Introduction

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The shadow economy is important to address because of its negative consequences. One major problem is that it hampers economic growth by pushing the allocation of resources from productive to unproductive use, causing countries to spiral into 'bad equilibrium' where tax evasion generally leads to increasing tax rates, resulting in further increases in the shadow economy (Estrin and Mickiewicz, 2012; Putniņš and Sauka, 2015). Given such consequences, tackling the shadow economy has become a focus – and in some cases even a priority – of policy makers around the world, both in relatively more and less developed countries.

Yet, despite the increasing number of attempts to measure both the size and determinants of the shadow economy, research in this area is still very much at the preliminary stage. Arguably, the main reason for this is that the shadow economy is very difficult to measure and currently there is no consensus on a commonly accepted method for measuring the size of the phenomenon. This is further hampered by the lack of a broadly accepted definition of the shadow economy in the literature.

The multidimensional nature of the research area makes exploring the shadow economy even more difficult. Specifically, since the prevalence of the shadow economy can be socially or culturally embedded, understanding the ethics, morality and social justification of practices leading to the shadow economy output are crucial perspectives that should be captured in such studies. Even more importantly, the shadow economy has a contextual dimension and it is not a static phenomenon but an evolutionary process. Moreover, the size and determinants of shadow economies can also vary across industries, company sizes and the economic cycle. For these reasons, both research and policy recommendations to decrease the shadow economy need to be seen as complex problems that should be constantly reassessed.

In the context of this discussion, this book aims to collect evidence that could shed some more light onto the existing discussion regarding the size and determinants of the shadow economy, linking the phenomenon with the entrepreneurship process. More specifically, this volume includes nine chapters – contributions by leading scholars in shadow economy research – that can be further divided into three main parts. The first part of the book deals with introducing the importance of exploring the shadow economy in particular in relation to entrepreneurship research and reviews the main existing methods that measure its size as well as the determinants of the shadow economy. In the second part, contributors then explore informal entrepreneurship and the shadow economy in various contexts, such as Russia, Ukraine and Finland as well as the Caucasus and Central Asia. The third and final part summarizes the policy perspectives and strategies on decreasing shadow economies in various contexts.

More specifically, the book starts with a chapter entitled 'The bottom-up power of informal entrepreneurship', written by José Ernesto Amorós, Juan Pablo Couyoumdjian, Oscar Cristi and Maria Minniti. The main contribution of this chapter is to review the nature of the informal sector, addressing the phenomenon taking into consideration contextual differences across the countries, thus shaping the background for further contributions within this book. The authors argue that even though it is generally perceived as having negative consequences, the involvement of entrepreneurs in the shadow economy can also be beneficial, especially in environments where institutions are weak. According to Amorós et al., in countries with weak institutions, such benefits can appear both at the individual level as well as the aggregate level, in that they can both improve the living standard of the population as well as actually increasing economic growth.

This chapter indeed raises issues that are not only interesting from a research perspective but also from a policy perspective. Namely, questions such as 'How much shadow economy is acceptable?', 'What would be the impact of rapidly reducing the shadow economy?', 'Shall we fight the shadow economy or simply let it be?', 'In what proportions should "stick" and "carrot" policies be used to reduce the shadow economy?' are of crucial importance, especially in countries with weaker institutions where the size of the shadow economy tends to be higher compared with more developed economies. Both in the light of the aforementioned questions as well as the findings of Amorós et al., who indeed find a positive relationship between informal entrepreneurship and contributions to the individual and economy, we would also encourage researchers and policy makers to consider the time dimension. Specifically, once formal institutions become stronger with time, informal institutions (attitudes and beliefs on what is acceptable and what is not) might not change (for example, Sauka, 2008). Thus, in the longer term, a policy of 'letting the shadow economy be', enjoying short-term benefits, might be very difficult to deal with.

