion.

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APPENDIX 1: The written questionnaire used in the field survey

CURRENT FINANCIAL CONCERNS OF HOUSEHOLDS IN TIRANA

Note: (1) In this questionnaire, a household is a group of people who live currently and regularly at the same address and who administer their total incomes and expenses in a joint way; and (2) This inquiry should be filled in by the main earner of your household.

A. As a start, we would like to ask you some general information about yourself and your household.

A.1. What is your gender? (*Please put a cross in one box*)

1

Male

2

Female

A.2. Could you please tell us the month and the year you are born in? (*Please fill out*)

Month: _____

Year: _____

A.3. Could you please tell us your family status? (*Please circle the appropriate answer*)

1. single without children

2. single with children

3. married or living together, without children who currently live with you

4. married or living together, with children who currently live with you

5. other (*please specify* _____)

A.4. Currently, how many persons (including you) live physically in the same household with you? (*Please fill out*)

_____ persons

A.5. How old is every person (excluding you) who lives physically at the present in the same household with you? (*Please fill out*)

1. Partner _____ years old

2. Child no. 1 _____ years old

3. Child no. 2 _____ years old

4. Child no. 3 _____ years old

5. Child no. 4 _____ years old

6. Other children..... _____ years old

Please specify below the ages of other persons, e.g. your mother, father, brothers, sisters, etc. if they live physically at the present in the same household with you

7. _____ years old

8. _____ years old

9. _____ years old

10. Other members..... _____ years old

A.6. What is the highest level of education you have completed? (*Please circle only the appropriate answer*)

1. none

2. primary

3. secondary

4. gymnasium/professional school

- 5. higher**
- A.7. Which region of Albania did you live in before 1991 (before the democratic changes)? *(Please fill out)*
1. **North of Albania**
 2. **Center of Albania**
 3. **South of Albania**
- A.8. Could you please tell us whether you have lived in a town or a village before 1991 (before the democratic changes)? *(Please fill out)*
1. **Town**
 2. **Village**
- A.9. Which of the following dwellings are you currently living in? *(Please circle only the appropriate answer)*
1. **own home**
 2. **own home subject to mortgage / other credit payment**
 3. **rented property**
 4. **my relative's house**
 5. **other** *(please specify _____)*

B. Based on the following questions, we would like to know various aspects of employment regarding you and your household.

Your personal employment

- B.1. Do you have paid work? Note that this question is asked for any kind of paid work (in public or private sector, own or family business, etc.) that you are currently working in and you are earning income from. *(Please circle the appropriate answer)*
1. **Yes** (if Yes, continue to answer questions B.1.1. – B.1.4.)
 2. **No** (if No, skip questions B.1.1. – B.1.4. and continue to answer questions (B.2.1. – B.2.2.))
- B.1.1. If you have paid work, what is your current occupation in your main working place? *(Please fill out)*
- _____
- B.1.2. If you have paid work, where do you work? *(Please circle more than one answer, if you work in more than one of the working places below)*
1. **employed by state employer in public sector**
 2. **employed by private employer in private sector (with a job contract)**
 3. **employed by private employer in private sector (without a job contract)**
 4. **self-employed in my own business, full-time or part-time, which may operate all the time, occasionally or seasonally**
 5. **employed in family business, full-time or part-time, which may operate all the time, occasionally or seasonally**
 6. **employed in occasional or seasonal work which can be full-time or part-time, in public or private sector**
 7. **other forms of employment** *(please specify _____)*

B.1.3. If you have paid work, how many hours per week do you work, on average, on each of the working sectors below? *(Please fill out)*

- | | | |
|---------------------------------------------|-------|-------|
| 1. public sector: | _____ | hours |
| 2. private sector (with a job contract): | _____ | hours |
| 3. private sector (without a job contract): | _____ | hours |
| 4. my own business: | _____ | hours |
| 5. my family business: | _____ | hours |
| 6. casual or seasonal work: | _____ | hours |
| 7. other forms of employment: | _____ | hours |

B.1.4. If you or other members, who live physically at the present in the same household with you, run a business, how many people work in this business? *(Please circle all the answers that apply)*

1. only myself
2. other members of the family
2.1. if yes, how many members? *(Please fill out)*
_____ members
3. other people *(Please put a cross in one of the boxes below)*
3.1. less than 5 persons
3.2. 5 – 10 persons
3.3. more than 10 persons
4. not applicable

B.2. If you have paid work (i.e. if you answered **Yes** to B.1.) skip questions B.2.1. and B.2.2. below and continue with question B.3.

