

INTRODUCTION

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This book gathers valuable contributions for the understanding of shadow economy, mainly concerning the manifestation of the phenomenon in Brazil.

The contributions were presented in the “*Economia Subterrânea*” seminar (Shadow Economy), promoted by *Instituto de Ética Concorrencial* (ETCO), in Rio de Janeiro, on March 11 and 12, 2008.

A team of specialists of *Instituto Brasileiro de Economia* (IBRE) from *Fundação Getúlio Vargas’ Instituto Brasileiro de Economia* (IBRE), with a renowned academic qualification, conducted a detailed survey of the different methodologies used to measure shadow economy. It assessed the qualities and deficiencies of each one of them, compiling confrontation of theories reported in specialized literature. The objective of the analysis would be to choose the most suitable methodology to proceed to an estimation of shadow economy in Brazil

At the end of the analysis, the team chose MIMIC (Multiple Indicators Multiple Causes) – econometric methodology that proposes to produce a temporal series of shadow economy based on the observation of the different impacts produced in it by causal impacts and their effects and signaled by its dependent indicative variables. These variables are selected based on relationships extracted from the economic theory.

The application of MIMIC to the Brazilian case showed that the variables with the most impact at shadow economy level are unemployment rate, tax burden, and the perception of corruption in Brazilian society. It also pointed that economic growth reduces shadow economy and that it reveals much more dynamic in the capability to adapt to new circumstances.

Professor Friedrich Schneider, internationally renowned Austrian economist and author of important studies related to the subject, explored the size and development of shadow economies in Central and South America, with emphasis in Brazil and in Colombia.

He pointed out, among the conclusions, that shadow economy in the region studied is propelled by indirect taxation, regulation and unemployment rate.

He also observed that the regional shadow economy, in the period studied, is around 41% of the GDP and that it grows continuously only in the Dominican Republic, Haiti, Paraguay and Venezuela. Shadow economy in Brazil and in Colombia is equivalent to the regional average, being more representative in Bolivia, Haiti, Peru and less representative in Chile, Costa Rica and Argentina.

Vito Tanzi, for many years director of the Fiscal Affairs Department of the International Monetary Fund, is certainly one of the major contemporary tax experts. Besides the stimulating studies that he has published on the issue, he has contributed to this study with thoughts about shadow economy, its causes, and consequences.

Tax burden, regulations, prohibitions, and corruption are pointed out by Tanzi as the primary causes of shadow economy, and each of them is analyzed in detail, especially in the Brazilian context. As a consequence, he emphasizes unfair competition, tax evasion, and the compromising of statistics, whether for public policy formulation purposes, or for qualifying the country in international forums. Lastly, he evaluated the methods utilized for estimating shadow economy.

Despite its importance, shadow economy only received scholars' attention starting in the seventies, a reason why there are neither solid conceptual marks nor methodologies. The issue still goes through valuable and open academic discussions.

To start with, the actual shadow economy concept is still subject to controversy. IBRE's study prefers to understand it as synonym of informal or illegal economy. Schneider emphasizes the diversity of understandings about the issue, however he chooses as conceptual dominance, the illegal and legal activity universe, with or without monetary transactions, not reported to the qualified government agencies, for example tax evasion, marketing of stolen goods, misappropriations, contraband, prostitution, drug traffic, fraud, trade, etc. Tanzi prefers to make a clear distinction between informality and shadow economy: activities carried out by the under privileged, non educated people, residing in remote or rural areas would be included in the first case; and in the other case, activities attained to by the concept proposed by Schneider.

Regardless of the terminology adopted, it is evident that the analyses carried out have the same scope. As I see it, the conceptual delimitation will solely depend upon the use that one intends to make of the concept. Terminological harmonization is something to be attained with time and with the intensification of academic production.

I observe that the different methodologies used to estimate shadow economy are frankly naive, because of axiomatic nature and with development rigidly set upon theories susceptible to questioning and to information of ambivalent content. Do not take this comment as

depreciative in regards to studies carried out, but to the acknowledgment that there is a long way to go through in the doctrinarian consolidation field.

Shadow economy's causes and consequences are well explored in the studies presented. It would be fit to maybe include, in the consequences field, the loss of economic efficiency due to shadow economy's low productivity, according to what recent studies show. In this level, clearly reaching the real meaning of concepts used in the measuring processes is a lot more complex.

Indirect taxing was thought of as a relevant cause of shadow economy in Brazil and in Colombia. I wonder, in our case, can we make a distinct segregation between direct and indirect taxation? Cofins (Tax for Social Security Financing) and PIS (Employees Profit Participation Program) are contributions normally accounted for in indirect taxing. Over 90% of taxpayers, however, opt for presumed profit tax regime or SIMPLES, whose calculation basis (gross income) is identical to the income tax's in the same regimen. Could the product of tax collection, in this case, have been understood as indirect taxation?

