

## DETERMINANTS OF SHADOWING OF THE ECONOMY: THE GENESIS OF ECONOMIC AND LEGAL DOCTRINES

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**Abstract.** The purpose of the article is to study the genesis of economic and legal doctrines, on the basis of which it seems possible to identify the main determinants of shadowing of the economy. Analysis of problematic issues of establishing causes of existence and spread of the phenomenon of economic shadowing, which is mediated by the need for influence on them in order to neutralize, that is, the definition of the subject of administrative and legal support of counteraction is presented. It is noteworthy that neither legal nor economic science provides a single understanding of the causes of the occurrence and spread of the phenomenon of economic shadowing. Taking into account the development of economic doctrines, it is established that the reasons reflect the main features of the concept of "shadowing of the economy". In general, the issue of preconditions for the existence of a "shadow economy" and "shadowing" is manifested in the fact that the institutionalization of informal manifestations in the economy is the basis for their legal formulation and recognition by legal economic institutions, without realizing the need to characterize shadowing as a threat. Along with this, it is necessary to recognize the starting positions and differences in the realities of modern Ukraine and the characteristics of the object of experimental study, since there are "restrictive" and "expanding" interpretations of the shadow economy and the shadowing of the economy, which identify the analysed concepts. In "restrictive" interpretations, "shadow economy and economic shadowing" are interpreted as dysfunction, deviation, pathological deviation or as a separate feature of the economic life of underdeveloped countries. By "expanding" interpretation, manifestations of these phenomena can be found in developed economic systems as a dogmatic component at all stages of the development of the economic life of mankind. The main gaps are the following provisions of the analysed doctrines, according to which the administrative management of the economy is the reason for the spread of the analysed phenomena; as a result, the main ways of eliminating the determinants are to reform management system, strengthen institutional capacities of certain bodies of state power, and so on. At the same time, under such conditions, in opposition to the shadowing of the economy, the decisive place is devoted to administrative and legal provision. *The practical significance of obtained results* is to formulate a hypothesis that provides a comprehensive, systematic vision of the determinants of economic shadowing, and in particular, an approach to establishing a ratio of the shadow economy and the shadowing of the economy, which will enable to identify and systematize the determinants of shadowing. At the same time, the correlation of these phenomena with general criminality, including organized crime in the sphere of economy, corruption, and other offenses in the sphere of the economy should also be taken into account. Having determined that all these phenomena are not some kind of "components", "sources", "sectors", "types" of the shadow economy, namely, their commitment in the "plane" or "sphere" of the economy shadows it. Specifying the types of determinants in accordance with the above list can be recognized as the task of the corresponding sciences

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and should be carried out within the limits of separate researches. *Methodology*. The methodological basis of research is the use of the systemic method of scientific knowledge, which allowed forming an approach at which the meaning of the concepts of “shadow economy” and “economic shadowing” is formed in accordance with causes, conditions, and consequences (determinants), which respectively are a subsystem of national security. This conclusion is proved in the process of scientific research and forms the path of practical (praxeological) confirmation of the proposed hypothesis.

**Key words:** shadow economy, economic shadowing, national security, causes of economic shadowing, conditions of economic shadowing, economic crime.

**JEL Classification:** O17, F52

## 1. Introduction

A significant number of monographic works are devoted to the study of the shadow economy; in fact, each publication in this direction primarily considers the issue of its causes, determinants. This is logical since the effectiveness of ensuring the impact on any phenomenon directly depends on the correctness of the determination of determinants, which lead both to its formation and to quantitative and qualitative changes. It is necessary to choose correct vectors of influence on these determinants. As in the case of studying the concept of the shadow economy and the shadowing of the economy, as well as studying the determinants of shadowing, there is no single vision of their system, even more likely, the impossibility of their unambiguous, exhaustive formulation is more clearly realized. Actually, this is an issue of studying the general “causality” and “determination” of any complex phenomena, economic-social, legal, political, etc. However, this situation does not eliminate the need for a given stage of scientific research, taking into account and within the scope of a particular work.

## 2. The lexical essence and the general problematic of approaches to the causality of economic shadowing

Different terms are used in the professional literature to characterize the process of the origin and development of the phenomenon of shadowing and the functioning (existence) of the shadow economy itself. Scientists investigate the causes, consequences, conditions, determinants, factors, risks, factors, which, in particular, are related to the lexical meanings of the above words, which are used in dictionary reference books as close by meaning. For example, determinant – any reason or such that precedes, a condition or means. In turn, condition – necessary circumstance that enables conducting, creating, forming anything or promotes something; circumstances, features of the reality, in which something happens, something is done; a set of specified provisions that underlie something. The reason is a phenomenon that causes or continues another phenomenon. The opposite is a consequence; the basis, a cause for any actions, goings. The difficulty

in clearly demarcating the said words in their lexical meaning raises the problems of distinguishing the concepts, in which they are based. The similarity of the above concepts produces a variant reading in the formation of scientific terminology used in the study of processes and phenomena, the possibility of their use depending on the author’s approach, which is based on signs that are most significant within the framework of concrete work.

Therefore, it is still difficult to expect unambiguousness and clarity in the construction of a general conceptual framework that can describe and clearly distinguish between causes, conditions, factors, determinants, factors of the shadow economy or the economic shadowing. However, this does not mean that there is no need to strive for this. An example of solving the outlined problem is the method used in rulemaking in the early nineties of the last century when the first laws were adopted for the settlement of new economic and political relations. Accordingly, during the formation of legal acts regulating various spheres of public relations, the requirement of a general policy of law-making activity aimed at the creation of reference books was respected.

The research of the conditions (causes) of the emergence and development of the phenomenon of “shadowing of the economy” was paid attention by many scientists, among them – winners of the Nobel Prize. At the same time, their scientific search was aimed primarily at solving the issues of the development of the economy itself by identifying the conditions of the person’s inappropriate behaviour, the degree of state interference in the economy, the institutionalization of informal (not legalized) relations, neo-institutionalization, etc.

## 3. Prerequisites for the formation of a deterministic complex of economic shadowing

The diversity of approaches to determining the causes of economic shadowing can be traced in their range – sociological, legal, economic, psychological, political, etc.; from the allocation of “deep” reasons, consisting in an affirmative answer to the question “Are they in the

human nature, the interest of citizens to get profit and abnormal profit in any way?" (Ispravnikov, Kulikov, 1997) or the formulation of general phrases about "excessive regulation of the economy" and "pressure from the state on the economy – free by its nature, self-sufficient with regard to the possibilities of regulatory methods" to the focus on a complex of causes of different origins, of which there are those that are included in the subject of the author's search, determined by the methodology of science, within which it is conducted.

Thus, as an object of scientific research, "shadow relations" in the economy are actively formed since 1970 based on studies of K. Hart about the informal sector of the economy of Ghana, namely, informal employment (Hart, 1973). Income classification proposed by the English sociologist has become the basis for the classification of shadow economic activity (or sources, types, sectors of the shadow economy, as some scholars point out) (Popovych, 2001). At the same time, it should be noted that the scholar rethinks the state of employment of the population and the conditions that have led to such a state, named "underdevelopment of the economy of the Third World countries."

As S.Yu. Borsukova specifies, K. Hart, being the author of the concept of the informal economy, enlisted to it only unregulated self-employment, and later he recognized the evolution of this concept and pointed that the informal economy in modern conditions (2006 year) can be considered as a universal quality of industrial countries and includes the range from the domestic self-sufficiency to the criminalization of the economy (Borsukova, 2008). Accordingly, even the abovementioned provisions allow drawing a conclusion on the development of the scientific knowledge of such a phenomenon, which today belongs to the shadow economy, changes in the allocation of its obligatory features even by the same scholar, whose work is the basis for many modern studies. Also, a change in the views of the scholar on the main cause of the economic shadowing is obvious, as the previously described "underdevelopment of the economy of the Third World countries" is no longer possible to explain this phenomenon.

