SHADOW ECONOMY IN THE BALTIC STATES

SIZE, CAUSES, DETERMINANTS, SOLUTIONS

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DEFINITION
What is ‘shadow economy’? Observed and non-observed components of GDP

(Putnins and Sauka, 2015)
SIZE
F. Schneider (2016) estimates

The identified challenges and solutions as suggested by the construction industry strongly indicate that:

- It is crucial to allocate appropriate resources in order to plan, implement and measure the results of activities to fight the shadow economy!
- Various ministries (Economics, Finance, Education, Welfare, Justice) should be involved in fighting the shadow economy!
- Coordination – mastery!
- Communication with industries!
Putnins, T. and A. Sauka (2016) estimates

Size of the shadow economy in Latvia, Lithuania, and Estonia 2009-2015
CAUSES
Benefits of not paying taxes compared to the risk of being caught evading taxes and the cost of the consequent punishment.

Tax evasion is much lower than can be explained by expected utility in financial terms alone!
**Tax morale** – a moral obligation to pay taxes and “a belief in contributing to society by paying taxes” (Torgler and Schneider 2009: 230)

DETERMINANTS
Components of the shadow economy in the Baltic countries, 2015

Source: Putnins and Sauka, 2016.
Envelope wages (average share of salaries in % which is paid by employers but concealed from the government) in the Baltic countries

Source: Putnins and Sauka, 2016.
Underreporting of business income (average share of revenue in % that companies conceal from the government) in the Baltic countries

Source: Putnins and Sauka, 2016.
Satisfaction with the State Revenue Service, 2010-2015

Source: Putnins and Sauka, 2016.
Satisfaction with the government’s tax policy, 2010-2015

<table>
<thead>
<tr>
<th>Year</th>
<th>Satisfied</th>
<th>Neither nor</th>
<th>Unsatisfied</th>
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<td>18.6%</td>
<td>75.7%</td>
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Source: Putnins and Sauka, 2016.
Satisfaction with the quality of business legislation, 2010-2015

Source: Putnins and Sauka, 2016.
Satisfaction with the government’s support for entrepreneurs, 2010-2015

Source: Putnins and Sauka, 2016.
Probability of being caught for underreporting business income, 2015

Source: Putnins and Sauka, 2016.
Consequences of being caught for deliberate misreporting, 2015

Source: Putnins and Sauka, 2016.
Framework for planning and measuring policy incentives to decrease the shadow economy

Determinant 1: Envelope wages.
Measure: average total, average industries (various sources): changes 2016 vs 2015

Determinant 2: Unreported income.
Measure: average total, average industries (various sources): changes 2016 vs 2015

Determinant 3: Underreported employees
Measure: …

Determinant 4: Tax morale
Measure: …

Challenge 1a: high labour taxes.
Activity (i): to decrease labour taxes…
Activity (ii): …
Activity (iii) …
Measures i, ii, iii …
Challenge 1b…
Challenge 1c…

Challenge 2a: VAT schemes.
Activity (i):
Activity (ii): …
Activity (iii) …
Measures i, ii, iii …
Challenge 2b: re-invested profits issue …
Is the shadow economy always “unproductive”? short and long term perspective

Venture level outcome

+ +
Quadrant I
Hero or success enterprises (productive)

- -
Quadrant II
Catalyst enterprises (productive?)

+ -
Quadrant III
Robber or re-distributive enterprises (unproductive?)

- +
Quadrant IV
Failed enterprises (always unproductive?)

Institutional features of any economic system (i.e. ‘context’) determine what entrepreneurs can do and find profitable to do (Baumol, 1990).

Most companies are actually involved in both productive and rent seeking activities at the same time (Rehn and Taalas, 2004; Scase, 2003).

Structure of payoffs in an economy can also render unproductive activities more profitable than productive activities. ... Allocation of resources to either productive or unproductive use varies across societies (Baumol, 1990).
Some recent studies exploring the shadow economy in the Baltic states


More:

