

## Dealing With The Shadow Economy In Terms Of Innovation And Creativity

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**Abstract:** *The shadow economy, perceived herein as reflecting the monetary transactions unreported to the related authorities, thereby being “exempted” from the payment to the same of the related taxes, represents a key issue affecting countries all around the world by decreasing, to a larger or lesser extent, the general welfare. Considering its importance, adequate measures should be taken so as to succeed in turning a situation apparently unsolvable into a favourable one. However, given that, despite of the law-related risks to which they are subject, the individuals involved in such activities are animated by very strong reasons to proceed that way, finding best possible solutions, either punitive in nature or stimulating and motivational, is a matter not only of knowledge, but also one of creative ideas, and, certainly, not a panacea, but a situational process.*

**Keywords:** shadow economy, tax avoidance, welfare, macroeconomic policies, creative ideas

**JEL Classification:** E26, E61, H62

### 1. A brief journey into the mind of shadow economy promoters

The present paper represents an incursion into the shadow economy, meant for identifying the main influencing factors determining individuals to evade taxes, thereby breaching the laws in force in the matter, with all related consequences, and for revealing, by resorting to innovation and creativity, some possible ways to push things into the right direction.

Several questions could be raised when approaching this topic: Which is the triggering element for making such radical decisions, for such actions? What is in the mind of that individual in that very moment? In there a deliberated, consciously assumed action or just a sudden, unconscious one? Which would be the behavioural pattern for such an individual? Is that kind of decision assumed by certain types of individuals? ... and the list could, indefinitely, continue.

The answers to each and every question are complex, in any such cases "it depends" being present.

Individuals are very different from one another and so are the contexts they live and act in: more or less intelligent, more or less educated or qualified, more or less emotional, more or less under the influence of others, more or less in a critical situation, financial or otherwise in nature and so on. The element triggering the reaction, deliberated or not, for breaching the law is highly dependent on the above-mentioned: on people nature and contexts.

Staying home and producing something that is subsequently sold, without being officially reported, a sort of unreported self-employment, can be determined by the need of an individual to find some minimum

subsistence means for him/her and his/her family, in the absence of an official job, or it can be about a person needing, for increasing his/her life standard or the life standard of his/her family, to add something more to the wage obtained from an "official" job. In such case, the risk of being caught is covered by the need to survive or to have a reasonable life.

But how deliberated could that be? A clear delimitation between consciousness and unconsciousness is not always possible. That person could fully ignore unfavourable consequences because the need is so strong that the risk ceases to be a problem for the moment, or because he/she is ignorant, not knowing he/she is breaching the law or, even more, because he/she is confident that there is a very low chance to be caught.

On the contrary, another individual, also unofficially self-employed, could avoid paying taxes for the income obtained as result of his/her activity, not because his/her life standard would be affected thereby, but because he/she considers that the state does nothing to help him/her, so, being on his/her own in all respects would be just the right way to follow. And, anyway, once again, why being caught? If you know how to act, why fearing? In any case, some money lost if caught is less than the entire amount of money that should have been paid if declared as required. All true, maybe, just maybe.

Going forward, the unofficially self-employed decides developing and creates an entire business. He/she is not any longer alone in that affair, but other persons are involved as well. And they are paid. And they work because their need for money, in the absence of an official job, is stronger than the law or because their official jobs do not provide

them with incomes high enough so as to have a normal, reasonable life, or, perhaps, because they want to have a significantly better life, or because they do not understand why to pay to the state on and on ...or just because. Now not only our main character's income, became profit, is unreported to the tax authorities, but also the incomes of his/her unofficial employees, the so-called wages, and so are the unreported wage-related-contributions. And, thus, we see a rolling effect of non-reporting...

Certainly, now, you could ask why an individual, acting on his/her own just to help himself/herself and/or his/her family to survive, would turn from a self-employed into a "businessman". Maybe because money is feed with money, because he/she can see that a better life is possible or just because nobody does anything to impede him/her to go on in that direction. He/she is happy, already accustomed with that situation and not fearing any longer the law threat (if ever did), the people working for him/her is also happy for having a job (be it unofficial, without the associated benefits of an official wage), so .... life must go on.

