

AN ANALYTICAL STUDY OF SHADOW ECONOMY OF BRICS COUNTRIES

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Abstract: Tax is the most important source of revenue for the government. Taxpayers are liable to pay tax on time as per the rules and regulations. But not every taxpayer or citizen is honest enough to pay tax or follow other rules and regulations as he should do. Therefore, the researcher has made an attempt to analyse the shadow economy of BRICS countries. For the analysis, secondary data has been collected. On the basis of the proportion of the shadow economy, ranking has been done of the BRICS countries. T-test has been used through the software SPSS.

Key Words: Revenue, Shadow economy, Tax.

1. INTRODUCTION:

It is difficult to measure shadow economy, as the people involved in these activities make serious efforts to remain hidden. The shadow economy is known by different names like “hidden economy, gray economy and black economy. It can be defined as” *The shadow economy includes all economic activities which are hidden from official authorities for monetary, regulatory, and institutional reasons.*” The size of the shadow economy is a medium to estimate the tax evasion and thus suggest some measures for its adequate control.

1.1. CAUSES DETERMINING THE SHADOW ECONOMY:

S.NO.	CAUSES	REASONING
1.	Tax and social security contribution burdens	The distortion of the overall tax burden affects labor-leisure choices and may stimulate labor supply in the shadow economy. The bigger the difference between the total labor cost in the official economy and after-tax earnings (from work), the greater the incentive to reduce the tax wedge and work in the shadow economy. This tax wedge depends on social security burden/payments and the overall tax burden, making them key determinants in the existence of the shadow economy.
2.	Quality of institutions or corruption	The quality of public institutions is another key factor in the development of the informal sector. In particular, the efficient and discretionary application of the tax code and regulations by the government plays a crucial role in the decision to work off the books, even more important than the actual burden of taxes and regulations. A bureaucracy with highly corrupt government officials tends to be associated with larger unofficial activity, while good rule of law through securing property rights and contract enforceability increases the benefits of being formal. A certain level of taxation, mostly spent in productive public services, characterizes efficient policies. In fact, production in the formal sector benefits from higher provision of productive public services and is negatively affected by taxation, while the shadow economy reacts in the opposite way. An informal sector developing as a consequence of the failure of political institutions to promote an efficient market economy, and entrepreneurs going underground due to inefficient public goods provision, may reduce if institutions can be strengthened and fiscal policy moves closer to the median voter’s preferences.

3.	Regulations	Regulations, for example labor market regulations or trade barriers, are another important factor that reduces freedom (of choice) for individuals in the official economy. They lead to a substantial increase in labor costs in the official economy and thus provide another incentive to work in the shadow economy: countries that are more heavily regulated tend to have a higher share of the shadow economy in total GDP. Especially the enforcement and not the overall extent of regulation – mostly not enforced – is the key factor for the burden levied on firms and individuals, inducing them to operate in the shadow economy.
4.	Public sector services	An increase in the shadow economy may lead to fewer state revenues, which in turn reduces the quality and quantity of publicly provided goods and services. Ultimately, this may lead to increasing tax rates for firms and individuals, although deterioration in the quality of public goods (such as public infrastructure) and of the administration continues. The consequence is an even stronger incentive to participate in the shadow economy. Countries with higher tax revenues achieved by lower tax rates, fewer laws and regulations, a better rule of law and lower corruption levels should thus have smaller shadow economies.
5.	Tax morale	The efficiency of the public sector also has an indirect effect on the size of the shadow economy because it affects tax morale. Tax compliance is driven by a psychological tax contract that entails rights and obligations from taxpayers and citizens on the one hand, but also from the state and its tax authorities on the other hand. Taxpayers are more inclined to pay their taxes honestly if they get valuable public services in exchange. However, taxpayers are honest even in cases when the benefit principle of taxation does not hold, i.e. for redistributive policies, if such political decisions follow fair procedures. The treatment of taxpayers by the tax authority also plays a role. If taxpayers are treated like partners in a (tax) contract instead of subordinates in a hierarchical relationship, taxpayers will stick to the obligations of the psychological tax contract more easily. Hence, (better) tax morale and (stronger) social norms may reduce the probability of individuals working in the shadow economy.
6.	Deterrence	Despite the strong focus on deterrence in policies fighting the shadow economy and the unambiguous insights of the traditional economic theory of tax non-compliance, surprisingly little is known from empirical studies about the effects of deterrence. This is because data on the legal background and the frequency of audits are not available on an international basis; such data are difficult to collect even for OECD countries. Either the legal background is quite complicated, differentiating fines and punishment according to the severity of the offense and the true income of the non-complier, or tax authorities do not reveal how intensively auditing is taking place.
7.	Development of the official economy	The development of the official economy is another key factor in the shadow economy. The higher (lower) the unemployment quota (GDP growth), the higher the incentive to work in the shadow economy, <i>ceteris paribus</i> .
8.	Self-employment	The higher the rate of self-employment, the more activities can be performed in the shadow economy, <i>ceteris paribus</i> .
9.	Unemployment	The higher the rate of unemployment, the higher the probability to work in the shadow economy, <i>ceteris paribus</i> .
10.	Size of the agricultural sector	The larger the agricultural sector, the more possibilities to work in the shadow economy, <i>ceteris paribus</i> .

