

**Fredrich Schneider and Dominik H. Enste.** *The Shadow Economy—An International Survey*. New Delhi / Thousand Oaks / London: Sage Publications. 2006. Paperback. Indian Rs 550.00.

Social security fraud, economic crime, prostitution, money laundering, smuggling, and other illegal actions have one thing in common—they are all considered to be “shadow economy” activities. Such activities are increasing and require immediate attention from social and economic policy-makers and law-regulating authorities. Fredrich Schneider and Dominik H. Enste have made a commendable effort to highlight the causes, effects, and size of the underground economy in their new book.

The authors have found that during the 1990s the average size of a shadow economy was 12 percent of GDP for the OECD countries, 23 percent for the transitional, and 39 percent for the developing countries. They have used currency demand, physical input (electricity) method, and a basic model approach to reach these conclusions.

The book consists of a total of ten chapters. It starts by postulating how the shadow economy has become a challenge for economic and social policy. Chapter 1 provides the reader with the vital information that compelled the authors to write the book. It suggests three main reasons why this area needs immediate attention. First, the problem needs to be curbed for obvious social and economic reasons. Second, it is a challenge for economic theory and policy. It is time when answers have to be found to such questions as to why people involve themselves in illicit activities, why transactions take place in the black market, and what the consequences of such actions are. Social sciences usually answer these questions from one dimension only; the authors realised that an interdisciplinary approach for the analysis of the causes was missing; hence the development of a basic “model” was necessary. Finally, the book aims to make suggestions for economic policy measures that are based on the analysis of relationships between the causes and effects of the shadow economy, and go far beyond the guidelines presented by the European Union Commission.

Chapter 2 notes that defining the shadow economy is indeed controversial. As the term encompasses various activities, it is difficult to provide one comprehensive definition. Consequently, the authors have focused on those aspects of the unofficial economy that present the greatest challenges to the Organisation for Economic Cooperation and Development countries.

The book argues that the national economy is a “dual economy”. This economy can be split into an official sector, which has two further sub-parts—the public sector and the private sector. Similarly, the other sector is the underground economy, in which informal economic activities take place. This too is sub-divided into the shadow economy, where illegal market transactions take place, and the household sector—which is the self-sufficient sector (i.e., its activities are not registered and include voluntary activities of non-governmental organisations).

Indeed, measuring the size of the shadow economy is a daunting task. Chapter 2 aims to provide the reader an overview of the numerous measures that were used to estimate the shadow economy. The chapter mainly focuses on three methods. The direct methods basically include surveys and inquiries on tax evasion and, hence, are of a microeconomic nature. On the other hand, the indirect method, also known as the “indicator” approach, is macroeconomic. Five indirect indicators have been used. These

include the discrepancy between national expenditure and income statistics, the discrepancy between official and actual labour force, the monetary methods (which include the transaction approach and the currency demand approach, which are most commonly used), the physical input (electricity) approach (which consists of the usage of the Kaufmann-Kaliberda method and the Lacko method), and, finally, the modelling approach.

Chapter 4 presents extensive data on the shadow economy that is present in the seventy-six countries that have been considered by the authors. It gives a detailed account of informal economic activities and their effect on the national income accounts. The shadow economies are analysed for the years 1989-90 and 1990-93. The data is divided into developing, transitional, and OECD countries, as well as according to continents. The continents and countries differ from each other on the basis of varying causes, consequences, size, and development of their black economies. The comparison concludes that for the 1989-90 time-period, Africa has the largest shadow economy with 44 percent of its gross national product, followed by Latin America with a rate of 34 percent, and finally Asia with 35 percent.

Chapter 5 provides data on the labour force that is employed by the shadow economies or the “black labour market”. Finding and providing data on this sensitive labour market is quite difficult. As a result, the authors have mainly used the World Bank’s data base on informal employment to make their comparisons. The findings are in their preliminary stage since it is one of the first attempts to calculate the shadow economy labour force on such a large scale.

After providing a holistic empirical overview of the state of the global shadow economy, the book focuses on the theoretical fundamentals, and uses economic theory to explain the relationship between the causes and effects of the shadow economy in Chapter 6. However, economic theory alone cannot explain this phenomenon. Hence, the authors have also used sociological and psychological arguments to explain the prevalence of the shadow economy. They refer to this approach of using various disciplines as the “integrative approach”, and use it throughout the book to explain the deviant behaviour, i.e., persistence of illicit activities. Although, the shadow economy is a macroeconomic phenomenon, it is actually based on various microeconomic, psychological, and microsociological theories that explain the social processes and institutional changes. This chapter gives a detailed account of such models used under the integrative approach and shows us that such an interdisciplinary analysis of the shadow economy could render possibilities for further integration of more social sciences.

By providing a comprehensive analysis of the causes of illicit work, Chapter 7 provides some solid economic policy measures that need to be implemented in the context of illicit work. Government failure, increased taxation, increased regulation and social security measures, and transfer payments have been identified as the most important economic causes of the shadow economy. While the first three causes encourage people to evade taxes, the last two reasons induce negative incentives to work, and this has been shown using a neoclassical income-leisure model.

The effects of the shadow economy on the economy is a topic that has attracted little attention and research up till now. Chapter 8 takes up this task and analyses the

consequences of shadow economic activities in a welfare economics and evolutionary economics context by discussing the allocative, distributive, stabilising, and fiscal effects.

Chapter 9 proposes a “Two Pillar Strategy” that suggests two approaches that can be used to contain the phenomenon. First, there is a need to reduce the attractiveness of tax evasion and regulation (exit option); and second, there is a need for improvement in the ways of voting and influencing formal institutions (voice option). Chapter 10 concludes the book by providing a summary of the policies suggested in the earlier chapters to combat this burning issue. Most of the work done on this topic till now only touches the tip of the iceberg. This book makes a valuable contribution to the existing literature on underground economies by answering questions and raising more issues related to this topic, while at the same time giving a holistic overview of the state of the shadow economy in seventy-six developing, transitional, and OECD countries.

Schneider and Enste give us the best existing survey on the size and causes of the shadow economy. Their comprehensive analysis also suggests solutions to the problem.

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