

Legalization of Shadow Economic Activity in Russia

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Abstract— The publication examines the current issues of a legal policy in relation to the shadow economy. The authors also estimate certain factors and conditions of shadow economy's determination. The scholars propose legal measures, institutional and economic arrangements to insure the rule of law addressed to business. The researchers observe a model of macroeconomic balance that incorporates the amount of the recovery of corruption proceeds and its effect. The paper makes the case for developing a long-term state strategy for the shadow business sector's shift to the formal economy. Moreover, it justifies the necessity for total monitoring the status and trends of shadow economic dynamism.

Keywords—shadow economic activity, legalizing the shadow economy, factors of shadow activity, multiplier of corruption seizures, supervisory authorities

I. INTRODUCTION

Recent global crises and upheaval gave more coverage to the role and place of shadow economic activity in society. Since a certain period, economic setbacks intended to cause progressive social dissonance. Shadow economic activity is usually considered as a negative phenomenon, which requires active and large-scale government countermeasures. Legalization of shadow economic processes is one of the most urgent issues of the contemporary economy. An acceptable solution to this problem provides social and economic development, as well as social and political state stability. In the present-day context the shadow economy has a key impact on socio-economic development of the state and the world economy in general [1]. The shadow economy and a problem of corruption in Russian society are closely connected. They are seen to be global factors that can slow down socio-economic development of the state at large. The enormous scale of the shadow economy running in different fields of economic setting substantially undermines social and economic capacity and opportunity to enact reforms. Thereby, this factor narrows financial resources as a state influence on the Russian economy. Thus, it contributes to foreign capital outflow abroad, predetermining the unequal distribution of

incomes among various groups in society. Funds held in the informal economy could take a major part in the economic growth of national economy and improve Russian citizens' welfare.

Although, Russia's integration into the world economy heavily depends on the state's policy success in bringing the grey economy into legality. Furthermore, the authors suppose that economic and social policy of Russia does not focus on the problem concerned in a proper way yet.

II. LITERARY REVIEW

It should be noted that the shadow economy used to be an issue of law -enforcement agencies' competence and the science of law, but is getting one of the significant subjects of Economics study today.

The general conception shared by economists, mentioned in this regard, means that the notion "shadow economic activity" cannot be defined by norms of current knowledge of law, i.e. is not considered to be legal. Nevertheless, a great deal of norms of criminal and administrative law provisions may and should be applied for legalization and effective fight against that phenomenon [2]. On the one hand, shadow economic activity is an economic phenomenon but not that of law. It reflects negative society processes [2]. This conclusion seems to be very judgmental because the issue of shadow economy is also the issue of law. The authors cannot disagree with the fact. On the other hand, it is not only a matter of law.

In the major concept of foreign Economic science, known as "Economics", the shadow economy is not considered as a subject of survey. This theoretical issue is the subject of research, first of all, carried out by institutional economists and scientists who undertake their studies combining law, economic, and social sciences. So, H. Abdel-Latif et al. and M. Hajilee et al. monitor the dynamics and impact of the shadow economy during financial crises [3, 4]. The works of W. Berger and others [5], A.N. Berdiev and J.W. Saunoris [6] are devoted to a driving force of the shadow economy in countries with leading economies. Peruvian economist H.D.

Soto proved the effect of the “illegal” sector in the economic system and responsibility that the state takes for its expanding [7].

The urgent issues of legalizing shadow economic activity and providing national security in the context of globalization are observed by F. Huang [8]. Well-known Russian scientists E.A. Kondrateva, V.A. Ostanin, Yu.V. Rozhkov et al. [9, 10] study these issues. M. Rochlitz, A.N. Pokida, L. Gaspareniene et al. [11, 12, 13, 14] estimated the dynamics of “shadow” processes. However, it should be pointed that these problems are not completely solved and require further study.

III. RESULTS AND DISCUSSIONS

To make arrangements for participating in the world This research is aimed at covering the concept of the shadow economic activity. It can clarify a range of recommendations on the generation and development of the system legalizing the shadow sector of Russia’s economy. Theoretical and methodological basis of the research are conceptual positions of fundamental and applied scientific works on the shadow economy issues introduced by leading Russian and foreign scientists.

After analyzing and synthesizing existing theoretical approaches to the interpretation of the current shadow economy the researchers could give the following definition. The shadow economy means a combination of various types of illegal, and (or) unobserved and (or) sham activities in order to gain an income; or the benefits that may be converted to things or services masked from official state authorities or unconcealed but not counted by official statistics agencies that cover all the stages of a public reproduction process for profit actually [1].

The shadow economic activity is based on operating destructive contradictions of the current social and economic system. However, since the shadow component is considered to be an essential component of any economic system, it should be influenced by bridging these inconsistencies. At the present time the Russian economy is featured by a steady growth and increasing diversity of shadow economy types that form the country’s criminalized economic life in general. “The shadow economy is not just a significant part of legal economy, but it keeps rising” [11].

