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METHODOLOGY OF MONEY-AND-CREDIT STREAMS FUNCTIONING OF CORPORATE FINANCIAL SECTOR ENTITIES OF ECONOMICS

The article is devoted to the questions of methodical technique improvement and effective money-and-credit streams functioning ensuring in the system of corporate financial sector entities of economics. It has been determined that money-and-credit streams conception has logistic system elements: stream process presence and definite system integrity which allows to consider money-and-credit streams as a complex interrelated system. It has also been proved that money-and-credit streams system improvement provides tax payment optimisation in economical activity system of corporate structure and allows to develop perspective models for financial sector entities with the tax payment consideration.

Keywords: financial sector entities of economics, financial system, integration process, corporate structure, money-and-credit stream, tax obligation.

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CONCEPTUAL BASES TO DEFINE SHADOW ECONOMY

The article presents theoretical bases to define shadow economy. The importance is stressed to study and tackle this challenge in transition countries and in Ukraine particularly. It is emphasized that a substantial size of shadow economy affects the official economy by causing corruption and, being a feature of a survival economy, hinders long-term growth perspective on a country level. The definitions of the 'shadow economy', 'non-observed economy' and 'underground economy' are provided based on the System of National Accounts and the principles of the Organization for Economic Cooperation and Development.

Keywords: shadow economy, non-observed economy, transition countries, Ukraine.

Introduction

After more than 20 years of independence, shadow economy (SE) stays the main challenges for Ukraine during its economic transformation period. Although the Ukrainian labour force is characterised as highly qualified and skilled, the level of labour remuneration is much lower than in developed and developing countries. Extensive underground economy, when workers are "paid under the table"

(colloquially described as "salary in the envelope"), is a challenge that needs to be addressed. The Ministry of Economic Development and Trade of Ukraine reports on the size of country's shadow economy for 2014 at the level of 42 per cent of GDP [16]. Meanwhile, according to one of the latest foreign researches, this number amounted to 46.8 per cent [11], which represents Ukraine as one of the most burdened with informal activities country in transition.

Shadow economy hinders economic development of Ukraine also on the international level, being one of the main reasons of the fluctuating descend of acceptance of Ukraine as a trustworthy and honourable economic partner, which is reflected in consistently low ranking of our country by the Worldwide Governance Indicators, Doing Business report and other independent foreign cross-country comparisons [12].

Literature review

For all countries, from the most developed to the most undeveloped, there is always some part of economy that is in shadow. Furthermore, it progresses according to the “principle of running water”: it adjusts to changes in taxes, to sanctions from the tax authorities and to general moral attitudes, etc. Such “hidden” activities may be relatively unimportant in developed countries and of great significance in developing countries [7]. Schneider presumes that for highly developed countries it is true that a government may not have a great interest to reduce the SE due to the fact that in these countries: (i) tax losses can be moderate, as at least 2/3 of the income earned in the SE is immediately spent in the official economy, (ii) income earned in the SE increases the standard of living of at least 1/3 of the working population, and (iii) people who work in the SE have less time for other things like going to demonstrations, etc. [10].

However, SE stays the main feature of the economies in transition. Whether it will have a positive or negative role for the country, depends on the speed with which the government will redefine its role in the market [2].

In the last few years particular attention has been attracted by the SE exactly in transitional countries. For these countries, the positive impact that SE has had on a national welfare was in keeping economies afloat, since the costs of efficient production in the official economy have often increased. It has also debunked the myths of lack of entrepreneurship and lack of readiness for the market by Former Soviet Union (FSU) citizens. Furthermore, it has provided valuable market experience to such budding entrepreneurs [5].

On the whole, higher rates of economic growth, lower rates of unemployment and the rapid development of the private sector can result in a fast and successful transition, while lower rates of economic growth and a powerful role for the government in the redistribution can lead to a more sluggish and unsuccessful process of transition to the market. It is particularly dangerous if there are no or few democratic, economic and regulatory institutions.

Such a background, in collusion with broad discretionary powers of public officials, can lead to corruption, lobbying, and various forms of informal activities. Informal activities tend to make the manners of behaving that have arisen in the SE become the moving force not only in the shadow sector, but also behind measures that are taken in the official economy, in the legal and political systems and so on. Such phenomena have been observed in the last few decades in all the transition countries, and they have been a great obstacle in the way of economic development and growth.

The SE and corruption are encouraged by monopolies and discretionary decision-making, and they are limited by transparency, accountability and the responsibility of governmental and social institutions. Most dangerous are those points where the private and the public sectors coincide, because then the unregulated opportunities in the public sector lead to corruption that can have an effect on further social, political and finally economic regression [9].

