

Jumping At Shadows? Australia's Underground (Black) Economy In The Post-Covid Era

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This perspective represents the author's personal views and does not necessarily reflect those of any government agency.



Overview



The shadow economy: what is it?



Some international comparisons



The Australian experience



Recent reforms and emerging issues



What happens after Covid?

What Is The Shadow Economy?

- Multiple different definitions exist
- Unreported economic activities
- “Economic activities (whether legal or illegal) which required to be reported but are not” (OECD 2017: 9)
- Illicit money-making activities that essentially occur “off the books”
- Out of sight and awareness by regulators, policymakers, administrators, tax collectors and statisticians
- Includes both legitimate legal economic activities (should be reported but are not), as well as illegal behaviour

But does not cover voluntary work, charitable activities, DIY

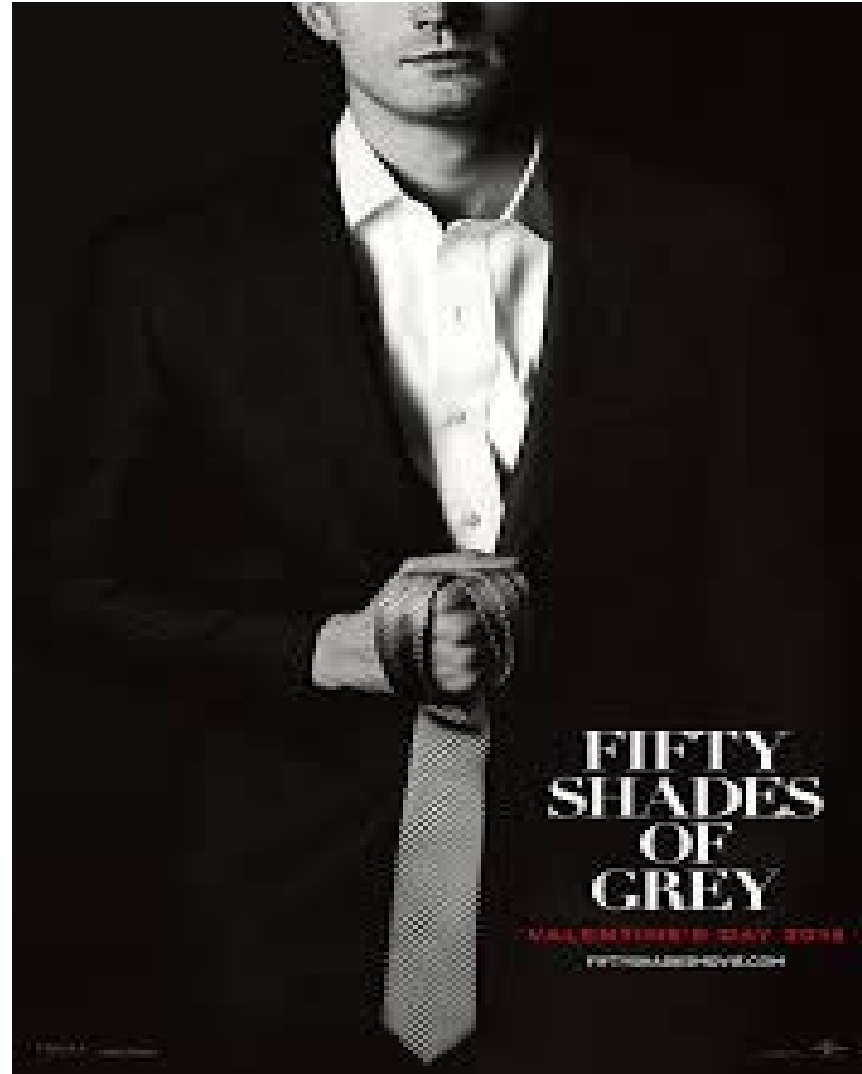
Typical Underground Economy Activities

- Employer fraud (wage theft)
- Unregistered businesses
- Unreported business earnings (ie “cash jobs” or “mates rates”)
- Unreported employment earnings (ie illegal immigrants)
- Fake/inflated invoices & receipts
- Phoenix companies
- Smuggling (ie illicit tobacco)
- Illegal drug manufacturing, distribution & sales
- Trade in stolen goods
- Tax ghosts (never register with ATO)
- Identity fraud
- Use of barter and cryptocurrencies
- Prostitution & gambling (where illegal)



Source: OECD (2017) *Shining Light On The Shadow Economy: Opportunities and Threats*, Paris: OECD, pp.10-11.