2. REVIEW OF LITERATURE:

- **Friedrich Schneider & Dominik Enste (2018) “Shadow Economies Around The World – Size, Causes, And Consequences”** The researcher concluded that an increasing burden of taxation and social security payments, combined with rising state regulatory activities and labor market restrictions (e.g. forced reduction in working hours) are the major driving forces for the size and growth of the shadow economy. But an interdisciplinary approach seems to be necessary for a more comprehensive analysis, which would consider aspects like tax morale, perceived fairness of the tax system and institutional aspects as well.
- **Friedrich Schneider (2019) “Shadow Economy”** In this paper the main focus lied on the shadow economy. The most influential factors on the shadow economy are tax policies and state regulation. The size of the shadow economy decreased over 1999 to 2019 from 34.0% to 31.2% for 161 countries.

2.1. NEED OF THE STUDY:

The analysis of shadow economy will help in understanding the factors which result in financial loss to the economy. As a result, the government can take proper steps for its removal and also increase the revenue. Thus the researcher has made an attempt to understand the shadow economy of BRICS countries as well as suggest some measures to minimise it.

2.2. OBJECTIVES OF THE STUDY:

1. To understand the concept of shadow economy
2. To analyse and compare the shadow economy of BRICS countries.

3. RESEARCH & METHODOLOGY:

A. Research Design: Explanatory and Analytical Research

B. B.Sample Size: This study includes shadow economy of BRICS countries from the assessment year 2011-2012 to 2016-2017.

3.1. ANALYSIS OF SHADOW ECONOMY:

HYPOTHESIS TESTING:

HO₂: There is no significant difference in the proportion of shadow economy of BRICS countries.

ANALYSIS OF SHADOW ECONOMY OF BRICS (IN % OF GDP)

S.NO.	COUNTRY	YEAR							RANK
		2012	2013	2014	2015	2016	2017	Avg.	
1.	BRAZIL	34.55	33.06	32.71	32.56	33.01	35.22	33.51	5
2.	RUSSIA	33.7	32.03	31.88	32.21	31.04	33.72	32.43	4
3.	INDIA	20.65	19.71	18.99	18.11	18.33	17.89	18.95	2
4.	CHINA	12.13	12.03	12.41	12.25	11.74	12.11	12.11	1
5.	SOUTH AFRICA	23.23	22.08	22.2	21.47	21.33	21.99	22.05	3

Source: TAX JUSTICE NETWORK

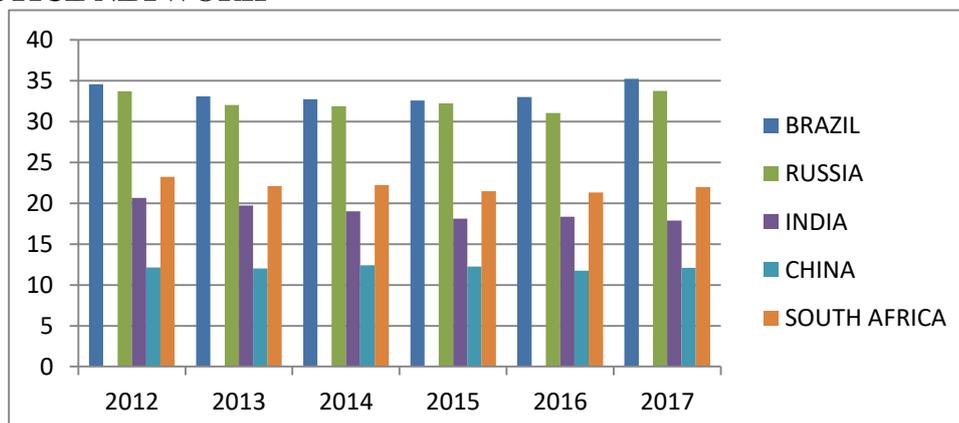


Chart.1

T-TEST USING SPSS

Sample Statistics

	N	Mean	Std. Deviation	Std. Error Mean
Average	5	23.8100	9.11046	4.07432

T-Test

	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
average	5.844	4	.004	23.81000	12.4979	35.1221

Interpretation: From the above table of shadow economy (Table 4.13), it is evident that amongst the five BRICS countries, Brazil is the country with the highest shadow economy. Brazil is followed by Russia, South Africa, India and China. China is the country with least %age of shadow economy which is a positive sign. The t-test analysis gave the result of p-value .004 which is less than .005. Thus from the analysis it can be concluded that the null hypothesis is rejected. It means that there is significant difference in the ethical issues (shadow economy) of BRICS countries. The countries have been ranked as per their proportion of shadow economy. Lower the proportion, higher the rank.

4. CONCLUSION:

The above analysis and interpretation make clear that China is the country with least %age of shadow economy followed by India and so on. Shadow economy is that portion which consists of all the unethical activities. Thus serious efforts should be taken to reduce the portion of shadow economy. Strict rules should be enforced so that the citizens don't indulge in unfair means.

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