The recognition of the existence of the shadow economy as a consequence of the deformation or underdevelopment of the legal economy not only in the economically backward countries but also in the highly developed countries such as the USA, is associated with the publications of the American economist P. Gutmann ("The Subterranean Economy", 1977) who drew attention to the need to calculate its scale in comparison with gross national product (Gutmann, 1977). At the same time, the basis for the formation of the author's approach to the concept of the shadow economy was the desire to correlate the official registered economic activity and real economic activity. This approach illustrates the attempt to determine the

criterion for distinguishing between the shadow and the "real" economy and the ratio of state-regulated economic processes and processes that are not subject to such regulation. According to this approach, the reason for the existence of the shadow sector in the US economy was the lack of registration of certain types of activities, and the prerequisite was the need to assess the effectiveness of the national economy.

American sociologist E. Feig estimated the scale of the shadow economy in 1979 at the level of one third of the gross national product, pointed out that the shadow economy is all economic activity, which for whatever reason is not taken into account and does not fall into the gross national product (Economic security, 2009). It should be noted that now the given approach with some clarifications is used to assess the share of the shadow sector in national economies of many countries. Evaluating the achievements of the scholar, the collective of authors of the monograph "Shadow Economy: the Essence, Features, and Ways of Legalization" under the general editorship of Z.S. Varnalii points out that the basis of E. Feig's model is the assumption that the historical development of society is associated with the gradual increase of state regulation of economic life and, accordingly, the "expansion" of the economy as a reaction to the challenge of "apparatus of violence" by the state (Shadow Economy: the Essence, Features, and Ways of Legalization, 2006). The urgency of this approach is determined by the existence of certain stages of the evolution of our state as a legal one, in particular, the path of its development, which lies between unregulated market capitalism of the XIX century – the early XX century and a totalitarian administrative model (Avrutin, 2005). Now in the conditions of a market economy, the qualitative result of economic modernization is a real reduction of economic and social gaps between Ukraine and countries with developed market economies, and the indicator of the success of such a process is the reduction of Ukraine's lagging by GDP per capita from developed countries and increase in Human Development Index (Course of administrative law of Ukraine, 2012). Emphasizing the condition of the emergence of the phenomenon of "shadow economy" and the actual development of the phenomenon of "shadowing" as "the expansion of the sphere of state regulation" (in accordance with the above provisions of the doctrine of E. Feig), it should be noted that such regulation should be recognized as a prerequisite precondition first of all with the elimination of the so-called root cause – the lack of legal norms' ordering of economic relations (their part). Consequently, the transition is actually made from the statement of the appearance of the phenomenon of "shadow economy" in connection with the presence of unregulated activity (the root cause identified by E. Feig) to the formation of another root cause and,

accordingly, the change of the first, the next reason for shadowing is excessive regulation, which is regarded as a pressure on economic entities. Therefore, they say, trying to overcome one “evil”, one managed to form “another”. The above provides an opportunity to point out certain patterns of formation and interoperation of the determinants of the economic shadowing and indicates the relevance of conclusions about the impossibility of a priori statement of the problem of “elimination” of the causes of shadowing.

A slightly different approach has been formed by Peruvian economist H. de Soto, who points out that the main reason for the expansion of the “urban” informal sector and the shadow economy is, in general, not the backwardness of migrants from rural areas, who seem to be unable to find their place in the legal sector, but bureaucratic excessive organization, which hinders the free development of competitive relations. An important conclusion of the scholar today is that the subjects of the shadow economy are establishing a genuine democratic economic order by organizing their private economy on the principles of free competition (Latov, Nestik, 2002). This conclusion once again confirms and clarifies the approach to the occurrence of the considered phenomena as a result of state regulation and dominance (primariness) of economic relations. One should agree that the institutionalization of informal manifestations in the economy (emergence of informal economic relations) is the basis for their legal registration and recognition by legal economic institutions. Despite the great value of the provisions laid down by the scholars, it should be pointed out that taking into account the achievements of this research in the domestic legal field should occur with the awareness of its starting positions and differences in the realities of modern Ukraine and the characteristics of the object of experimental study, on the basis of which the author’s conclusions were formulated. Absolutisation of such conclusions, “pulling them out of the specified context” is inappropriate.