What's In A Name?



Also often known as ...

- Cash economy
- Black economy
- Parallel economy
- Grey economy
- Underground economy
- Hidden economy
- Non-observed economy



Why Does It Matter?

- Lowers government revenue (tax)
- = others pay more tax
- ... = reduced government services to the public
- Unfair competition to small legitimate businesses
- Put consumers at risk
- Worker exploitation
- Supports other serious crimes (people trafficking, money laundering, organised crime)



Ignorance

- Don't realise that income must be declared
- Can be unclear in some parts of tax and labour laws

Tax & Regulatory Burden

- Tax, wage bill is too great
- Too many rules to follow

Excluded Groups

- Illegal migrants, social security recipients, etc
- Unable to work in conventional jobs

Why Do Individuals Participate In The BE?



Opportunity

- Is it easy to cheat the system?

High Profits

- Make more \$
- More "take home" income than under licit systems

Low Risk Of Being Caught

- Weak compliance/enforcement systems
- Low chance of being audited
- No or low penalties

"Everyone Else Does It"

- Believe others are getting away with it
- Corruption
- Community acceptance/support

The Grey Economy Can Also Have Positive Effects



Much black money becomes white:

- About 2/3 of BE income is immediately spent in the official economy
- A positive stimulus on the formal/legitimate economy

Jobs and wealth are created:

- In developing countries, often only way to earn a livelihood
- But no wealth is shared with the public (government)

Many underground operators move to the legitimate arena:

- When opportunity arises and legal incomes increase (ie Canada)

How Can We Measure It?

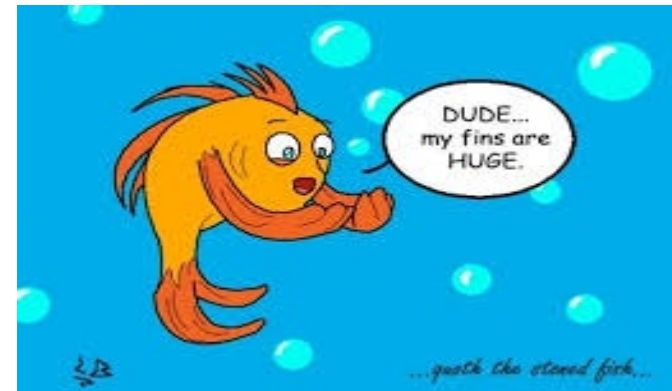
Difficult; no universal standard method or definition used

Direct approaches:

- Interview members of the public (informal work, informal buying/selling)
- Interview company managers (business turnover, wages reporting)
- Undertake tax audits

Measuring discrepancies:

- Between GDP income & expenditure
- Between official & actual labour force size
- Between estimated & actual tax collection
- Demand for currency (cash) & GDP
- Usage of physical inputs (ie electricity)
- Night lights (energy)
- Waste water (drugs)



Sources: Schneider, Friedrich and Enste, Dominik (2002) *Hiding In The Shadows: The Growth of the Underground Economy*, IMF Economic Issues No. 30, Washington DC: IMF, p.2; Medina, Leandro & Schneider, Friedrich (2018) *Shadow Economies Around the World: What Did We Learn Over the Last 20 Years?*, IMF Working Paper WP/18/17, Washington DC: International Monetary Fund.

