

Evaluation of Shadow Economy Emergence and Development Factors in Service Sector: Greek Case

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Abstract

Despite the steady growth in the number of the studies on shadow economy, relatively little research has been done to identify the factors that cause emergence and development of shadow economy in particular countries. This article is aimed at evaluation of shadow economy emergence and development factors in Greek service sector. The methods of the research include logic, systematic analysis of scientific literature and the method of expert evaluation. The research has enabled to identify the factors contributing to the emergency and development of shadow economy in such factor groups as market-related, economic-financial, public administration, social and individual factors. Neither of legal factors was marked by the statistically significant number of the respondents, and weak resource base of the country, attributed to the group of resources-related factors, was not marked by any respondent, which shows that its impact on the emergency and development of shadow economy was not recognized. From all analysed factor groups, economic – financial factors were recognized as the ones that have the greatest impact on the emergency and development of shadow economy in Greece service sector.

Keywords: shadow economy, the factors of shadow economy, informal activities, service sector.

2. Introduction

During the recent decades, both Western and Eastern countries face the phenomenon called shadow economy. It means that many entities transfer their activities to households and perform illegal, unregistered business. Shadow economy is not a new phenomenon. Although the state always attempts to define economic and juridical lines between official and non-official business, the activeness of shadow economy has always been linked with the strength of administration and standardization. The potential of shadow economy is caused by interaction of sufficient material and financial resources and demand (Misiunas, 1999).

Shadow economy has earned scientific attention due to its serious implications for economic performance and a deeper level of awareness about the steady growth of black-owned business startups, warranting the description as the "fastest mutating phenomenon" (Nwankwo et al., 2010). The informal economy is a sizeable and expanding feature of the contemporary global economy (Charmes, 2009; Jutting, de Laiglesia, 2009; Sallah, Williams, 2011; Schneider, 2007; Williams, 2010).

Researching the phenomenon of shadow economy, much of the existing scientific literature focuses on the following points:

- Black business characterisation (La Porta, Shleifer, 2008; Charmes, 2009; Nwankwo et al., 2010; Williams, 2006; Williams, 2010; Williams, Nadin, 2012; Dellot, 2012; Barbour, Llanes, 2013 and others);
- Shadow economy size (Williams, 2006; Bose et al., 2012; Jutting, de Laiglesia, 2009; Rasanayagam, 2011 and others);
- The scope of illegal activities (Aidis et al., 2006; Williams, 2006; Arbex et al., 2013 and others).
- The methods of an appropriate shadow economy measure (Schneider, 2007; Minard, 2009; Williams et al., 2012; Williams, Martinez, 2014 and others);
- Identification of shadow economy regions and sectors (Williams, 2007; Virta, 2010; Watkins, 2011; Williams, Nadin, 2012 and others);

- Analysis of the impact of shadow economy on different industrial sectors (banking - Bose et al., 2012; Watkins, 2011; medicine – Worou-Houndekon, Pesqueux, 2013; farming – Tiemann, 2004).
- The determinants of informal activities (Misiunas, 1999; Friedman et al., 2000; Aidis et al., 2006; La Porta, Shleifer, 2008; Dabla-Norris et al., 2008; Williams, Round, 2009; Williams, 2010; Nwankwo et al., 2010 and others).

But, despite the steady growth in the number of the studies, relatively little research has been done to discover and identify the factors that cause emergency and development of shadow economy in particular countries. **The aim of the article** is to evaluate the factors of shadow economy in Greek service sector. The following **objectives** have been raised to fulfil the defined purpose: 1) to present the interpretations of the term of shadow economy; 2) to systematize the factors of shadow economy; 3) to present the methodology of the research; 4) applying the method of expert evaluation, to identify the factors that determine the emergence and development of shadow economy in Greek service sector. **The methods of the research** include logic, systematic analysis of scientific literature and the method of expert evaluation.

The rest of the paper is organized as follows: section 2 presents different scientific interpretations of the term of shadow economy; section 3 reviews the factors that determine the entrenchment of shadow economy; section 4 describes the methodology and data; section 5 presents the results of the empirical research and section 6 concludes.