B.2.1. If you do not have paid work (in none of the above mentioned sectors), what is your current labor status? *(Please circle all the possible answers if more than one is applicable to your case)*

1. unemployed, not looking for job
2. unemployed, looking for job
3. work in household
4. pensioner
5. disabled
6. other *(please specify _____)*

B.2.2. If you do not have paid work (in none of the above mentioned sectors), are you registered at the employment registration office to find a job? *(Please put a cross in one box)*

- 1 Yes 2 No 3 not applicable

Employment of other members of your family

B.3. How many persons (excluding you), who live physically at the present in the same household with you, have paid work? Note that this question is asked for any kind of paid work (in public or private sector, own or family business, etc.) that these persons, be them children, youth, adults, women or elders, are currently working in and are earning income from. *(Please fill out)*

_____ persons

B.4. What is the total number of household members that currently live abroad (who in case of living in Albania would live in the same household with you), who support your household financially? *(Please circle the appropriate number)*

- 0 1 2 3 4 5

C. The answers to the following questions would help us very much to know the current financial situation, which Albanian households are in generally faced with. As most of us know, some employers deduct personal income taxes from their employee's monthly salaries. Please note that when questions below refer to taxes, you should give an answer for both taxes: the ones withheld by your employer and the taxes you pay yourself in case you run your own business. If you have more than one work, please answer for all taxes paid by your employer or you yourself in all the works you have. To end up, some of the questions below refer to your household, therefore your answers should consider what is said above for every member of your household, who has at least one work.

C.1. Does your employer (state or private) deduct your personal income tax from your monthly salary? *(Please put a cross in one box)*

1 **Yes**

2 **No**

(If **Yes**, how much: _____ **new Leks**)

3 **not applicable**

4 **don't know**

C.2. Could you tell us your total personal income for the last month, BEFORE paying taxes on personal income (be these paid by you or your employer) or on small business; house rent; electricity; water or any other household expenses? Note that your total personal income should consist of the incomes from all your personal sources of income during the last month *(Please fill out as precisely as possible)*

_____ **new Leks**

C.3. Could you tell us your total personal income for the last month, AFTER paying taxes on personal income (be these paid by you or your employer) or on small business; but before paying the house rent; electricity; water or any other household expenses? Note that your total personal income should consist of the incomes from all your personal sources of income during the last month *(Please fill out as precisely as possible)*

_____ **new Leks**

C.4. Could you tell us the total income of your household for the last month, BEFORE paying taxes on personal income (be these paid by each of the household members themselves or their employers) or on small business; house rent; electricity; water or any other household expenses? Note that the total income of your household should consist of the incomes from all sources of income of all members of your household (including you too) during the last month *(Please fill out as precisely as possible)*

_____ **new Leks**

C.5. Could you tell us the total income of your household for the last month, AFTER paying taxes on personal income (be these paid by each of the household members themselves or their employers) or on small business; but before paying the house rent; electricity; water or any other household expenses? Note that the total income of your household should consist of the incomes from all sources of income of all members of your household (including you too) during the last month *(Please fill out as precisely as possible)*

_____ **new Leks**

C.6. Could you indicate, on average, your household's monthly expenses during the last month?
(Please circle the approximate amount for each category)

Electricity and Water <i>(in new Leks)</i>	Food and Other Household Consumption (e.g. clothing, washing powder, etc.) <i>(in new Leks)</i>	Tax on Personal Income <i>(in new Leks)</i>	Tax on Small Business <i>(in new Leks)</i>	Social Security & Health Insurance <i>(in new Leks)</i>	Traveling <i>(in new Leks)</i>
a. 0	a. 0	a. 0	a. 0	a. 0	a. 0
b. 250 - 1.399	b. 4.000 - 14.999	b. 500 - 1.499	b. 600 - 1.599	b. 500 - 2.499	b. 50 - 499
c. 1.400 - 2.299	c. 15.000 - 24.999	c. 1.500 - 2.999	c. 1.600 - 3.599	c. 2.500 - 4.499	c. 500 - 999
d. 2.300 - 3.499	d. 25.000 - 39.999	d. 3.000 - 9.999	d. 3.600 - 8.499	d. 4.500 - 11.999	d. 1.000 - 1.999
e. 3.500 or more	e. 40.000 or more	e. 10.000 or more	e. 8.500 or more	e. 12.000 or more	e. 2.000 or more

C.7. Is your monthly household income (AFTER paying taxes on personal income or on small business for every household member) sufficient to fulfill your monthly minimum living requirements? *(Please circle only the appropriate answer)*

1. **more than sufficient**
2. **sufficient**
3. **neither sufficient nor too little**
4. **barely sufficient**
5. **not sufficient at all**

