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.

FRIEDRICH SCHNEIDER is Professor of Economics and Vice-President for Foreign Affairs of the Johannes Kepler University of Linz, Austria. He is the European editor of Public Choice, and has written for various journals including The Quarterly Journal of Economics, The American Economic Review, The Economic Journal, and Kyklos.

DOMINIK H. ENSTE studied Economics, Sociology, and Economic Psychology in Cologne, Dublin, and Fairfax, Virginia. He was Assistant Lecturer at the Department for Economic Policy at the University of Cologne and Lecturer at the University of Applied Science in Cologne, Germany. He has published several books and articles in a variety of journals including the Journal of Economic Literature, Perspectives of Economic Policy, and IMF-Working Papers. He is currently working as a Human Resources Manager for Gerling Insurance Company in Cologne.
The Shadow Economy

*An International Survey*

Friedrich Schneider
Dominik H. Enste
To Sabine and Julia
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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