



Analysis of the shadow economy in the Spanish regions

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Received 19 March 2015; received in revised form 13 August 2015; accepted 26 September 2015

Abstract

The aim of this paper is to analyze the shadow economy in the Spanish Autonomous Communities. In so doing, we employ the Currency Demand Approach to analyze the 1987–2010 period. The results show that the size of the shadow economy ranges from 18% to 30% of regional GDP and an approximate mean value of 25% for the entire territory. The Personal Income Tax has the greatest impact on the shadow economy. By region, Andalucía and the Islas Canarias have the highest values for the shadow economy, whereas Madrid presents the lowest value. We extract some implications for the public authorities.

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JEL classification: G18; O17; H11; H26

Keywords: Shadow economy; Currency Demand Approach; Black economy; Hidden economy; Black market

1. Introduction

Researchers, politicians and economists have studied the shadow economy for decades because of its implications for the official economy of a nation-state. Its correct quantification may be crucial for the economic authorities of a nation or region to develop economic policy. Additionally, this analysis is important in the context of the current financial crisis because the shadow economy reduces public resources to face the crisis. In this sense, the objectives of this paper are twofold.

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On the one hand, it attempts to analyze the current state of the shadow economy in the Spanish Autonomous Communities. On the other hand, it aims to examine the most appropriate economic policies to limit the impact of the shadow economy in these regions. The importance of the shadow economy is more than just the legal issues it raises because it also has a number of economic consequences that have significant effects on the economic and monetary policies of a country (Dell'Anno, Gómez-Antonio, & Alañón-Pardo, 2007; Schneider & Enste, 2000). A large shadow economy may cause a country's leaders to make decisions based on indicators that are unrealistic. When this occurs, the "positive" indicators (GDP, IPI, etc.) are undervalued and the "negative" indicators (unemployment, inflation, etc.) are overrated. A correct estimation of the shadow economy lets us adjust these measures to reflect the actual needs of a country. This analysis thus has budgetary implications and influences the taxation and distributive policy in a country (Giles, 1997).

Overall, there are many international and national studies of the shadow economy based on different perspectives, different methodological approaches and different objectives. The main motivation of this paper is to extend the limited literature addressing this matter at the regional level in Spain and to analyze the implications that this phenomenon has on the economy of a country or territory. Because of the importance of the Spanish Autonomous Communities in the development of the Spanish economy, it is necessary to know the regional implications of the sizes of the regional shadow economies because they are relevant for the implementation of regional policy measures and the allocation of public resources. For this purpose, we use the Currency Demand Approach proposed by Tanzi (1980) to estimate the size of the underground economy in the Autonomous Communities.

Before analyzing the shadow economy, it is necessary to determine the activities that are included in it. Schneider and Enste (2000) indicate that the shadow economy contains those economic activities that contribute to official GDP but do not appear in official records. According to the OECD, it comprises all economic activities whose final product is legal but that are deliberately hidden to avoid taxation or to avoid labor standards, such as minimum wages, social security contributions, etc. We assume that the shadow economy includes all goods and services produced legally and that are deliberately hidden from public authorities for any of following reasons²: (i) to avoid paying taxes; (ii) to avoid payment of social security contributions; (iii) to avoid compliance with minimum legal requirements regarding wages, safety, quality, etc.; or (iv) to avoid complying with certain administrative procedures, such as completing statistical questionnaires or other forms. It is clear that there is a common denominator in all the activities included in the shadow economy: they consist of hidden activities that are not listed in official records (Choi & Thum, 2005). Throughout this paper, we refer to the shadow economy and irregular activities without distinction.

This paper is structured as follows. The next section presents a brief review of the literature and present some of the major papers related to this issue. In the third section, we describe the data and methodology used in the analysis. The hypotheses formulation is presented in the fourth section. In the fifth section, we analyze and describe the results and determine whether the hypotheses are supported. The final section summarizes the main conclusions of the study.

² This definition has been commonly used in the literature; Schneider (2005, 2008), Schneider and Savasan (2007) and Feld and Schneider (2010) use this definition, among others.

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