3. Interpretations of the Term of Shadow Economy

Before identifying and evaluating the factors of shadow economy in the analysed sector, it is purposeful to review interpretations of this term in the scientific literature. It should be noted that the term of shadow economy is not universal. Scientific literature applies different economic, juridical, sociological and other criteria to define it. Shadow economy is known by a multitude of names such as the "informal", "black", "cash-in-hand", "underground" and "hidden" economy (Barros, 2005; Bahmani-Oskooee, 1999; Dessing, 2004; Gang, Gangopadhyay, 1990; McCrohan, Sugrue, 2001; Odedokun, 1996; Williams, 2006). The origin of the term *informal economy* has been attributed to the papers written by the anthropologist Keith Hart in the early 1970s when he used it to refer to the irregular income earning opportunities of the urban poor in Ghana (Rasanayagam, 2011). Also, shadow economy can be interpreted as a small family business where simple technologies and intensive work are applied (Misiunas, 1999) or a new business which emerged in the market not regulated by competitive environment (Williams, 2006). With reference to different interpretations of informal activities in the scientific literature, the following types of shadow economy can be distinguished:

1. Shadow economy not depending on economic systems – it is any economic activity that increases GDP of the country but is not included in the national accounting.
2. Shadow economy under market conditions – it is amount of illegal activities that fail to meet formal regulations of the state.
3. Transition period shadow economy - it is a hidden, profit-making activity in public and private enterprises in transition economies.

Summarizing, despite such wide variety of terms, definitions of informal activities share some common characteristics - informal activities involve market-based production and sale of goods and services which are unregistered or hidden from authorities for tax (avoidance payment of income, value added taxes, social security contributions), benefit (profit or income increase) and/or performance simplicity (avoidance having to meet labour standards, certain administrative procedures) purposes.

4. Systematization of the Factors of Shadow Economy

In order to reduce the volumes of shadow economy, the factors that determine its emergence and development have to be identified. Applying the methods of shadow economy evaluation, scientific literature leans on numerous factors (economic, social, labour market, legal and others), and in some cases the impact of particular factors remains unresearched due to the lack of the statistical data. However, interdisciplinary analysis of the causes of shadow economy is necessary since the research based on a single category of factors can only partly explain emergence and development of shadow economy while the factors of different categories have a complex impact on the tendencies of economics in the country (Krumplyte, 2008). The factors of shadow economy analysed by different authors have been presented in Table 1.

Table 1. The factors of shadow economy (compiled by the authors)

Author, year	Country	The factors of shadow economy
Nwankwo et al., 2010	UK	Failure to market services effectively; lack of cultural awareness and understanding of business support; business tendency to be more concentrated in non-priority sectors (e.g. retailing); weak resource base
Williams, 2007	UK	Competition, regulations, taxation, cost of premises, shortage of skills generally, shortage of managerial skills, lack of financial knowledge, criminal mind
Virta, 2010	Finland	Different kinds of corruption
Watkins, 2011	Canada	Investment in leading-edge technology, particularly related to computers and communication; lack of skilled managers; failure to adapt best practices; failure to meet business innovation pace
Williams, 2006	UK	Taxes, high costs of social security
Bose et al., 2012	USA	The level of financial development of the country
Schneider, 2007	145 countries	Public policy, public administration, the burdens of taxes and social security contributions, complexity and perceived fairness of tax systems, the extent of bureaucracy, regulations, and corruption
Misiunas, 1999	Lithuania	Market imbalance, inelasticity of economic systems, structural distribution problems, the problem of debts, asymmetries in the labour market, inflation
Arbex et al., 2013	Brazil	Worker's education level, ability bias and wage differentials
Rasanayagam, 2011	Uzbekistan	Political issues, corruption, extractions for personal profit, complicated formal structures of state organs
Williams, Nadin, 2012	UK	Population's low income, excluding population from formal labour market, absence or unattractiveness of other opportunities
Williams, Martinez, 2014	UK	The need for business mature before formalizing it, tax burdens, policy issues
Williams, 2010	Developing countries	Unattractiveness of other opportunities, necessity, avoiding taxes, rationality, difficulties to get a job, strict procedures of business formalization
Dabla-Norris et al., 2008	Developing countries	Tax and regulation burden, financial market development, financial constraints, the quality of the legal framework, legal obstacles
Friedman et al., 2000	69 countries	High tax rates, wish to keep all profits, inefficiency of political and social institutions, bureaucracy, corruption, weak legal system
Krumplyte, 2008	Lithuania	Tax burden, income inequality, regulation intensity, imbalance between labour supply and demand, significant gap between medium and minimal wages in the country, distortion of competition caused by tax exemptions, regulation gaps, constant changes of laws

As it can be seen from Table 1, the factors of shadow economy noted and analysed by different authors can be attributed to the following groups:

1. Market-related factors (failure to market services effectively, competition, competition distortion caused by tax exemptions, failure to meet business innovation pace, market imbalance between demand and supply, distribution problems).
2. Economic – financial factors (the burden of high taxes, high costs of premises, high costs of social security, poor financial development of the country, poor development of financial market, problem of debts, inflation, inelasticity of the economic system, financial constraints).
3. Public administration factors (intensive regulation, corruption, bureaucracy, complicated formal structure of state organs, inefficient political and social institutions).
4. Legal factors (complexity of the tax system, perceived fairness of the tax system, complicated procedures of business formalization, poor quality of loyal framework, constant changes of laws).
5. Resources related factors (weak resource base of the country).
6. Social factors (lack of cultural awareness, poor understanding of business support, wage differentials, population's low income, excluding population from formal labour market, unattractiveness of other opportunities to earn income).
7. Individual factors (low education level, shortage of skills, shortage of managerial skills, lack of financial knowledge, wish to keep all profits, criminal mind).

Market-related factors reflect imbalance between demand and supply. Developed market economies usually face the problem of demand surplus. In such situation, official economics can only partly meet all customers' needs, which causes emerging of unofficial production, speculation.

Economic – financial factors reflect the negative market reaction to the inelasticity of the industry and poor development of financial market. Under such conditions, governments are hardly able to make efficient investment, they increase their indebtedness, which, in turn, causes tax and cost rising for business and increases the attractiveness of shadow economy.

Public administration factors reflect inefficiency of the work of public institutions, complexity of public administration system as well as too intensive and/or unreasonable business regulation. Although the apparatus of state institutions is extensive, it does not provide the expected effects. On the contrary, the wish to prevent these barriers while performing business activities becomes a strong incentive to operate underground.

Legal factors reflect the weakness of legal framework in the country. Businessmen can hardly be expected to make a decision to formalize their activities when they find it difficult to understand complicated regulations, when businessmen's rights are not sufficiently protected, when activity and income planning is impossible due to constant changes of laws and/or when it is thought that tax system in the country is unfair. It all becomes a strong motive to perform in a shadow.

The resources related factor – weak resource base of the country - means that the country is not rich in resources, so the resources necessary to start-up and develop a business can be expensive or difficult to access. This motivates businessmen to look for illegal ways to get access to cheaper resources.

Social factors reflect weakness of the social system of the country. Asymmetry in the labour market between supply and demand, wage differences as well as inability to create attractive business alternatives discourage citizens from business formalization. Also, perception of inequality contributes to public thinking changes. It all becomes an incentive of shadow economy emergence and development.

Finally, individual factors of shadow economy are related with businessmen's personal characteristics such as low education level, shortage of skills, especially managerial and financial ones, the wish to keep all profits and even criminal mind. On one hand, these factors seem not to be linked with general economic state in the country, but on the other hand, higher development level often serves as a base to provide businessmen with necessary education. Therefore, according to Misiunas (1999), the role of these factors increases in the countries with transition economies.

Although the analysis of theoretical literature has enabled to establish the factors of shadow economy, it has not revealed what factors and factor groups explicated above have significant impact on shadow economy emergence and development. That is why it is purposeful to carry out the research that would enable to identify the factors determining the emergence and development of shadow economy in particular countries and industries, in this case – in Greek service sector.

5. Methodology

In order to identify the factors that contribute to the emergency and development of shadow economy in Greek service sector, 14 enterprises, operating in service industry in Greece, were included in the research.

The representatives of the enterprises (enterprise owners or managers), treated as experts, were asked to fill in the questionnaire consisting of 5 questions. At first, the experts were asked if their business had ever had any activities of shadow economy. The following two questions were included to find out the activity sphere of the enterprises and the type of businessmen the respondents attribute themselves to. Finally, the respondents were asked to indicate the factors that, in their opinion, contribute to the emergency and development of shadow economy in their country and write down the motives which have the most significant impact on the presence of shadow economy in their business.

The distribution of the researched companies by activity sphere has been detailed in Table 2.

Table 2. Distribution of the researched enterprises by industry and activity sphere (compiled by the authors)

Number of the enterprises	Activity sphere
6	Catering
2	Handicraft
1	Dressmaking
1	Rent of carnival accessories
1	Real estate management
1	Sport facilities
1	Video rental
1	Education

As it can be seen from Table 2, distribution of the researched enterprises by the activity sphere is rather wide: the majority of the researched enterprises are involved in catering, 2 – in handicraft, and the remaining 6 enterprises are engaged in dressmaking, rent of carnival accessories, real estate management, sport facilities, video rental and education. Since the research covers a wide variety of service businesses in Greece, the data collected during the research can be treated as representative and statistically reliable.

