

SHADOW ECONOMY- IT'S COMPLICATED...



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Definition problems: what is ‘shadow economy’?

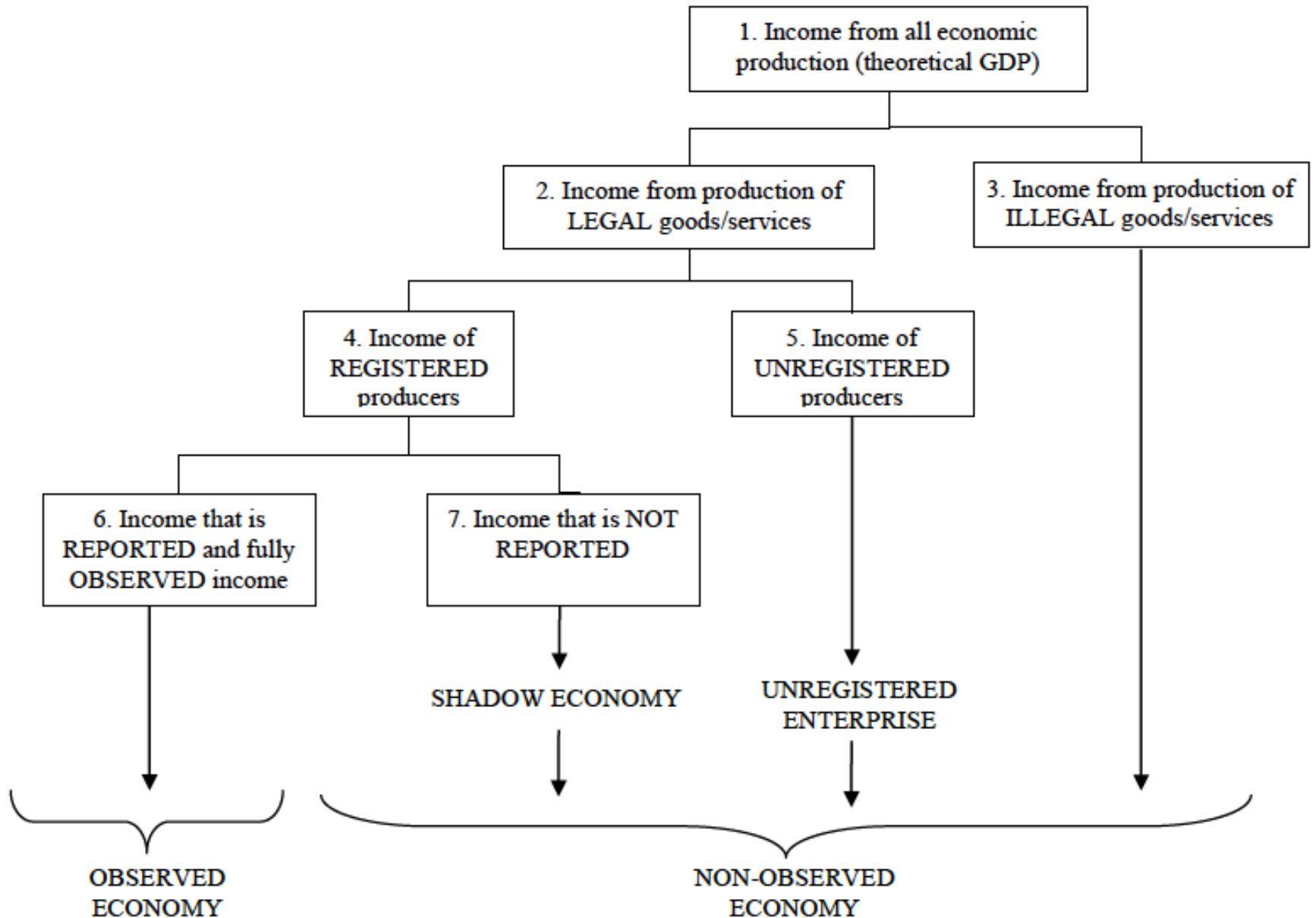


Shadow economy:

all legal production of goods and services that is deliberately concealed from public authorities.

According to OECD (2002), World Bank (2010), SNA (1993)

Definition drawing on the distinction between observed and non-observed components of GDP (Putnins and Sauka, 2015)



**‘Shadow economy’- always
unproductive?**

Various outputs: productive/ unproductive?

		Venture level outcome	
		+	-
Societal 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?)

Source: Davidsson (2004)

Most companies are actually involved both in productive and rent seeking activities at the same time (Rehn and Taalas, 2004; Scase, 2003; Smallbone and Welter 2001; Aidis, 2006).

It is an important function of contracts and property rights systems to implement *optimal combinations* between ‘productive’ and ‘destructive’ entrepreneurial activities (Foss and Foss, 2002).

