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Shadow economy and economic growth in Romania. Cons and pros

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Abstract

Shadow economy (SE) represents a complex phenomenon, which is having undoubtedly many negative sides and undesirable implications upon economy and society, but might also have some good effects, offering social self-protection and alternative solutions for unemployment, insufficient consumption and investment in the official economy, etc. Since the attempts to analyze SE based on only one indicator may be misleading, we developed a new synthetic index of SE that includes three relevant indicators: SE measured in euro per inhabitant, SE as percentage of GDP and SE of each EU member state as percentage of the total EU-28 shadow economy. We analyse these three indicators, as well as the synthetic index of SE, for Romania, over 1999-2012. The synthetic index of shadow economy is further introduced into an econometric model in order to assess its impact on the Romania's economic growth. We have tested the links between shadow economy and economic growth in Romania and found a cointegrating relationship, suggesting that SE is consistently related to the official economy and they display similar trends on the long-run.

Key words: shadow economy, synthetic index, economic growth, Romania.

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1. Introduction

Researchers usually agree upon the many negative aspects of shadow economy (SE), namely tax evasion, labour lacking social and health insurance, inefficient public administration and shortcomings in private sector, unfair competition, etc. Nevertheless, shadow economy might also have some good effects on the economy, offering social self-protection and alternative solutions for unemployment, insufficient consumption and investment in the official economy, etc. Potential positive sides of shadow economy are apparent when public administration is corrupt, when public money is misused and behaviour of decision makers is dishonest.

The literature on shadow economy in Romania usually draws on individual indicators (Albu, 2007; Alexandru et al., 2009; Andrei, 2011; Manole, 2012). Attempts to analyze SE based on only one indicator may be misleading. For instance, Romania is on second place in EU-28 as regards SE relative to GDP, but is the last country in EU-28 from the perspective of SE per capita (Zaman and Goschin, 2013). As single indicators provide different (and even opposite) results, we developed a new synthetic index of SE that includes three relevant indicators: SE measured in euro per inhabitant, SE as percentage of GDP and SE of each EU member state as percentage of the total EU-28 shadow economy. We analyse these three indicators, as well as the synthetic index of SE, for Romania, over 1999-2012. In this context, we have tested the links between shadow economy and economic growth in Romania by introducing the synthetic index of shadow economy into an econometric model in order to assess its impact on the Romania's economic growth.

The reminder of the paper is organized as follows. Section 2 addresses some aspects regarding the pros side of shadow economy (SE). Section 3 introduces the synthetic index of SE. Section 4 specifies the econometric model, variables and data and discusses the results from estimating the model. Finally, Section 5 concludes.

2. Some cons and pros aspects of shadow economy

The analysis of the pros side of shadow economy (SE) could be related to a series of opinions according to which its complex approach needs to take into consideration not exclusively the negative influence of this phenomenon, but also the positive ones, if there is the case. In this respect we should remind the case of great recession (international financial crisis triggered in the first decade of 21 century) which is supposed to be not only a negative phenomenon, but a factor which should be exploited in what could be its favourable progressive inputs. Einstein wasn't the only one to point out that, in a way, the economic crisis could be considered a stimulating factor for investment, technological progress, new products and processes, the development of new labour market forces, so that in perspective there are reasons to be considered a potentially favourable phenomenon, besides its well-known unfavourable effects.

Taking into consideration the both sides of the coin, we are in favour of the approach according to which decision-makers should pay attention to minimisation of negative effects at the same time with maximisation of potentially positive consequents. As far as good sides of economic crisis are concerned, our research is mainly based on opinions and comments of a good part of specialists, as well as causality relationships between some macroeconomic indicators involved in the SE matrix.

A large part of opinions are sustaining that SE, especially under the circumstances of a corrupted state, represents an important buffer and counterweight for solving problems such as high rate unemployment, complementary income for poor, future usage of black money in the official economy, local efficient use of public goods based on market principles for the case of goods used by a limited number of beneficiaries (private/public local beneficiaries) who are paying different and voluntary-based contributions (Lindahl strategy). On the contrary, sometimes a bad phenomenon could reflect some positive effects in the sense that for instance some result macro indicators such as GDP are directly related to the volume of some negative macro indicators, such as SE. According to our research, the higher GDP/cap the higher is the volume of SE