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Friedrich Schneider and Dominik H. Enste
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The Shadow Economy

An International Survey

Illicit work, social security fraud, economic crime, and other shadow economy activities are fast becoming an international problem. Friedrich Schneider and Dominik H. Enste use currency demand, physical input (electricity) method, and the model approach, to estimate the size of the shadow economy in seventy-six developing, transition, and OECD countries. They argue that during the 1990s the average size of a shadow economy varied from 12% of GDP for OECD, to 23% for transition, and to 39% for developing countries. They examine the causes and consequences of this development using an integrated approach explaining deviant behaviour, which combines the findings of economic, sociological, and psychological research. The authors suggest that increasing taxation, social security contributions, rising state regulatory activities, and the decline of the tax morale, are all driving forces behind this growth, especially in OECD countries. They propose a reform of state (public) institutions, in order to improve the dynamics of the official economy.

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[More information](#)

To Sabine and Julia

Contents

<i>List of figures</i>	<i>page</i> ix
<i>List of tables</i>	x
<i>Foreword by Vito Tanzi</i>	xiii
1 The shadow economy: a challenge for economic and social policy	1
2 Defining the shadow economy	6
2.1 Informal economic activity and national income accounts	7
2.2 Shadow economy, tax evasion, and illicit work	10
3 Methods to estimate the size of the shadow economy	15
3.1 Direct approaches	15
3.2 Indirect approaches	16
3.3 The model approach	24
3.4 Summary of the methods used to estimate the size of the shadow economy	27
4 Size of shadow economies around the world	29
4.1 The results for seventy-six countries	29
4.2 The development of the shadow economy in the OECD countries from 1970 to 1999	37
4.3 Comparing the results for different estimation methods	39
5 The size of the shadow economy labour force	43
5.1 Illicit work and the shadow economy labour force	43
5.2 Developing countries	44
5.3 Transition countries	45
5.4 OECD countries	51
6 An integrated approach to explain deviant behaviour	54
6.1 Structure of the model	54
6.2 Criticising the neoclassical and welfare-theoretical considerations	57
6.3 Micro-economic foundation	63
6.4 Institutional and sociological aspects	76
6.5 Explanatory approaches in socio- and economic psychology	84
	vii

Cambridge University Press
0521814081 - The Shadow Economy: An International Survey
Friedrich Schneider and Dominik H. Enste
Frontmatter
[More information](#)

viii	Contents	
6.6	An integrative approach	95
6.7	An evolutionary theory of the shadow economy	97
7	Analysing the causes and measures of economic policy	102
7.1	Government failure – the main cause of illicit work	102
7.2	Growing tax burden in the official sector	106
7.3	Density of regulation	124
7.4	Working hours agreements	127
7.5	Empirical examination of the influence of main causes	143
7.6	Control frequency and the level of punishment	149
7.7	Tax morality and the supply of public goods	151
8	Effects of the increasing shadow economy	155
8.1	Allocation effects	157
8.2	Distribution effects	166
8.3	Stabilisation effects	169
8.4	Fiscal effects	171
9	The ‘two-pillar strategy’	178
9.1	On the necessity for a rational economic policy	178
9.2	‘Exit’ and ‘voice’ as behavioural options	179
9.3	Decreasing the attractiveness of the ‘exit option’	181
9.4	Strengthening the ‘voice option’	183
9.5	Legalising illicit work?	185
9.6	Combating illicit work: the perspective of public choice theory	185
10	Conclusion and outlook	190
	<i>List of references</i>	194
	<i>Index</i>	215

Figures

2.1	The dual economy	<i>page</i> 8
2.2	Categorisation of the underground economy	11
2.3	The structure of illicit work in Austria	13
2.4	The structure of illicit work in Germany	14
3.1	The basic monetary methods to measure the shadow economy	18
3.2	The basic idea of ‘soft modelling’	25
6.1	The causal analysis	56
6.2	The integrative RREEMM human concept	59
6.3	Economic explanation for deviant behaviour	64
6.4	Economic factors influencing illicit labour supply	66
6.5	The basic model with optimal allocation of working and leisure time	70
6.6	Overtime, illicit work, and regular working hours	73
6.7	Reduction of working hours and illicit work	74
6.8	Sociological explanation based on Homo Sociologicus	76
6.9	Sociological and institutional determinants	78
6.10	Willingness to work illicitly, evade taxes, and abuse the system	80
6.11	Economic and socio-psychological explanation of deviant behaviour	85
6.12	Correlation between weight of tax burden, perception of tax burden, and tax evasion, and their determinants	90
6.13	A few psychological causes	92
6.14	Attitudes towards a choice of causes for illicit work	94
6.15	Integrative model for deviant behaviour	96
6.16	The correlation between tax yield, tax rate, and the development of the shadow economy	99
7.1	Economic causes for the shadow economy	104
7.2	Correlation of tax burden and size of the shadow economy	111
8.1	Systematisation of allocation effects	157
9.1	Behavioural options of households and firms	180
9.2	General economic policy recommendations	182