6. Research Results

The results of the research have revealed that all enterprises had had some business of shadow economy. It shows that the volumes of shadow economy in Greek service sector are really significant. The biggest part of the businessmen (9 out of 14 respondents) attribute themselves to the group of permanent entrepreneurial moonlighters acting in officially registered business and paying taxes, but not declaring part of the income and having no intention to declare it in the future. The rest part of the businessmen (5 out of 14 respondents) consider themselves to be temporary entrepreneurial moonlighters acting in officially registered business but not declaring part of the income with intentions to act absolutely legally in the future. These results show that Greek entrepreneurs operating in service sector see the necessity to register and formalize their activities. Shadow economy appears as avoidance to declare part of the income which is acceptable for most of the entrepreneurs working in Greek service.

Analysing the factors that contribute to the emergency and development of shadow economy in Greek service sector, it has been established that competition (which was marked by all 14 respondents) is the dominating factor that contributes to the emergency and development of shadow economy in the group of market-related factors. In the group of economic – financial factors, high costs of social security (which were marked by 93 per cent of the respondents) are considered to be the most influential. In the group of public administration factors, the predominant factor is complicated formal structure of state organs, which was marked by 57 per cent of the respondents. In the group of legal factors, there was not any single factor to be recognized by more than 50 per cent of the respondents. Anyway, the respondents admitted the importance of complexity of the tax system (37 per cent of the respondents) and constant changes of laws (29 per cent of the respondents). Weak resource base of the country, which in the questionnaire was attributed to the group of resources-related factors, was not marked by any respondent, so its impact on the emergency and development of shadow economy was not recognized. In the group of social factors, population's low income appeared to be the most influential factor (it was marked by 79 per cent of the respondents). Finally, in the group of individual factors, the majority of the respondents (64 per cent) recognized the wish to keep all profits as the factor significant for the emergency and development of shadow economy.

From all analysed factor groups, economic – financial factors were recognized (79 per cent of the respondents) as the ones that have the greatest impact on the emergency and development of shadow economy in Greece service sector. The factors that have the greatest impact on the emergency and development of shadow economy in different Greek service sphere enterprises have been detailed in Table 3.

Table 3. The factors determining the emergence and development of shadow economy in different Greek service spheres

Service sphere	The factors of the shadow economy
Catering	Economic - financial
Handicraft	Economic – financial
Dressmaking	Economic - financial
Rent of carnival accessories	Market-related
Real estate management	Economic - financial
Sport facilities	Market-related
Video rental	Public administration
Education	Economic - financial

As it can be seen from Table 3, economic – financial factors determine the emergence and development of shadow economy in such service enterprises as catering, handicraft, dressmaking and real estate management. Wrong invoices presented by business partners and suppliers as well as avoidance to issue an invoice were identified as additional influential market-related factors in the spheres of rent of carnival accessories and sport facilities. An additional public administration factor that was appointed as the one determining the emergence and development of shadow economy in

the sphere of video rental was availability of illegal films and music records in the internet.

7. Conclusions

Considering the results of the research, the following conclusions can be made:

1. The analysis of the theoretical literature has revealed that definitions of informal activities share some common characteristics - informal activities involve market-based production and sale of goods and services which are unregistered or hidden from authorities for tax (avoidance payment of income, value added taxes, social security contributions), benefit (profit or income increase) and/or performance simplicity (avoidance having to meet labour standards, certain administrative procedures) purposes.
2. Since the results of the survey have revealed that all researched Greek enterprises had had some business of shadow economy, it shows that the volumes of shadow economy in Greek service sector are really significant. The biggest part of the businessmen attribute themselves to the group of permanent entrepreneurial moonlighters acting in officially registered business and paying taxes, but not declaring part of the income and having no intention to declare it in the future, which shows that Greek entrepreneurs operating in service sector see the necessity to register and formalize their activities. Shadow economy appears as avoidance to declare part of the income which is acceptable for most of the entrepreneurs working in Greek service.
3. Analysing the factors that contribute to the emergency and development of shadow economy in Greek service sector, it has been established that competition is the dominating factor that contributes to the emergency and development of shadow economy in the group of market-related factors, high costs of social security – in the group of economic – financial factors, complicated formal structure of state organs – in the group of public administration factors, population's low income – in the group of social factors and the wish to keep all profits – in the group of individual factors. Neither of legal factors was marked by the statistically significant number of the respondents, and weak resource base of the country, attributed to the group of resources-related factors, was not marked by any respondent, which shows that its impact on the emergency and development of shadow economy was not recognized.
4. From all analysed factor groups, economic – financial factors were recognized as the ones that have the greatest impact on the emergency and development of shadow economy in Greece service sector.

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