Going even forward, for certain reasons, known only by him/her, for whatever external funds he/she could access, our individual decides to set up an official business but, as old customs do not perish so soon, he/she officially employs just few persons, all others continuing working unofficially as before.

Is it possible to outline a universal pattern for such character? No, certainly not. And we are talking just about few possible cases.

Afterwards, who is to blame? The person in need, not understood by the society and trying "to do justice" for him/her or for

his/her family, the individual not supported, in any way, by the same society, neither financially nor as concerns medical or social-security related issues for which he/she is required to pay, to mention just two important issues? Or the authorities, which, deliberately or not, turn they "face" away when coming about helping their people, when being about doing their best to provide the same with everything necessary to have a normal, safe and confident life?

Maybe the answer is somewhere at the midway. Both parties have their share of guilt and both their reasons to act that way, more or less pushed by circumstances. However, such issues should be settled, in one way or another, in a favourable direction, if not for each and every individual, at least for most of them, for the well-being of the whole. And this is, without any doubt, the responsibility of the entitled parties, the macroeconomic authorities, having at their disposal the necessary power to act, by resorting to the right instruments, for reasonably balancing such cases.

## **2. Setting the pattern of the shadow economy**

Although the shadow economy represents just a part of the of a larger context, namely the underground economy (the latter encompassing also the black economy, another destructive component), synergically affecting, to an increased extent, the real economy in its entirety, both by the funds due to the state and not received by it and by other indirect issues, rather related to the decrease of the quality of life, diseases, injuries and deaths (as result of the use and trade of drugs or weapons, due to gambling,

prostitution and many others), our focus hereinafter will be exclusively on the shadow economy pattern.

In this paper, the shadow economy is approached strictly as that form of undesired economy characterised by unreported, non-criminal monetary transactions, more exactly by incomes of any kind: wage-related incomes, profit-related incomes, tips-related incomes or similar others not officially declared and, thereby not subject to the legal taxation.

The target group when coming about the shadow economy is represented by individuals / groups of individuals, working on their own or under business-type organised forms and carrying out activities resulting in the production and/or trade of goods and/or services. However, unfortunately, due to corruption-related issues, the subjects supporting the shadow economy are to be found not only in the private area but, sometimes, also in the public one.

Considering the definition given by Smith (1994) to the unreported monetary transactions, as being reflected by the legal or illegal production of goods and services not included in the official estimated of the gross domestic product, we can identify the above-mentioned shadow economy subjects by revealing the Keynesian equilibrium on the market of goods and services:

$$GDP = C + I + G + NX$$

with GDP - the gross domestic product, standing for the aggregate supply of goods and services, and C, I, G and NX - private consumption, private investments, public (governmental) consumption and investments, respectively net exports, standing for the aggregate demand at macro-level.

It is, certainly, obvious that most of the shadow economy is related to private

consumption and investments as, on one hand, the Government, via its public consumption and investments, beyond the so unwanted but still existing corruption, is somehow more visible, by its actions, to the mass "audience" and more likely to be sanctioned by mass-media and, finally, by the electorate, this keeping its contribution to the shadow economy within certain limits, and, on the other hand, the exporters/importers are much more controllable, given the additional "barriers" they should pass when practising international trade.

Given that, the decisions made as for the diminishment, as much as possible, of the shadow economy in total real economy should be made, without forgetting about the public and international monetary transactions, with an intensive focus on the private area, more precisely on households, be they made by single individuals, family members, couples or groups of friends, and on companies, therefore targeting the economic agents most susceptible of being tempted to become involved in such activities.

This should be also done taking into consideration the level of development of the related economy, because, as revealed by the literature, the shadow economy covers about one third of the gross domestic product in developing countries as opposed to something more than ten percents of the same in developed ones, aspects detailed by Schneider and Enste (2000), and subsequently updated in Schneider (2002), Schneider, Buehn and Montenegro (2010), Buehn and Schneider (2016), Elgin and Schneider (2016), Schneider (2016) or Hassan and Schneider (2016), therefore strengthening the idea that the inappropriate social and economic conditions are the key elements exerting pressure

on people, pushing them towards shadow economy specific actions.

