

Chapter 1

Introduction

Gorana Krstić

1.1 Introduction

The shadow economy is one of the biggest challenges to the Serbian economy, with its consequences in terms of tax evasion, labour market distortion, unfair competition, and inefficient allocation of resources. In many transition countries and in Serbia it is a major obstacle to the development of a strong business sector and to the building of a well-functioning market economy. Even though the shadow economy is still an important safety net for many individuals and households in Serbia, the disadvantages for workers, business, and society at large far outweigh the advantages.

During the economic crisis in Serbia since 2008 the need to deeply understand the shadow economy and to find ways to reduce it through formalisation has become acute. In times of crisis it becomes more apparent that the shadow economy is not only a consequence but also a cause of the greater decline in gross domestic product, and can spread the crisis further. Thus, the overall goal of this study is to develop a strategy and specific recommendations that will enhance the formalisation of the shadow economy in order to improve the competitiveness of the Serbian economy and contribute to economic growth.

We define the shadow economy as the ensemble of all market-based legal production activities that are deliberately concealed from public authorities for one or more reasons: to evade payment of income, value added, or other taxes; to evade payment of social security contributions; to evade certain legal labour market standards, such as the minimum wage, maximum working hours, safety standards, etc.; and to evade certain administrative procedures, such as completing statistical questionnaires or administrative forms (Schneider et al. 2010).

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For the purpose of this research, a special Survey on Conditions for Doing Business in Serbia was designed and implemented on a representative sample of 1,251 registered businesses and entrepreneurs in Serbia. This survey allows us to explore the shadow economy in Serbia from the business perspective for the first time, as all previous research has been based on household surveys.

In this study we apply an approach that combines elements of macro- and micro-economic analysis using all relevant statistical data, data from the survey on registered businesses and entrepreneurs, and qualitative research involving interviews with key informants and stakeholders. More specifically, the macro estimates of the shadow economy are based on two methods: the MIMIC approach (multiple indicators, multiple causes) and the Household Tax Compliance approach. Micro-estimates are based on the survey data, identifying the types of shadow economy that exist within the formal sector across the various sectors of economic activity, region, firm size, and other business characteristics. In addition to estimating the extent of the shadow economy we also estimated the tax evasion gap—the difference between evaded taxes and statutory tax liabilities.

It is worth mentioning that in 2013–2014, after the final version of the study was completed in March 2013, the Serbian government implemented a few of the proposed policy measures for formalising the shadow economy presented in the study.

The report is organized as follows. The next chapter by Mihail Arandarenko reviews the various negative consequences and positive effects of the shadow economy in Serbia over the last decade. Chapter 3 by Gorana Krstić describes the design and methodology of the survey of registered businesses and entrepreneurs. Chapter 4 by Milojko Arsić, Mihail Arandarenko, Branko Radulović, Saša Randelović, and Irena Janković identifies the main causes of the shadow economy concerning the tax system, labour market institutions, and the financial sector, as well as other institutional and economic causes of the shadow economy. Chapter 5 by Friedrich Schneider, Gorana Krstić, Milojko Arsić, and Saša Randelović presents estimates of the shadow economy in Serbia using different methods, while Chap. 6 by Gorana Krstić and Branko Radulović introduces estimates of the main types of shadow economy among business entities, determinants of their participation in the shadow economy, and the impact of competition from the informal sector on businesses. Chapter 7 by Milojko Arsić and Gorana Krstić provides estimates of the potential fiscal effects of reducing the shadow economy to the level observed in more developed countries and the effects that formalisation of the shadow economy can have on economic growth. Chapter 8 by Mihail Arandarenko reviews the institutional capacity, inter-governmental coordination, and policy framework for fighting shadow economic activity. Chapter 9 by Gorana Krstić, Friedrich Schneider, Mihail Arandarenko, Milojko Arsić, Branko Radulović, Saša Randelović, and Irena Janković presents the main findings and specific recommendations, policies, and programmes concerning fiscal and labour market policy and financial sector development to enhance the formalisation of the shadow economy. Chapter 10 by Gorana Krstić, Friedrich Schneider, Mihail Arandarenko, Milojko

Arsić, Branko Radulović, Saša Ranđelović and Irena Janković provides an executive summary.

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Reference

Schneider F, Buehn A, Montenegro CE (2010) New estimates for the shadow economies all over the world. *Int Econ J* 24(4):443–461