The persistence of a large shadow economy over time within countries with comparably weak formal institutions, as indicated by the findings of the next chapter within this volume, can at least partly be explained by the acceptance of such behaviour; a potential indirect outcome of the aforementioned policies. Or lack of appropriate policies, perhaps? More specifically, in his contribution 'Estimating the size of the shadow economies of 162 countries using the MIMIC method', Friedrich Schneider applies this specific method to measure the size of the shadow economy across the globe. Even though, as discussed by the author of this contribution himself, the 'multiple indicator multiple cause' (MIMIC) method has a number of drawbacks, so far it is the only method that, applied by Schneider, has been used to measure the size of the shadow economy in so many countries across time. For this reason, many policy makers are using these indicators both to refer to the size of the shadow economies within particular countries as well as a measure for the success of their policy initiatives to decrease the shadow economy.

The first part of the book then proceeds by introducing another method to measure the size of the shadow economy. This is the contribution by Tālis Putniņš and Arnis Sauka, entitled 'The components and determinants of the shadow economy: evidence from the Baltic countries'. In contrast to the method applied by Schneider, which is of an indirect nature, Putniņš and Sauka develop a direct method that is based on an annual survey of entrepreneurs. This method draws on the notion that those likely to know how much production/income goes unreported are the entrepreneurs that themselves engage in misreporting and shadow production. Given the sensitive nature of the shadow economy, Putniņš and Sauka use various tools to elicit more truthful answers from the respondents which results in estimates of the size of the shadow economy as a proportion of GDP (see Putniņš and Sauka, 2015 for more information).

Highlighting the benefits of their method, Putniņš and Sauka argue that it requires fewer assumptions than most existing methods, in particular compared with methods based on macro indicators, and is relatively precise about what parts of the economy are captured. Even more importantly, the method by Putniņš and Sauka allows one to directly link the amount with the key determinants of the shadow economy, thus providing some valuable evidence on why the shadow economy exists and what can be done to reduce its size within specific environments. Putniņš and Sauka apply this method to measure the size and analyse determinants of the shadow economy in the Baltic countries, namely Estonia, Latvia and Lithuania.

The first part of the book concludes with the contribution of Colin Williams, Ioana Horodnic and Jan Windebank, who present and apply yet another method to measure some important aspects of the shadow economy. Their contribution 'The participation of the self-employed in the shadow economy in the European Union' draws on a Eurobarometer survey conducted in 28 countries involving 1969 face-to-face interviews with the self-employed about their participation in the shadow economy. This contribution focuses on the self-employed, aiming to evaluate which groups of self-employed engage in the shadow economy. The authors argue that until now, the self-employed people participating in the shadow economy have been predominantly viewed as marginalized populations such as those on a lower income and living in deprived regions (that is, the 'marginalization thesis'). However, an alternative emergent 'reinforcement thesis' conversely views these marginalized self-employed as less likely to do so. Their key contribution is thus evaluating these competing perspectives.

The contribution of Williams et al. has a number of policy implications. First, the authors demonstrate the need for specific policy instruments that need to be applied to target specific populations in specific contexts. In this light, Williams et al. highlight the need for more in-depth thinking when allocating resources, such as European structural funds, for fighting the shadow economy. The authors emphasize that, so far, East-Central and Southern Europe have received most of the support, yet, as exemplified by their study, the self-employed in relatively developed EU regions have significantly higher participation rates in the shadow economy. Williams et al. also complement their contribution by providing some valuable policy suggestions which can be used by policy makers to decrease the participation of the self-employed in the shadow economy.

The second part of the book starts with two chapters that aim to explore the specifics of the shadow economy in rather particular contexts, certainly very interesting for shadow economy research, namely Russia and Ukraine. In his contribution 'Informal entrepreneurship and informal entrepreneurial activity in Russia', Alexander Chepurenko aims to explore the motives and forms of informal entrepreneurship in Russia, drawing on a survey of start-ups located in Moscow. The key argument of this study is that, similar to more advanced market economies, in countries with a Soviet past, most informal entrepreneurship happens within formally registered companies, not companies or units that work entirely illegally. Given that involvement in informal entrepreneurship within registered companies is high or at least existent, depending on the context, one of the implications of such a conclusion is that entrepreneurship research simply cannot neglect both the individual- and aggregate-level impact of the part that is operated informally.