Except the undermined effectiveness of the country management, among other concerns that SE poses is the fact that it is the feature of mostly a survival economy, where trading, services, stripping of state assets (and/or of their income flows), and focus on short-term turnover dominate the longer-term view. Large-scale and sophisticated investments, which are crucial to the longer-term growth prospects of the country, are virtually absent. And third, when compared with a liberalized official economy, the functioning of the unofficial economy is associated with significant efficiency losses. This is because of the non-productive payments and time wasted by the briber and the bribed in getting around licenses and taxes, as well as the decapitalization of assets [5].

In general, the most important consequences of the SE are: distorted information, lack of governmental revenue, effects on efficiency (depending on whether it is good or bad regulations that are infringed), impact on distribution (the poorest and the richest are most apt to be involved in the SE), and the destruction of the fabric of society [3; 9].

Schneider and Enste point out three reasons why policy makers should be especially concerned about the rise of the SE [10]:

1. A growing SE can be seen as the reaction of individuals who feel overburdened by the state and who choose the “exit option” rather than the “voice option”. If the increase of the SE is caused by a rise in the overall tax and social security burden together with “institutional sclerosis” [8], then the “consecutive flight” into the SE may erode the tax and social security bases. The result can be a vicious circle of a further increase in the budget deficit or tax rates,

additional growth of the SE, and gradual weakening of the economic and social basis of collective arrangements.

2. A prospering SE may cause severe difficulties for politicians because official indicators on unemployment, labour force, income, consumption – are unreliable. Policy based on erroneous official indicators is likely to be ineffective, or worse.

3. The effects of a growing SE on the official economy must also be considered. On the one hand, a prospering SE may attract workers (domestic as well as foreign) away from the official economy and create competition for official firms. On the other hand, at least two-thirds of the income earned in the SE is immediately spent in the official economy, thus having a positive effect on the official economy.

The factors that affect the tendency towards the growth of the SE in transition countries offered by different authors are summarized in Table 1.

numerous small enterprises which did not provide any information to statistical authorities on their activities. Decrease of the standards of living of the population urged many households to expand their informal activities in order to secure additional sources of income [6].

Different surveys conducted by the prominent economists [2; 5; 10] estimate the SE share in FSU countries from 2 % to 261 %¹ of a country's GDP and summarise that “there is no justified evidence that an expansion of the unofficial sector would halt in the near future”. The very existence of SE implies deterrent development environment and failure of government economic policy.

Definition of the shadow economy

SE may be regarded as all currently unregistered economic activities that contribute to the officially

Table 1. Factors that affect the tendency of the SE to rise in transition countries

Factors	Source
Political repression, inadequate legal system, institutional weaknesses, administrative control and discretionary decision-making in the economy, high tax burdens, macroeconomic instability and a non-payment culture	Kaufmann & Kaliberda (1996), North (1997), Vehovec (2002)
Non-functioning of property rights, high entrepreneurial risk and high transaction costs	North (1997), Vehovec (2002)
Wide ranging legislative and regulatory changes, enormous redistribution of the national wealth, lack of existence or ineffectiveness of institutions of public control	World Bank (2001)
Lack of democratic, economic and regulative institutions, absence of experience of paying taxes, discretionary rights of public servants, governmental waste	Bejakovich (2001)

Based on the source [9]

Besides belonging to transition countries, Ukraine is also a member of the Former Soviet Union (FSU) block. SE existed in the Soviet Union republics on a large scale but the official figures on net material product (NMP) included only a fraction of it – production of agricultural goods by households and construction of dwellings by households on own account. Underground and illegal activities were not included in the NMP estimates and official methodology of compilation of the material product system (MPS) did not contain specific provisions on this matter. Therefore the experience with recording the SE was very limited. The major factors which contributed to transition from centrally planned economies to market oriented stimulated the growth of various types of the SE. In more specific terms the major factors that contributed to this growth were liberalization of economy, violation of laws in connection with privatization process, appearance of

calculated (or observed) GDP. This definition was commonly used by researchers in the 1990's [3; 4; 10] and after. During the next decades a massive avalanche of terms were added to define the notion of what is considered as “shadow” economy in this research: black, cash, dual, hidden, informal, irregular, marginal, moonlight, non-observed, parallel, subterranean, twilight, underground, unobserved, unofficial, and unrecorded. The use of this wide variety of terms, often with different conceptual underpinnings, has often resulted in difficulties in interpretation and sometimes misleading comparisons [1].

Principally, the main distinction between shadow and non-shadow (or official) economy is that the official economy implies compliance with the rules,

¹ 261 % is the estimation of the shadow economy of Kyrgyz Republic for the year 1995 according to the modified electricity method (Eilat & Zinnes, 2000, 28).

and the SE implies non-compliance with the rules [9]. A *Handbook for Measuring the Non-Observed Economy* (2002) prepared by the Organization for Economic Cooperation and Development defines this term as “the groups of activities most likely to be non-observed are those that are underground, illegal, shadow, or undertaken by households for their own final use. Activities may also be missed because of deficiencies in the basic data collection programme”. These groups are then regarded as “NOE problem areas” because of their non-inclusion to the official statistics [7].