There has also been an increase in focus on the issue. Thus, a number of papers devoted to the theoretical and methodological aspects of the research, development of methods used for quantitative evaluation, data collection and processing, and the methods of analysis have been increasing lately [11, 12, 15]. Even official figures show 50-65% of the specific growth of illicit economy achieved in Gross Domestic Product. The World Bank estimates that the shadow economy in Russia is now close to 49% of GDP [1].

It should be mentioned that the problem of counteracting shadow economic activity seems to be very contentious and disputed [1].

However, it is important to point out that there seem to imply the contrary points of view on the ways to solve the problem. They contain proposals for a global strengthening the

state law enforcement agencies to tackle the situation through essentially liberalizing processes of legal and regulatory framework [16, 17].

The effective social and economic policy of the state against the shadow sector of the Russian economy is supposed to be put into practice only if there is a balance of economic and administrative tools in the governance mechanism. But despite all the importance of the problem mentioned both in Russia and different regions, the authors cannot confirm any effective measures to legalize the shadow component of the national economy.

Thus, there is neither systematic monitoring of shadow economic activity, nor a unified national strategy, neither specially developed, adapted state programs to oppose nor legalize the shadow component of Russia’s economy. Decree of the President of the Russian Federation No. 208 dated of May 13, 2017 “On an economic security strategy of the Russian Federation rising 2030” requested to provide for state measures aimed at increasing corporate transparency of financial and investment activities of economic entities, including reducing incentives for tax evasion in the Russian Federation of offshore companies and ephemeral firms [18]. Nevertheless, from the researchers’ point of view, the state measures programmed under this decree do not cover the whole set of existing challenges, and unable to legalize shadow economic activity in all sectors of the Russian economy as much as possible.

It is important to note that legalizing the shadow economy for Russia specially means in present-day for facing the aggravating crisis under anti-Russian economic sanctions and the world economic so-called “exclusion” of the country [19].

A legit (open) economy hardly functions under these circumstances. Total generation of employment of labor force and a decent standard of wage is not available. To the contrary, newly emerging enabling environment pose the rapid development of an illegal (latent) part of the Russian economy. It is necessary to understand that shadow economic activity is one of the main factors destabilizing the domestic consumer market of the Russian Federation, social and economic crisis deepening even further, especially in the financial and investment fields. The growth of the shadow component of the national economy is prompted not only by economic crises, but the shadow economy relates to exacerbating the effects of crises [10]. The increasing shadow component in the crisis period of the Russian economy affects extremely heavily the state’s budget revenues. The monitoring revealed that the Russian budget has been currently suffering losses of revenues about 2 to 3 trillion rubles because of the unpaid revenues from shadow activities. [1].

Meanwhile, this amount will certainly increase in the face of possible aggravation of the socio-economic crisis. It is necessary to give sufficient attention to the main factors and objective reasons for emerging, functioning and developing shadow economic activity in order to determine the priority trends of state policy focused on legalizing shadow economic activity.

A very close connection, informal relations, and often merging of the shadow economy with state (public) authorities, and forming the operating “shadow power” is supposed to be one of the most important reasons for appearing and expanding shadow economic activity. Reviewing a link between shadow economic activity and shadow power in the state policy, some economists emphasize “... the peculiarities of this phenomenon, i.e. 1) interaction of three “shadow” fields: economy, politics, law; 2) systematic nature of political and economic “shadow” activities in Russia goes across the boundaries of individuals and groups and threatens the whole society; 3) realizing harmfulness of this process does not transform into proper countermeasures against “shadow” activity [20].

Moreover, there an “underground” segment of population is coming up, a clan-based corporate form of ownership takes place in the country, corruption relations are expanding for the benefits of a certain part of the ruling policymakers and representatives of power elite” [21]. As it seems to the scholars, merging of political state power and the shadow sector of the Russian economy is a significant and fundamental factor that causes shadow economic activity.

The negative consequences for the current Russian economy are observed in the resources obtained in the shadow economy. They must be “laundered” in a certain way. After that they may turn into the state financial resources. Besides, these invisible financial resources do not reduce the marginal propensity to consume. They become the objects that ought to be sustained, that are a transformed form of “thrift” with a negative effect and the “paradox of thrift”. In the authors’ opinion, these resources will not contribute to an increasing aggregate demand for domestic goods; they are rather able to deal with the problems of employment, economic growth not in Russia’s economy, but in foreign countries [22].

That means that a large percentage of the income obtained by procedures providing tax exceptions is confiscated from domestic business entities, and this fact cannot be overlooked by economic science.

The authors observe the model of macroeconomic balance considering the effect of total corruption seizures:

$$\Delta Y_o = c^* Y_o \Delta W / (1 - c^* (1 - t - w)),$$

where

c^* is the marginal propensity to consume in the national economy after decreasing the initial income Y_o by the amount of tax paid at the tax rate (t) and the share of seizures from income by corrupt segments (W);

t - Income tax rate;

w - Bureaucratic seizures coefficient.

According to the given model it can be seen that the economic consequences of corruption seizures are similar to those of reducing or increasing the tax burden on the consumer sector of the economy or on business.

$\text{Mult}(w) = \Delta Y_o / \Delta w = 1 / (1 - c^* (1 - t - w))$ is the multiplier of corruption seizures [10, p. 67].