C.8. Considering current prices, what monthly household income (AFTER paying taxes on personal income or on small business for every household member) would you consider for your household as:

very bad..... _____ **new Leks** *(fill out)*
 bad..... _____ **new Leks** *(fill out)*
 neither bad nor good..... _____ **new Leks** *(fill out)*
 good..... _____ **new Leks** *(fill out)*
 very good..... _____ **new Leks** *(fill out)*

C.9. Considering your monthly total personal income, which would be the monthly amount of money you would be willing to pay for the tax on personal income or tax on small business? *(Please fill out the approximate amount)*

_____ **new Leks**

C.10. How satisfied are you with the financial situation of your household? *(Please circle one of the numbers of the scale)*

0 _____ 1 _____ 2 _____ 3 _____ 4 _____ 5 _____ 6 _____ 7 _____ 8 _____ 9 _____ 10

Not at all Satisfied

Very Satisfied

D. Next, we would appreciate if you could give us some information about tax issues, based on the following questions.

D.1. What do you think is the percentage of people in Tirana, who have at least one job, who pay the tax on personal income (be this paid by them themselves or by their employers) or the tax on small business? *(Please circle only one answer)*

- | | | | |
|----|-----------------|-----|------------------|
| 1. | 0 – 10 percent | 6. | 50 – 60 percent |
| 2. | 10 - 20 percent | 7. | 60 – 70 percent |
| 3. | 20 – 30 percent | 8. | 70 – 80 percent |
| 4. | 30 - 40 percent | 9. | 80 – 90 percent |
| 5. | 40 – 50 percent | 10. | 90 – 100 percent |

D.2. Would you mind telling us which of the following monetary obligations do you and your household pay? *(Please circle all the answers that apply, if you pay more than one)*

1. electricity payments
2. tax on personal income (be this paid by you yourself or your employer)
3. water payments
4. tax on small business
5. social security and health insurance
6. tax on business profit
7. annual tax on TV
8. tax on rental profits
9. other taxes
10. none of the above

D.3. Please indicate who pays your tax on personal income or your tax on small business? *(Please circle only the appropriate answer)*

1. completely my private or state employer
2. partly myself (my private or state employer pays the rest)
3. completely myself
4. nobody
5. not applicable

D.4. If you or other household members run a business, where other people are employed as well, could you tell us who pays the tax on personal income of these people? *(Please circle only the appropriate answer)*

1. completely the employees
2. partly myself (employees pay the rest)
3. completely myself
4. nobody
5. not applicable

D.5. Please indicate who pays for your social security and health insurance? *(Please circle only the appropriate answer)*

1. completely my private or state employer
2. partly myself (my private or state employer pays the rest)
3. completely myself
4. nobody
5. not applicable

D.6. If you or other household members run a business, where other people are employed as well, could you tell us who pays for the social security and health insurance of these people? *(Please circle only the appropriate answer)*

1. completely the employees
2. partly myself (employees pay the rest)
3. completely myself
4. nobody
5. not applicable

D.7. To what extent do you agree or disagree with the following statements of different people? *(Please put a cross in only one box for each statement)*
 {NB. Numbers reflect the distribution of responses and the number of cases (last column)}

	Strongly Agree	Mildly Agree	Neither Agree nor Disagree	Mildly Disagree	Strongly Disagree	<i>Total cases</i>
1. The tax system in Albania is quite applicable to the economic situation in the country	6.4	26.1	20.1	20.4	27.0	1288
2. I pay the taxes I am supposed to	53.8	24.5	10.7	6.0	5.0	1273
3. Taxes are low in Albania	10.2	14.3	19.1	20.3	36.1	1269
4. The Albanian government deserves to be supported	30.9	21.0	18.2	7.9	22.0	1268
5. The moral attitude of Albanians towards taxes is low	37.2	22.8	19.7	10.7	9.6	1253
6. Corruption in Albania is high	67.0	11.3	13.3	4.2	4.1	1278
7. I (We) haven't paid taxes in the past, so I do not find any reason for paying now	14.3	15.2	18.2	19.5	32.8	1233
8. I would pay taxes if my income were higher	60.4	14.0	6.8	8.7	10.1	1257
9. Our country is characterized by political stability	15.5	18.3	14.6	14.7	36.9	1269
10. Anyone is allowed to evade taxes in order to maximize his/her profit	22.2	18.2	14.2	14.8	30.6	1256
11. I do not feel like paying taxes as long as the government cannot be trusted	27.2	19.0	14.6	15.9	23.4	1254
12. I would pay taxes if other people would pay taxes too	42.4	16.0	10.1	11.2	20.3	1254
13. Audit rules on tax compliance are efficiently and equally enforced by the relevant state institutions	15.2	15.2	26.4	20.6	22.6	1260
14. People should pay taxes because if they do, they will benefit from them (e.g. better roads, more parks, more schools, etc.)	68.6	17.3	8.0	2.7	3.4	1282
15. Not paying social and health insurance today, would cause serious financial problems for me in the future (e.g. no pension benefits)	80.9	10.9	3.8	1.4	3.0	1284
16. The majority of people in Albania do not pay taxes	37.6	29.9	20.6	7.8	4.0	1279
17. The average income of the majority of Albanians is low	72.6	13.4	8.5	3.3	2.3	1288
18. I think that everyone is morally obliged to pay taxes	73.5	15.7	6.0	2.3	2.6	1282
19. The Albanian public is continuously informed about tax legislation and any problems are quickly clarified	18.9	24.3	18.7	16.4	21.7	1278