The System of National Accounts (SNA) unites the international standard for the national accounts. It is a statistical framework that provides a comprehensive, consistent and flexible set of macroeconomic accounts for policy making, analysis and research purposes. SNA was elaborated by the United Nations Statistical Commission under the auspices of the United Nations, the European Commission, the Organization for Economic Cooperation and Development, the International Monetary Fund, and the World Bank Group and was adopted in Ukraine in 1993.

According to the SNA [13], we should consider two main definitions:

- shadow economy – comprising production units that operate on a small scale and at a low level of organization, with little or no division between labour and capital as factors of production, and with the primary objective of generating income and employment for the persons concerned; operationally, the sector is defined on a country specific basis as the set of unincorporated enterprises owned by households which produce at least some products for the market but which either have less than a specified number of employees and/or are not registered under national legislation referring, for example, to tax or social security obligations, or regulatory activities;

- underground economy – activities which may be both productive in an economic sense and also quite legal (provided certain standards or regulations are complied with) but which are deliberately concealed from public authorities (e.g. to avoid the payment of taxes and/or social security contributions or to avoid meeting certain standards or administrative requirements).

Applying the definitions “non-observed economy” (NOE) and “informal sector”, the System of National Accounts 2008 is based on the *Handbook for Measuring the Non-Observed Economy*. The Handbook illustrates their connection with the Figure.

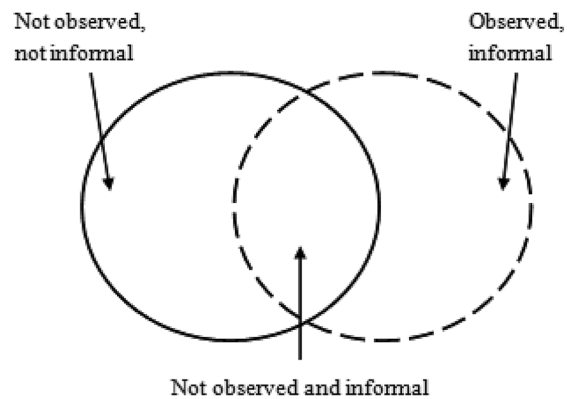


Figure. The Non-observed economy and informal sector
Based to the source [13]

There is an overlap between non-observed economy and informal sector. However, neither is complete subset of the other. Thus the overlap consists of activities that are not observed and undertaken informally but there are some activities that are not observed but are not undertaken informally and some that are undertaken informally but are observed. The sizes of the three segments in the Figure 1 will vary from country to country [13].

According to Ukrainian researchers, the definition “shadow economy” encompasses three groups: informal economy, hidden economy and underground (criminal) economy [14; 15]. They follow the system where informal economy refers to the economy of households performing economic activities to satisfy their needs. Hidden economy is considered to be legal, but not formally reported, which can be associated with hidden business. Finally, underground economy has criminal and, therefore, only destructive nature.

Conclusions

Shadow economy has been a scientific interest for many researchers, for different countries and for many decades. The more a specific country or group of countries are burdened with shadow sector, the higher this interest is for them. Countries in transition, and Ukraine respectively, have a significant need to study shadow economy and further – address its roots and consequences. Participants of the informal sector profit from it by paying less taxes, avoiding specific procedures and not obeying all the rules. Even though, working in shadow may decrease country’s unemployment, a considerable informal sector is rather an attribute of a survival economy and hinders economic progress.

The existence of shadow sector in Ukraine and its significant raise during last years is caused by

imperfections of economic policy of the government, in particular by the disputes in the legislation that regulates economic activities. Introducing healthy

reforms and implementing special policies will improve institutional environment in Ukraine, so that SE become economically unprofitable.

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КОНЦЕПТУАЛЬНІ ЗАСАДИ ВИЗНАЧЕННЯ ТІНЬОВОЇ ЕКОНОМІКИ

У статті представлено концептуальні підходи до визначення тіньової економіки. Обґрунтовано важливість дослідження та розв'язання цієї проблеми в країнах з перехідною економікою, підкреслено її актуальність для України. Наголошено, що суттєвий розмір тіньового сектору негативно впливає на офіційну економіку, спричинюючи корупцію і, будучи характеристикою економіки виживання, стає перепорою для довгострокового економічного зростання. Наведено визначення «тіньової економіки», «непостережуваної економіки» та «сірої економіки», які базуються на Системі національних рахунків і принципах Організації економічного співробітництва і розвитку.

Ключові слова: тіньова економіка, непостережувана економіка, країни з перехідною економікою, Україна.

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