Yet, in this contribution, Chepurenko also finds and discusses the characteristics that shape informal entrepreneurship in the specific context of Russia. This in turn results in targeted and context-specific policy suggestions to decrease informal entrepreneurship activity and thus also the size of the shadow economy in Russia. Context-specific policy suggestions are also provided by Elena Denisova-Schmidt and Yaroslav Prytula who explore the nature of the shadow economy in Ukraine. This chapter, entitled 'The shadow economy and entrepreneurship in Ukraine', once again highlights the role of the context, weak institutions in particular, which shapes entrepreneurs' strategies.

In particular, Denisova-Schmidt and Prytula argue that entrepreneurs in Ukraine react to market discrepancies by involving themselves in certain corruption activities and other informal entrepreneurship practices, often seeing this as a solution to save their business and retain their employees. Yet also gaining competitive advantage is mentioned as one of the reasons for involvement in informal entrepreneurship which in turn implies that part of the reason entrepreneurs involve themselves in the shadow economy is a result of rational choice. Obviously, the likelihood of being caught and the severity of punishment is not an obstacle for these businesses. Another explanation could be that entrepreneurs simply see that other businesses in their industry are involved in the shadow economy and thus working entirely formally could mean losing competitive advantage. We have referred to this process as 'bad equilibrium' at the beginning of the introduction and already discussed the potential drawbacks of such processes, especially in the longer run. To avoid this, Denisova-Schmidt and Prytula call for more targeted and evidence-based policy measures to fight the shadow economy in Ukraine, pointing to the lack of political will to implement such reforms.

The second part of the book then proceeds with exploring the shadow economy in contexts other than Russia and Ukraine. The contribution of Markku Virtanen, 'A normative analysis of the measures to prevent the shadow economy in Finland', aims to explore the share of various informal entrepreneurship activities and forms of shadow economy as well as to suggest some policy measures for reducing the shadow economy in Finland. The author also reviews previous key efforts of policy makers in Finland to reduce the shadow economy in the country. To do that, Virtanen mainly draws on the information available in various reports available from the Ministry of Finance and the Ministry of Employment and Economy of Finland.

The second part of this volume concludes with the contribution of Yasser Abdih and Leandro Medina entitled 'The informal economy in the Caucasus and Central Asia: size and determinants'. As the title suggests, the authors concentrate on exploring the amount of shadow economy and the reasons behind it in this particular region. By using the MIMIC method, Abdih and Medina find that the inappropriate tax system and excessive regulation of financial and product markets, as well as the rigid labour market, are the main contributors to the shadow economy in the region. Overall, this study is one of the few available that aims to link the size of the shadow economy with its determinants, thus potentially being useful for policy makers to design context-specific policies for fighting the shadow economy.

This volume concludes with the third part, which consists of one chapter: 'What is to be done about entrepreneurship in the shadow economy?', written by Colin Williams. In his contribution, Williams provides an extensive review and evaluation of policy options, approaches and measures available to policy makers to address the shadow economy. In particular, Williams offers to choose amongst 'taking no action', 'eradicating shadow entrepreneurship', 'moving legitimate entrepreneurship into the shadow economy' or 'transforming shadow entrepreneurship into legitimate entrepreneurship'. The author then examines which of these policy approaches, which, as stated by himself, are not mutually exclusive, are most efficient, taking into consideration influential factors both on the micro and macro levels.

By collecting contributions that analyse the nature of the shadow economy and key available policy measures, which explore the shadow economy in particular contexts and provide an overview of available policy measures to decrease the shadow economy, we aim to encourage further research on this often challenging research topic. In this regard, apart from uncovering new ways to measure the shadow economy, we would call for research on the shadow economy exploring regional variations and differences across the sectors. Furthermore, little is still known about the relationship between the motives of entrepreneurs or the general population and the size of the shadow economy, which is another relevant area for further in-depth research. Altogether, apart from facilitating an interesting academic discussion, this will provide policy makers in particular countries with more evidence-based and targeted tools to decrease the shadow economy and thus, in the longer term, foster economic development and growth.

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