Tables

3.1 A summary of all the approaches to estimate the extent of the shadow economy	<i>page 27</i>
4.1 The size of the shadow economy in developing countries	31
4.2 The size of the shadow economies in transition	34
4.3 The share of the shadow economy of official GNP in the OECD countries: a comparison of estimation with different methods	35
4.4 The size of the shadow economies in OECD countries	36
4.5 The size of the shadow economies: summary and comparison	37
4.6 The development of the shadow economy in OECD countries from 1970–97	38
4.7 The extent of the shadow economies in German-speaking countries, 1998 and 1999	39
4.8 A comparison of the results of the estimations of the shadow economies of five OECD countries using nine different methods over the period 1970–90	40
4.9 Comparing estimations of the size of the shadow economy using different methods	41
5.1 Shadow economy labour force in Africa	46
5.2 Shadow economy labour force in Asia	48
5.3 Shadow economy labour force in Latin and South America	49
5.4 Shadow economy labour force in transition countries	50
5.5 Shadow economy labour force in OECD countries	52
7.1 The development of public expenditure and tax rates in OECD countries	108
7.2 Shadow economies, tax, and social security contributions in OECD countries in 1996	109
7.3 The density of regulation as an influencing factor for the size of the shadow economy	126
7.4 Regulation regarding working hours and overtime in OECD countries	128
7.5 Part-time employment in the OECD countries 1973–96	130

Cambridge University Press
0521814081 - The Shadow Economy: An International Survey
Friedrich Schneider and Dominik H. Enste
Frontmatter
[More information](#)

List of tables	xi
7.6 The share of gainfully employed persons older than 55 years	132
7.7 ‘Atypical’ working hours of employees in the EU (1993)	134
7.8 The divergence between agreed and desired working hours in Germany (1997)	137
7.9 Estimation results for the cash demand function	145
7.10 Influence of changes to the taxation system on the development of the Austrian shadow economy	146
7.11 Dividing the development of shadow economic activities into its components by their respective influencing factors	147
7.12 The tax moral as an influencing factor for the rise of the shadow economy	152
8.1 Tax deficits due to illicit work in Austria (1997)	176

Cambridge University Press
0521814081 - The Shadow Economy: An International Survey
Friedrich Schneider and Dominik H. Enste
Frontmatter
[More information](#)

Foreword

More than two decades ago, economists discovered what they considered a rather strange phenomenon to which they gave many names including that of ‘underground economy’. This discovery was followed by attempts aimed at defining it; measuring its size; assessing its implications for economic policy and its effects on the economy; and suggesting policies that would reduce or eliminate it. As one would have expected, there was inevitable controversy accompanying this work. Surprisingly, though, this early great interest was soon followed by a period of neglect. It seems that the economic profession, immersed as it was in its theories, could not cope or was unwilling to cope with the messy world of the underground economy.

In more recent years, and for a variety of reasons, including the obvious one that the growth and large size of the underground economy made it progressively more difficult for economists and statistical offices to keep ignoring it, interest in this phenomenon has revived with a vengeance.

Friedrich Schneider was one of the few daring souls who entered this area early and who has kept a continuing interest in it. I was fortunate a few years ago, when I was director of the fiscal affairs department of the IMF, to have invited him to take up a visiting professorship to the Fund to continue his work on the underground economy. He produced a substantive paper that has grown into a book that represents a major contribution to this area. Economists and policymakers will learn much from this book. And they will learn much that is important and deserves attention. I hope that many will invest the time that it deserves.

VITO TANZI
*State Secretary
Ministry of Economy and Finance
Rome*