It is a kind of responsibility for inertia on the part of the state in the fight against corruption in the economy, politics and other fields of Russian reality. Moreover, it is necessary to highlight that the state on its own paves the objective socio-economic and legal way for appearance and expansion of shadow economic activity [10].

These conditions include strong measures of legislative regulation (for example, in tax legislation), which drive business entities into the “underground”; lack of a common permanent control over the enforcement of laws and respect of legal and regulatory provisions, which enables the shadow business to work beyond legislation; lack of proper control over the use and involvement of the shadow sector in a production of some state's natural resources nearly free of charge; the shadow economy’s use of gratis mainly of state production infrastructure funded by tax money; application and involvement of human capital, trained by the state education system funded from state public funds, and so on. It is obvious that the state maintains the same conditions not only for the shadow sector of the Russian economy, but the latent sector, which unlike the open (official) sector does not pay taxes to the state budget and does not participate in setting up public funds, through which the state promotes such conditions.

Although, since the shadow sector of the Russian economy takes an active part in the social reproduction process, it seems difficult to distinguish between open and shadow activities in this process. The state has to establish conditions that are more conducive to emerging and growing shadow economic activity. It needs to be noted that nowadays there is not a clear line between illegal and legal activities any more, which makes it difficult to develop a full set of effective measures to reduce business activity in the shadow economy. One of the most important drivers for this process is a very simple mechanism of money laundering, which the informal economy earns. So, at present there is an urgent need to develop a state strategy to legalize shadow economic activities that would allow reducing the shadow sector of the Russian economy.

Legalizing (laundering) anti-money is giving a legal form to the possession, use or disposal of funds or other property obtained through committing a crime (except the crimes under articles 193, 194, 198, 199, 199.1 and 199.2 of the Criminal Code of the Russian Federation) [10]. It is believed that legalization is a component of any criminal activity, a core element of the criminal economic cycle - the process of the consistent change of separate stages necessary for operating and constant renewal of shadow economic activity [23]. As the international experience [23] has shown, fight against shadow economic activity through repression and regulatory pressure is ineffective. Therefore, it is necessary to search for economic and political solutions that would contribute to a symmetrical interaction between the state and other subjects of economic relations. That is why it is necessary to search for economic and political solutions that would contribute to a balance in the relations between the state and other subjects of economic relations. Thereby, H.D. Soto truly could say that in order to counteract the development of the shadow economy,

it is necessary to bring the legislative system closer to the existing reality [7].

In view of the foregoing, it is believed to be important to remove barriers slowing down the process of integration of the legal and unobserved economy, and shape a unified, interrelated legal and economic system. Consequently, there is a need to run a detailed economic and legal monitoring of shadow economic activities to develop effective ways to reduce their number. At the same time, the authors believe that combating the shadow economy is even more difficult than knowing the actual extent. The main goal is legalizing shadow activities in Russia and the reduction of the volumes of the criminal component.

Since many factors and conditions have a great impact on the illegal (latent) economy, the approaches for reducing its rate should also be comprehensive, including economic, political, social and legal aspects. The authors believe that to arrange such scientific study, it is useful to initiate planned scientific research and constant monitoring condition and trends of shadow economic activity in the state as a whole and at the regional level. To do this, one needs to build a special multi-level analytic system; develop and implement a scientifically based strategy for legalizing the shadow sector of the Russian economy; determine and justify measures of state policy on legalization of shadow activities for a long period; develop the state target program on legalization of the shadow economy sector for the medium-term period. To solve vital and basic tasks effectively, it is necessary to conduct a whole range of legal, organizational and economic measures to maximize a possible provision of legalizing shadow economic activities that had been outlined above.

IV. CONCLUSION

As evident from the above, there may be summarized as follows. So, it is necessary to establish a state system functioning effectively. Within that structure federal and regional sectoral institutions and functional ministries and departments, municipal authorities will perform the function of the development and provide the state support of business activities. The agencies of the Ministry of Internal Affairs will guarantee functioning of business structures in accordance with the laws. The Federal Internal Revenue Service will ensure their state registration, tax records, income taxation accuracy and completeness. Government Service authorities will enable the validity of business statistics.

In the authors' opinion, such kind of arrangements, which are looked ahead, adopted and approved by law, will allow not only legalizing shadow economic activity, but also more favorable conditions for the entrepreneurship development, further strengthen and increase legal (formal) economic development. Public intervention in the informal sector of economy is required but it cannot be regarded as a temporary campaign necessitated by any pre-completion views. It should take the form of an integrated program of public policy, designed for a long period of time.

The effective public policies in minimizing the negative effect on the economic, political and social environment of a growing amount of the shadow economy will be determined

mostly by scientific credibility of theoretical and methodological principles, state management tools of the economy and appropriate assessment of clandestine activities. Nevertheless, the implementation of the state social and economic strategy aimed at legalization of the shadow economy sector should not be shocking, but must be consistently applied. That will facilitate the greatest effect.

The outcomes that the state will achieve in legalizing shadow economic activities are going to be determining in choosing the main way of the national economy and social development in general.

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