Different Economies Have Very Different Levels of BE Activity

Regional Average, 2010-15	GDP %
OECD	15.28%
East Asia	21.24%
Middle East/North Africa	23.42%
South Asia	28.11%
Latin America/Caribbean	33.39%
Sub-Saharan Africa	36.16%
Global Average	31.9%

Source: Medina, Leandro & Schneider, Friedrich (2018) *Shadow Economies Around the World: What Did We Learn Over the Last 20 Years?*, IMF Working Paper WP/18/17, Washington DC: International Monetary Fund, Figure 3.4, p.58. Derived using MIMIC approach.

International Comparisons

BE tends to be highest in developing countries, lowest in OECD nations

Is lower in countries with

- low tax rates
- fewer laws & regulations
- clear efficient enforcement of the law
- well-established rule of law
- few self-employed workers



Source: Schneider, Friedrich and Enste, Dominik (2002) *Hiding In The Shadows: The Growth of the Underground Economy*, IMF Economic Issues No. 30, Washington DC: IMF, p.2.

Best (and worst) Global Performers, 1991-2015

Country Average, 1991-2015	GDP %
Switzerland	7.2%
USA	8.3%
Austria	8.9%
Zimbabwe	60.6%
Bolivia	62.3%
Georgia	64.9%

Source: Medina, Leandro & Schneider, Friedrich (2018) *Shadow Economies Around the World: What Did We Learn Over the Last 20 Years?*, IMF Working Paper WP/18/17, Washington DC: International Monetary Fund, Table 18, pp.50-54. Derived using MIMIC approach.

Global Trends & Evidence

More people move into the black economy when:

- Taxes increase too much
- Employment/labour laws and pay rates become too high
- Social security payments are too low or rules too difficult to comply
- Limits are placed on how many hours people can officially work

More people move out of the black economy when:

- Wages in the formal economy increase
- Corruption in official economy is reduced

Source: Schneider, Friedrich and Enste, Dominik (2002) *Hiding In The Shadows: The Growth of the Underground Economy*, IMF Economic Issues No. 30, Washington DC: IMF, p.2.



Cultural Views & Differences Also Matter

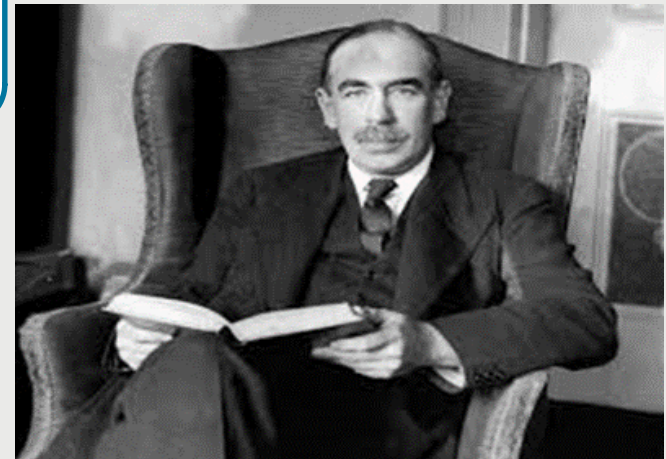


“Only fools
pay.”

Popular Italian saying.

“The avoidance of taxes is the
only intellectual pursuit that
carries any reward.”

John Maynard Keynes (1883-1946)



How Big Is Australia's Black Economy?

Several estimations:

- IMF: 12% of GDP in 2015
- ABS: 1.9% of GDP in 2012
- Black Economy Report: 3% of GDP in 2017 (= \$50 billion)



Sources:

Medina, Leandro & Schneider, Friedrich (2018) *Shadow Economies Around the World: What Did We Learn Over the Last 20 Years?*, IMF Working Paper WP/18/17, Washington DC: International Monetary Fund, Figure 3.4, p.58. Derived using MIMIC approach.
Treasury (2017) *Black Economy Taskforce Final Report*, October, Canberra: The Treasury, p.1.