**Measurement problems:
how to assess the size of the shadow
economy?**

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ENTREPRENEURSHIP
and the
SHADOW ECONOMY



SSE RIGA

“No ideal or dominating method – all have serious problems and weaknesses” (Schneider, 2014: 41)

**What causes shadow economy?
Not an easy task...**

Approaches to understand impact of shadow economy on sustainable entrepreneurship practices

Rational choice: the amount of tax an individual chooses to pay **depends on the individual's expected utility of the benefits of not paying taxing compared to the risk of being caught evading taxes and the cost of the consequent punishment** (Allingham and Sandmo, 1974; Yitzhaki, 1974).

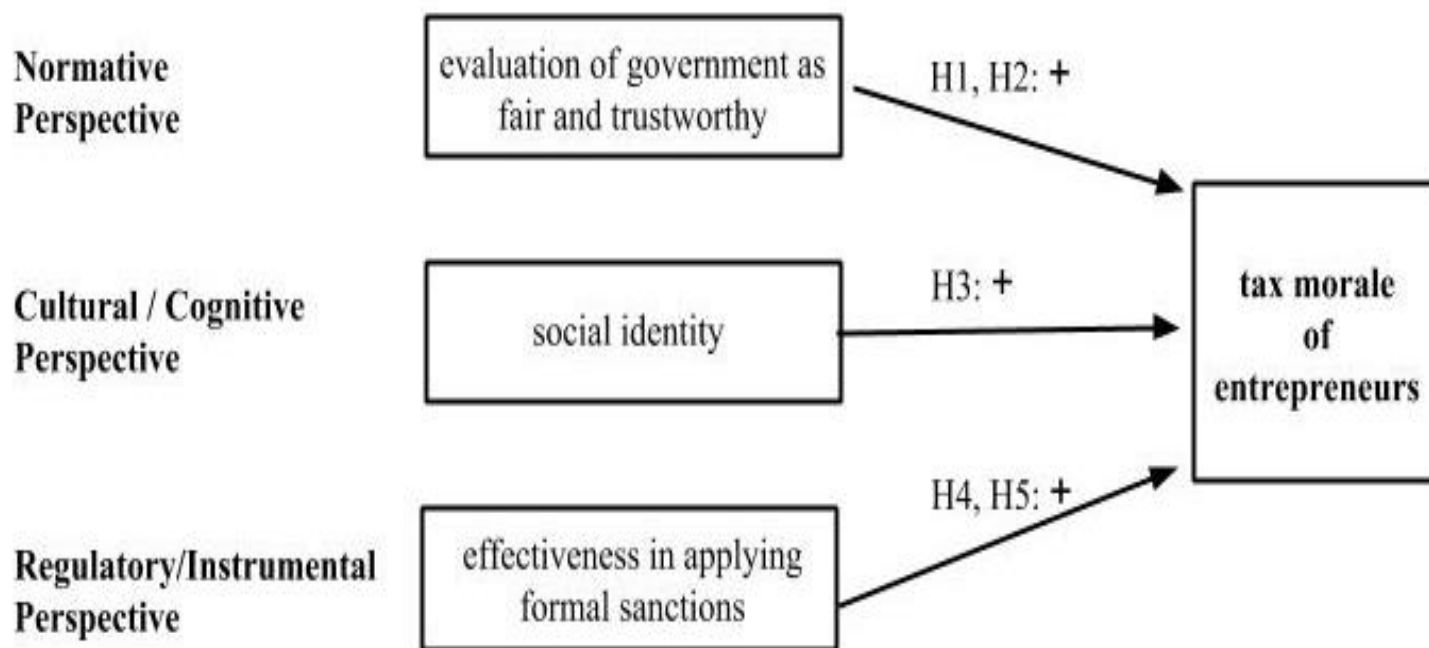
Tax evasion is much lower than can be explained by expected utility in financial terms alone!

Approaches to understand impact of shadow economy on sustainable entrepreneurship practices

This discrepancy can be explained by the existence of tax morale.

Tax morale- a moral obligation to pay taxes and “a belief in contributing to society by paying taxes ” (Torgler and Schneider 2009: 230)

Framework to understand tax morale: to pay or not to pay taxes (Mickiewicz, Rebmann, Sauka, 2016)



Mickiewicz, Rebamnn and Sauka (2016)

**Even harder to develop policy
measures to decrease the shadow
economy!**

**Mostly because shadow economy is
very complex phenomena...**

Conclusions from Sauka (2016), exploring shadow economy determinants in the construction industry in Latvia



Policy makers should work on issues related to:

- Business legislation
 - Tax system
 - Legal system
- Improving quality/ methods of controlling institutions
 - 'Mindsets' and motivation schemes
 - Communication with industry

AT THE SAME TIME WITHOUT PRIORITISING ONE, SINGLE ACTIVITY in order to decrease amount of shadow economy in the construction industry in Latvia.

Thank you!

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