It should be noted that the positive attitude to the shadow economy leads to the recognition of its right to exist and develop. As a result, there are “restrictive” and “expanding” interpretations of the shadow economy. In “restrictive” interpretations, the shadow economy is interpreted as dysfunction, deviation, pathological deviation, or as an isolated feature of the economic life. Shadow economy is considered to be a phenomenon typical for the economies of the Third World, respectively, the restriction and disappearance of the shadow economy is associated with overcoming the low level of development, poverty, lowering the level of state regulation of economic life (Tiugashev, 2007). Such provisions are unlikely to be consistent with the logic of the study of the abovementioned phenomenon, once again testifying to the problems in relation to the lack of separation of the phenomena of

the shadow economy and shadowing. Consequently, the conclusions are made that the reason for shadowing is the low level of development, poverty, and the reduction of the level of state regulation of economic life. In this case, it is more appropriate to say that the shadow economy is one of the factors that negatively influence the possibility of implementing a state policy on the reform of the administrative system, the civil service, and other processes (Bytiak, 1999). In the “expansive” interpretation, manifestations of the shadow economy can be found both in developed economic systems and in the historical past. The shadow economy is interpreted as a kind of constant at all stages of the development of the economic life of mankind (Tiugashev, 2007). Criticizing this approach, first of all, it should be pointed out that “shadow economy” is identified with the causes of “economic shadowing” since the deviation from the generally accepted standard of behaviour is actually the cause, not the consequence or result.

Another renowned scholar, Joseph E. Stiglitz, points out that individuals and firms will better plan and implement their activities if they can accurately predict what the state (government) is going to do. One of the main uncertainties that business faces is the uncertainty associated with knowing the steps that the government will take. The state defines “rules of the game” and, at the same time, is obliged to control the implementation of these rules by all economic actors; it is actually a systemic function of the state. Both business and the state are striving to maximize their revenues. Theoretically, business does not need to “go into the shadow,” if there is no withdrawal from the state, and problems with the distribution of its income do not arise. However, uncertainty and risk are related not only to the incomprehensibility of the rates of business income distribution, which is set by the state. In the hypothetical absence of withdrawals, uncertainties and risks are rising in connection with the withdrawal of the state from the system of establishing “rules of the game” and statutory regulation of entrepreneurial activity (Stiglitz, 1997). For the given interpretation of the reasons for the economic shadowing, it should be noted that the researcher emphasizes the mutual balance of formally regulated economic activity and informal one, however, this statement seems valuable and practically applicable in countries with already formed legal traditions and a high level of legal culture. At the same time, in these countries, economic relations are less formalized than in Ukraine since competent entities in many cases can assess the level of economic and legal consciousness of a person (economic agent).

Some authors, in particular O.V. Kostin, describing the criminal and unconsidered economic activity as sectors of the shadow economy, divide the reasons for its occurrence depending on the sector: in relation to the

unconsidered economy – the reduction of tax burden and expenses for legalization, and for criminal economic activity – the avoidance of criminal punishment. The scholar also points out the common reasons that, in his words, are simultaneously factors of the shadow economy's change: corruptions and bureaucracy, which hinder the implementation of legal actions (Kostin, 2011).

Famous criminologist, Professor V.V. Luneev, describing the shadow economy, notes that it is available in all countries of the world only with its peculiarities of the scope, forms of implementation, and the level of social and legal control over it. In this case, the scientist notes the practical limitless forms of its implementation and calls the main reasons for its magnitude as the criminalization of privatization, which pushed a significant part of production into the shadow, and the lack of a basic legal order in the country's economy. However, continuing, the scientist said about the expediency of characterization in the criminological purposes of its two features – destructiveness and wrongdoing (Luneev, 2004).