Recent Australian Initiatives

- Ban on **sales-suppression software**/electronic tills
- **ABF**: Illicit Tobacco Taskforce seized 77+ tonnes (worth \$89m)
- **Treasury**: Black Economy Advisory Board meeting 2/3 times annually
- **11 agencies**: Black Economy Standing Taskforce operating
- **ATO**: bidders for major federal tenders must provide statement of their tax records
- **ATO**: Taxable Payments Reporting System (expanded from just building & construction to also now include others)
- **ATO**: 13,000+ business field visits
- **ATO**: Over 100,000 tip-offs to Tax Integrity Centre (hotline)

Additional \$1.5 billion revenue raised



What Next in Australia?

\$10,000 cash limit

- Governs business-to-business and business-to-consumer acts, not private ones
- Still to be legislated: *Currency (Restrictions on Use of Cash) Bill 2019* currently in Parliament (awaiting Senate consideration)

Illicit tobacco: ongoing area

Wage theft: continued area of concern

ABN reforms: reduce unused ABNs, require regular re-registration

Sharing economy: from July 2022, will be required to advise ATO what income payments have been made to whom



Did You Know?



There are over 500 billion
banknotes in circulation globally

Source: OECD (2017) Shining Light On The Shadow Economy: Opportunities and Threats, Paris: OECD, pp.16.



How Big Is The Typical Cash Transaction?

Reserve Bank of Australia 2016 consumer survey:

- Average cash transaction is **\$28**
- Cash is used for **2/3rds of all sales under \$10**
- Since 2007, **only 20 transactions** out of 5,700 persons surveyed (involving 82,000 transactions) were over \$10,00 – and none of these were in cash.

Source: Reserve Bank of Australia (2016) *2016 Consumer Payments Survey*, Sydney: Reserve Bank of Australia (available <https://www.rba.gov.au/payments-and-infrastructure/consumer-payments-survey>)

What Do We Use Our Cash For?

The Reserve Bank of Australia is the sole issuer and redeemer of Australian banknotes. It estimates that of all banknotes:

- 15–35% are used for legitimate transactions;
- 50-75% are hoarded/stored;
- 4–8% are used in the shadow economy;
- 5–10% are lost.



Source: Finlay, R.; Staib, A. & Wakefield, M. (2018) *Where's the Money? An Investigation Into The Whereabouts and Uses of Australian Banknotes*, RDP 2018-12, Sydney: Reserve Bank of Australia.

Not All Outcomes Are Predictable...



What Happens After Covid?

More electronic banking?

Reduced smuggling?

More illegal tobacco?

Easier compliance checking?



Reduced drug/cash trafficking?

A greater (or lesser) compliance culture?

More (or fewer) shadow businesses?

Useful Reading

Bajada, Christopher & Schneider, Friedrich (2005) "The Shadow Economies of the Asia-Pacific," *Pacific Economic Review*, Vol.10 No.3, pp.379-401.

Finlay, R.; Staib, A. & Wakefield, M. (2018) *Where's the Money? An Investigation Into The Whereabouts and Uses of Australian Banknotes*, RDP 2018-12, Sydney: Reserve Bank of Australia.

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Schneider, F. & Enste, D. (2002) *Hiding In The Shadows: The Growth of the Underground Economy*, IMF Economic Issues No. 30, Washington DC: International Monetary Fund.

The Treasury (2017) *Black Economy Taskforce Final Report*, Canberra: The Treasury, Commonwealth of Australia.

What Happens After Covid?

More electronic banking?

“Many of us have chosen to be cashless for the moment. I must say for my own business it has made transactions so much easier to manage ... I know the concept of being a cashless economy is often in discussion. I for one would support no wages in cash.”

Better intelligence?

“With the community preferring to have no contact transactions, the use of credit and debit cards is allowing us much better compliance and tracking ... ”

More illegal tobacco?

- *“During the lockdown here, beers and cigarettes were prohibited from being distributed and production ordered to stop ... As a consequence, the illicit/smuggled liquor, alcohol and cigarettes became rampant again to fill the void.”*

More small-scale, home-based businesses in future?

More businesses moving out of the regulated economy?