If you have any other comments you wish to add, on this questionnaire or other topics, they would be appreciated.
 Please write them in the space provided below.

We appreciate very much the time and effort you have taken to answer our questions.
THANK YOU FOR COMPLETING THIS QUESTIONNAIRE!

APPENDIX 2: Construction of the main tax evasion variables from the questionnaire.

Table 1: Construction of the tax evasion variables

	Question(s)*	Indication of evasion	Applicable to		
			PITE	BITE	ITE
Deducted tax on personal income	C.1.	C.1. = 2	+		
Gross minus net personal income	C.2., C.3.	C.2. – C.3. = 0	+	+	+
Household monthly expenses on: <ul style="list-style-type: none"> • personal income tax • small business income tax • social & health insurance tax 	C.6.	C.6. = a	+	+	+
Payment of personal income tax	D.2.2.	D.2.2. = 0	+		
Payment of small business income tax	D.2.4.	D.2.4. = 0		+	
Payment of social and health insurance tax	D.2.5.	D.2.5. = 0			+
Who pays the: <ul style="list-style-type: none"> • personal income tax • small business income tax 	D.3.4.	D.3.4. = 1	+	+	
Who pays the personal income tax of employees	D.4.4.	D.4.4. = 1		+	
Who pays the social and health insurance tax	D.5.4.	D.5.4. = 1			+

* for a detailed description of the questions, see Appendix A.

Table 1 shows that given that a respondent is obliged to pay the personal income tax and/or the small business income tax and/or the social and health insurance tax:

- (1) C.1. = 2 indicates evasion because if those respondents whose personal income tax is supposed to be deducted by their employers say that it is not, this means that they are working on an unofficial basis. In case of an ‘official’ employment, the employer is obliged by law to deduct personal income tax from the monthly salary. Consequently, if it is not, the tax on personal income is evaded;
- (2) C.2. – C.3. = 0 indicates non-compliance because if the reported gross and net incomes are equal, one potential explanation is the evasion of personal income tax and/or small business income tax and/or social and health insurance tax;
- (3) C.6. = a indicates evasion because the selected respondents report that they do not spend any money on personal income tax, small business income tax or social and health insurance tax. Although the question asks for the household’s monthly expenses, I believe this to be an indication of PITE, BITE and ITE due to the fact that the respondent is the main income earner of the household;
- (4) D.2.2. = 0 indicates evasion because the selected respondents report that they do not pay their personal income tax;
- (5) D.2.4. = 0 indicates evasion because the selected respondents report that they do not pay their small business income tax;
- (6) D.2.5. = 0 indicates evasion because the selected respondents report that they do not pay their social and health insurance tax;
- (7) D.3.4. = 1 indicates evasion when the payment of personal income tax or small business income tax is expected and the answer is that nobody pays it;
- (8) D.4.4. = 1 indicates evasion of the small business income tax (albeit indirect) because the information obtained from this question shows the extent to which small businesses fail (are not willing) to deduct the personal income tax from their employees’ salaries;
- (9) D.5.4. = 1 indicates evasion when the payment of the social and health insurance is expected and the answer is that nobody pays it.

There are four to five indications of personal income tax evasion, small business income tax evasion and social and health insurance tax evasion. The observed responses indicating evasion varied from 11.5% to 31.4% with respect to PITE, from 9.7% to 47.3% with respect to BITE, and from 10.8% to 21.7% with respect to ITE. An important reason for this discrepancy is that respondents are reluctant to admit that they evade. Moreover, some respondents might not know the answer to some questions. As a consequence, it is not possible to obtain precise information. I adopt the simple, but intuitively sensible assumption that more indications of tax evasion make it more likely that a respondent is evading taxes. Hence, I simply count the number of times (out of four or five) that a respondent fulfilled the criteria listed above.