The size of the tax burden is an evident cause of shadow economy. Its growth can, however, have a number of explanations, without bearing repercussion on the majority of taxpayers or their segments, for example atypical income resulting from actions aimed at the recuperation of taxable liabilities, expansion of the fiscal instrument efficiency, reduction of credit rights and loss to be offset, etc.

The raising of tax burden can only be understood as a tax evasion inducing factor and, on occasion, shadow economy, when it results from the increase of nominal rate or calculation basis – which I qualify as fiscal pressure.

Not uncommonly the tax burden, before being the cause, is the effect of the reduction of shadow economy. Furthermore, one would have to consider the increase of the fiscal pressure restricted to products or to economic segments that may not have an impact on shadow economy.

Regulation of the economy is imperative for the economic order, otherwise at risk of allowing situations that involve the marketing of prohibited products, unfair competition, the production of information that prevents tax evasion, sanitary and environmental controls, urban safety, etc. The excess of regulation, however, is an inhibitor of free initiative and an incentive for corruption and practice of illegal activities.

The complexity of legislation and the excessive demands of accessory obligations directly contribute to the expansion of shadow economy. In the United States, reminds us Tanzi, income tax legislation that, introduced in 1913, contemplated 400 pages of laws and regulations, in 2006 reached the expressive number of 65,000 pages, not to mention the 600 distinct types of

forms. Certainly, in this factual evidence lies a good explanation for shadow economy in that country.

I do not consider valid, however, certain conclusions of studies sponsored by the World Bank that emphasize high costs of conformity for the Brazilian taxpayer. I consider it an inattentive understanding of the matter. In reality, the intensive use of new Information Technologies and communication by the Brazilian fiscal administration makes the fulfillment of accessory obligation extremely simple and agile, in comparison to any other country. It is possible that the great diversity of taxes combined with the possibilities of exploiting cracks in the fiscal system demands a great deal of time for the fulfillment of fiscal obligations. This, however, is another matter.

The unreasonable constitutionalizing of the Brazilian tax system, which involves judicialization of tax issues, may better explain the costs associated with the departments specialized in legal entities.

Actual problems lie, for example, at the level of procedures related to taxpayers' registration and reversal. Probably, this is a cause that explains Brazilian shadow economy, although it is not the only one, nor the most important. They are excessive, in this case, the fiscal and extra fiscal requirements.

Shadow economy is also an illicit way used by formal taxpayers in order to reduce tax burden or to, in lieu of copyrights, practice piracy. Schneider shows evidence of the interrelation of shadow economy with the formal economy in Colombia. In the latter case, shadow economy is a typical case of illegal interposition.

A crucial question consists in the construction of an index that reproduces shadow economy, in order to depict variations in the phenomenon or measure its participation in the GDP. One cannot refute the importance of this construction. Actually, all methodologies aim at this objective. Its utilization, however, is limited.

Considering the ample possibilities of shadow economy's expression, a global index does not serve as a formulation of policies that tend to confront it. Shadow economy when entailed, for example, to tobacco economic activities has little to do with what might happen in the beverage sector.

For the formulation of public policies, therefore, it is more useful to know the sectorial shadow economy. What is done to reduce shadow economy, in the field of labor relations, in the tobacco economy, or in the imports of information technology products has limited usefulness for these specific objectives. Only incidentally, will the proposed measures be able to have cross repercussion. They never apply to generalizations. Therefore, the construction of specific index is more functional, yet lacking studies within

the academic scope. Nothing or very little has been done in order to estimate sectorial shadow economy.

For exemplification purposes, IBRE's study concluded that the institution of the SIMPLES, as applicable taxation rule to small businesses, had little impact on the overall reduction of shadow economy. Seeing this assertion as true, there is no way of rejecting, however, the importance of the regimen in the formalization of business of that size. It just so happens to be trivial evidence.

The confronting of shadow economy should, also, recognize operational limits. One cannot expect the institution of formalization rules for agricultural product commercialization activities, carried out directly by the producer to the final consumer, which is in no way similar to the commercialization of durable goods. In the same fashion, large company's formalization requirements cannot be in the same nature of what should be demanded of the small businesses. Specificities related to the nature of the activity or the size of the company must be taken into account.

The questions raised in this introduction have the purpose of simply highlighting the complexity of the issue and the ample spectrum of issues to be clarified.

It is our duty, therefore, to emphasize ETCO's inspired initiative in bringing into discussion the instigating issue of shadow economy with the intellectual participation of specialists of renowned competency, and from there produce information to the better understanding of this worldwide phenomenon and of great importance to this country. Furthermore, the continuity of the studies may result in important subsidy in the development of specific public policies.