Shadow economy as a prerequisite for economic crime is considered in the works of the group of criminologists, in particular, A.M. Boiko calls the shadow economy an integral part of the determining complex of economic crime (Boiko, 2008), although the work of the latter does not consider criteria for the delimitation of these phenomena. In view of this, an attempt to investigate the cause-effect relationship between these autonomous phenomena seems somewhat questionable. In addition, the accumulation of "unaccounted capital" occurs as a result of the crime commission, and not vice versa. This reflects the sequence of such an approach, in which the shadow economy is considered as a consequence, the result of the shadowing process, that is, the activities in the economic sphere with a violation.

As noted above, there are opposing views on the appropriateness of speaking about any offenses other than criminal ones, considering issues of the meaning of the concept of the shadow economy and its determinants. In addition, in the process of scientific inquiry, researchers are limited to indicating the relationship of offenses and the shadow economy, without defining the nature of such interconnection, individual scientists in general use within the same work different approaches to establishing the correlation of these phenomena. Some characterize offenses (while limited to crimes only) in the field of the economy as a shadow economy.

Such discrepancies are associated with certain miscalculations due to the lack of a consistent approach to the definition of the shadow economy and the determinants of economic shadowing, as well as in connection with the attempt to compare the concepts and categories of different origins, artificially forming

the signs for such a comparison. The complexity, the systemic nature of the phenomena the researchers are talking about is only stated in the works, which sometimes leads to unreadiness to argue the author's conclusions about the significance of their characteristics.

It should be noted that in the basis of these and other, so-called "criminological" approaches, are the scientific achievements of G.S. Becker, who identified the main cause of shadowing strictly as the purpose of economic behaviour of a person, aimed at satisfying economic interest (benefits) (Becker, 1968). The above gave an opportunity to consider the acquisitive crime as the reason for the shadow economy (existence or spreading, distribution). Given the special social harm of crime, it is they that determine the level of threat to national interests. However, if criminal offenses fall under well-regulated national records, then other non-criminal (including partly administrative, characterized by a small degree of social harm) are not accounted for so carefully. There is no generalized data on these violations in the open access; they are conducted by individual entities according to their activities. At the same time, the reasons that are typical for the spread of crime, coincide with the causes of economic shadowing and are complemented by the peculiarities of determination peculiar for administrative delinquency (misconduct). To the established author's approach, it should be noted that the reasons for the activity that shadows the economy are those that are related to the result – the emergence of a material result, which will have signs – violations of the legal norm (prescription) and the absence of reflection in the gross domestic product.

The concept of a socially oriented market economy, which has gained practical implementation in most developed countries of Europe, attracts attention and is of particular interest for the formation of the opinion of scholars today when economic systems of post-socialist countries are beginning to transform into market relations. In accordance with this concept, the main task of the state is to create normal conditions for the functioning of all business entities, taking into account that the basis of the economic phenomenon of entrepreneurship is the ability to create new opportunities out of the very fact of change. Beyond the current state of the market development, the entrepreneur gets the chance to use this advantage in order to provide for a certain period of time profits as a result of the jump in production. This ability is characteristic only for the economically active population (Liashenko, Berezhnaia, 2009).

An example is the spread of economic relationships in a relatively new way of calculating – with the help of cryptocurrency. At the same time, the development of the so-called "informal relations" now shadows a significant part of the world economy, exceeding the "income" from arms trafficking and drug trafficking.