### **3. Dealing with the shadow economy in terms of creative ideas**

Irrespective of the shadow economy approaching perspective, its overall effects on the society as a whole are not the most desirable ones, such circumstances imposing making adequate decisions not only to correct, as much as possible, the arising negative consequences, but also, most important, to succeed in impeding the manifestation of their origin causes.

As before-mentioned, the steps to be taken in such respect also depend on the level of development of the target economy, the range of instruments at hand in a developing country, for instance, being considerably more extensive than in a developed one, as the latter has probably already benefited from certain corrective actions in the matter having resulted in the diminishment of the shadow market.

However, leaving the economy development level aside, what kind of standard, universal measures would be recommendable for a country in order to deal with the shadow economy?

Any economy macroeconomic authority will certainly think, first of all, of implementing traditional policies oriented towards the increase of the overall economic comfort of its population, namely carrying out basic expansionary macroeconomic policies.

This would be translated, in terms of fiscal approach, by a reduction, by the Government, of the taxation level, with direct impact on the increase of the purchasing power of the private economic agents,

households or companies, therefore on a better living standard, associated with a decreasing temptation for performing in the shadow. The same Government could act in the direction of subsidising certain categories of economic agents, the ones more in need and, therefore, more likely to avoid reporting their incomes, of any type, to the entitled organisms. As for the budgetary policies, these are related to the augmentation of the public expenses, thus creating benefits at national level, with a surplus at the public sector level, as the case may be, via increased wages for those operating therein.

Expansionary monetary policies are not neglectable at all, this being transposed, by the decrease of the reserves funds imposed by the National Bank to the commercial banks, by the decrease of the monetary policy interest rate practised by the same in relation to such commercial banks or by the increase of the level of acquisitions of governmental bonds or treasury bills, into a larger monetary mass available for the national economic agents, therefore in a decrease of the interest rate, generating infinitely more possibilities for consumption and investments, thereby for being less restricted from a financial perspective and, thus, less inclined to resort to officially unreported monetary transactions.

Yet, beside such classical measures, there are also modern measures, more creative, that should be considered in dealing with the shadow economy, such as the development and implementation in schools of fiscal education-based programmes, the limitation, up to exclusion, of the cash transactions, by creating well-developed electronic payment services, the enforcement of a bonus / malus application, meant to encourage, by discounts, those constantly stating

their revenues and to discourage, by sanctions, ranging from penalties up to confiscation and/or work in favour of community, those trying to breach the law, the creation of a thorough networking-related communication system, allowing for the fiscal authorities, acting locally, nationally and even internationally, to have centralised databases in the matter, and so on.

Fortunately, some measures have been already tested and implemented in Romania, with more or less concrete impact on the real economic life, among which deserving to be mentioned the traditional measure, related to the decrease of the bakery products VAT from 24% to 9%, or the modern ones, related to the inverse, source taxation of profits for cereals and technical plants, the decision of organising bill-related lotteries, or even the reduction of the bureaucracy, by allowing for the virtual payment of taxes.

It is, obviously, a long way up to succeeding in aligning with well-developed countries from the perspective of lowering of the shadow economy to about 10% of the gross domestic product, but we should never give up. By constantly testing and applying measures directed towards the improvement of the existing circumstances, the beneficial results will not remain invisible. But it takes

time and involves patience, a lot of patience to succeed in reaching such desirable target.

#### 4. Conclusions

In this paper, we undertook to create the profile of the underground economy subjects, trying to identify the key issues triggering their law-breaching decisions of hiding from the related authorities their arising income, and to set the general pattern of the shadow economy, so as to detect the areas to act on as well as the measures to implement therein in order to get favourable results at macroeconomic level.

Traditional or modern, rather based on creative ideas, taken over from others, considering their successful stories, or tailored according to the particularities of the target country, such measures oriented towards the diminishment of the shadow economy should become one of the most important steps to be taken by the national authorities, while permanently keeping in mind that the well-being of a nation should be seen through the eyes of its population, that a stable, sustained economy growth is to be reflected in a grounded increase of the people living standard, in the overall welfare.

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