

## Chapter 82

# Shadow Economy: An Analysis for EU-27 and Turkey

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### ABSTRACT

*The aim of this chapter is to investigate shadow economy on an EU-27 and Turkey basis. For this purpose, firstly the definition, causes and consequences of shadow economy together with its relationship with tax evasion are discussed. In addition, the causes of shadow economy are examined for EU-27 during the period 2003-2012. It was done both statistically and empirically by employing scatter plot diagrams and the random effects model. While empirical findings confirm the effects of taxes, income level, trade and population on the shadow economy, statistical findings mention the effects of governance related indicators. Another main finding of this chapter is about Turkey. Accordingly, shadow economy in Turkey is observed to be higher than in the EU-27 and taking into consideration the comparative statistical findings about the causes of shadow economy, the main reasons of shadow economy in Turkey are thought to be governance related.*

### INTRODUCTION

Today a large share of economic activities performs in the so-called “shadow economy” in both developed and developing countries. In addition to its large volume, the shadow economy is usually perceived as an economic problem as it has harmful effects on the economy such as distorting taxation justice and decreasing the efficiency of economic policies. These circumstances, together with some increasing economic problems such as budget deficit and unemployment, increased the concerns about shadow economy. However, the definition, structure and the causes of shadow economy are still not clear. This chapter investigates related deficiencies on an EU-27 and Turkey basis.

The chapter is built on three main aims. The first aim of the chapter is to clarify the definition and the structure of shadow economy. For that purpose, previous studies together with the work of the OECD (2002) are employed and the structure of shadow economy, its specific characteristics, its relationship with

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## **Shadow Economy**

other non-observed economic activities, and tax evasion are investigated. The causes and consequences of shadow economy are discussed and its measurement is given. The second aim of the chapter is to explore shadow economy and its causes in the EU-27. In line with these, both statistical and empirical relationships between shadow economy and various indicators are examined by using data from the period 2003-2012. The correlation between the shadow economy and some economic and governance related indicators are examined by employing scatter plots diagrams.

The last aim of the chapter is to explore the shadow economy in Turkey. The trend of the shadow economy in Turkey for the period 2003-2012 is given and a comparison with the EU-27 is made in order to have more rational inferences. The data of possible factors that cause shadow economy is compared with EU-27 averages. This chapter also presents a modest guide for policy makers as it relatively presents the effects of both economic and governance related indicators which would be beneficial while struggling with the shadow economy among the countries in question.

The chapter is organized as follows. It starts with the definition and some characteristics of the shadow economy and the impacts of shadow economy including both benefits and harms are also discussed. The causes and consequences of shadow economy are also given in that section. The following section investigates the measurement of the shadow economy and problems of data and measurement are given. In order to clarify the definition and structure of the shadow economy even further, its relationship with tax evasion is presented. The next section presents a detailed analysis of the shadow economy in the EU-27 and followed by an exploration of the structure of shadow economy in Turkey. The next section includes an empirical analysis which examines the relationship between shadow economy and its causes in the EU-27. Concluding remarks and views are provided in the last section.

## **BACKGROUND**

### **Shadow Economy: Definition, Causes and Consequences**

The shadow economy is one of the main problems of many countries in different forms and degrees. An important share of economic activities occurs in a shadow economy in both developed and developing countries. In addition, some economic problems such as the need for public finance, high unemployment rates, and budget deficit have increased the concerns about the shadow economy. However, a clear definition of shadow economy has not yet been formulated. Schneider and Enste (2000, p. 78) stated one commonly used definition of the shadow economy as “all economic activities that contribute to the officially calculated (or observed) gross national product but are currently unregistered.” Choi and Thum (2002, p. 2) states that in simple term the shadow economy “constitutes activities that are not recorded in the government statistics.”

Economists usually use different terms such as “shadow economy,” “underground economy,” “informal economy” or “hidden economy” without always clarifying what they mean. The OECD handbook for “Measuring the Non-Observed Economy” (2002, p.36) is a beneficial source that shed some light on the definition of shadow economy and its relationship with some other non-observed economic activities. The handbook states that “the groups of activities most likely to be non-observed are those that are underground, illegal, informal sector, or undertaken by households for their own final use.” And “the deficiencies in the basic data collection program” are also admitted as being a part of non-observed economy.

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