Thus, in his speech, the head of the Central Bank of Nigeria expressed legitimate concerns about the choice of an official position in relation to “digital currencies” since decentralized cryptocurrency, for example, bitcoin, at the moment provides for the possession of personal property that has no restrictions and cannot be confiscated. On this occasion, the official stressed the need to guide the regulatory policy in this direction (Central Bank of Nigeria: Cryptocurrency Wave Cannot Be Stopped, 2018). The given example gives an opportunity to talk about such ways of economic shadowing, which are actually not connected with violations of the established legal requirements of carrying out activities in the economic sphere but are determined by the absence of such legal regulation. Accordingly, it is proposed to counteract shadowing by regulating these relationships. In this way, the leading countries of the world are already operating, while choosing whether to formulate rules of prohibition, recognizing such activity as illegal, or defining the concept of “cryptocurrency” and imposing requirements for its circulation at a level of another currency.

#### 4. Conclusions

Summing up the description of approaches to the allocation of determinants of economic shadowing, depending on the chosen approach to the definition of the concept or some features of the shadow economy, one can point out that they are logically based primarily on studies of foreign scholars. Accordingly, they relate to certain conditions, in which they were carried out, and the time period, within which they were carried out and, therefore, were rethought by domestic scientists, mostly enlarged, supplemented. At the same time, unfortunately, it is sometimes possible to state that such an expansion occurred with losses in their system. Realizing the need to move away from the vastness of introducing the causes and conditions of shadowing, the need to allocate them more specifically, in order to develop adequate measures of influence, scientists form the basic practices that are sometimes reflected in the regulatory acts, however, as a rule, subordinate.

It is advisable to support a (broadside) approach to defining the concept of “shadow economy”, in which this is the activity in the economy aimed at obtaining a material result that is not reflected (not accounted for, not controlled) and is not included in GDP. Important is the allocation during the formation of the determination complex of the following determinants that impede such a reflection (accounting, control) and inclusion in GDP. (Or they lead to the fact that the activity in the economic field aimed at obtaining a material result is not reflected (not accounted, not controlled) and is not included in the GDP.) Accordingly, in connection with the development of such determinants, economic shadowing is taking place – the process of transformation

of the economy, in which the material results of activities in the economic field are not legal (that is, dynamics, while if legalized – statics). Such a process, provided that it reaches a critical level, poses a threat to economic security. It is decisive that the transformation of the economy takes place by violating the requirements established by legal rules for activities in the field of economy, aimed at obtaining a material result. This approach deepens existing scientific approaches to the concepts of the shadow economy and the shadowing of the economy, reflects the dynamic nature of the processes associated with the economic shadowing. The scientific approaches that were considered envisaged the perception of the shadow economy mainly from the point of view of statics since the static perception of a certain legal phenomenon makes it possible to distinguish its structure. The domination of such an approach is related to the priority task of knowing this phenomenon in previous periods – the definition of the level of the shadow economy in relation to the economy – and the attempt to establish, at which level the threat to national security is formed. In this case, the role of the hypothesis is played by the assertion that economic science, despite the awareness of the need for the development of a dynamic theory, is predominantly static. This statement is still relevant to the established subject of the study. Taking into account the dynamics of a certain phenomenon of social reality involves knowledge of the development of a definite structure in social existence. The holistic perception of any social phenomenon, the disclosure of its legal nature involves a logical-semantic connection between the statics and the dynamics of this phenomenon. The advantage of the formed author’s position is a combination of statics and dynamics, which made it possible to analyse the issue of administrative and legal support for counteracting the economic shadowing using the ordering potential of administrative law science and allows covering by scientific analysis social processes in a combination of their social content and legal form. The given approach to the establishment of the ratio of the shadow economy and the shadowing of the economy makes it possible to systematize the determinants of shadowing. At the same time, the correlation of these phenomena with general criminality, including organized one, another crime in the sphere of economy, corruption, and other offenses in the sphere of the economy should be taken into account. Having determined that all these phenomena are not some kind of “components”, “sources”, “sectors”, “types” of the shadow economy, namely, their commission in the “plane” or “sphere” of the economy shadows it, it is possible to distinguish three main groups of determinants: 1) social; 2) economic; 3) legal. Specifying the types of determinants in accordance with the above list can be recognized as the task of the corresponding sciences and should be carried out within the limits of separate researches.

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