



Abstract

- The potential economy of a country is the total sum of GDP and a “second economy” comprising several components in the form of informal / irregular / shadow / unobserved / parallel / underground – economy
- The second economy can result to substantial economic and societal impacts, unless it is efficiently monitored and enforced effectively.
- This study aims to provide more insights into the characteristics and size of the second economy for further remedial actions.
- The scope of this study is the “underground economy” (UE), presumably escape taxes. UE is defined as the sum of irregular economy (legal activities that escape taxes) and illegal economy (illicit activities which naturally escape taxes to avoid detection).

Problem Statement

- The “second economy” has a considerable short term positive economic effects in terms of employment creation as part of survival strategies to make ends meet.
- However, in a long run mainstream economy, the negative effects would outweigh the benefits of life line and redeployed profits.
- The ultimate negative impacts can be very costly. Literature indicate UE associates with; deterioration in public finances, policy crises and distortion of the state economic structure. Proxies for UE include; inefficient goods and labour markets; dubious statistics; deprived worker’s rights; and diverted finances through tax non-compliance.

Research Questions

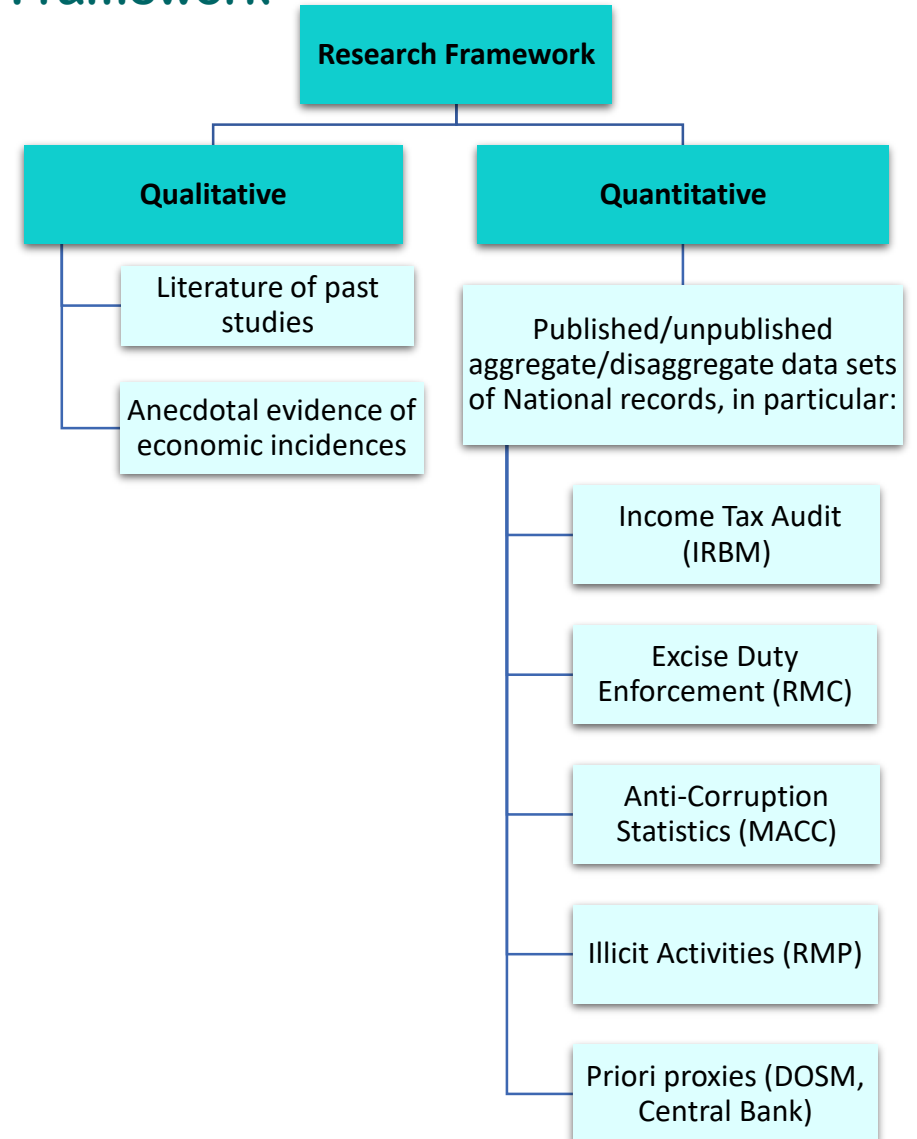
- i. Malaysia lacks empirical studies about the “second economy”.
- ii. We ordinarily believe the existence of the UE, however sceptical about the size and effects.
- iii. Past studies result to a wide range of estimates.
- iv. How can we justify the adequacy and reliability of the estimates of the UE?

Objectives

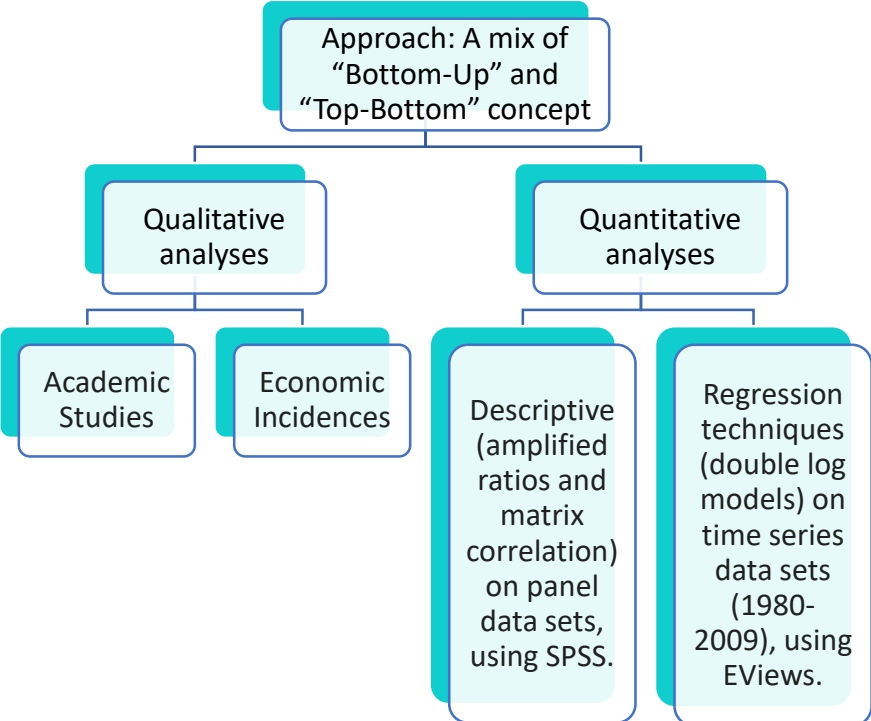
To document the evidence of the UE in Malaysia according to:

- i. Economic incidences of observable traces (proxies) of the UE
- ii. Empirical estimates of the size and growth of the components of UE by; institutional and individual participants
- iii. Characteristics of UE by; business sectors, income level and income distribution
- iv. Economic association of UE with priori proxies; macro indicators; negative indexes,
- v. Remedial efforts and effects on the UE

Framework



Methodology



Findings

- Literature studies highlighted the natural existence of UE with positive and negative effects on the economy and society. Growth and size of UE is between 4% (developed countries) and 60% (developing countries). UE associates with priori proxies implying some causal effects of intervention.
- “Negative” economic incidences in Malaysia compel visibility of proxies and putting forward for a flourishing UE, and spurring calls for quantitative examine on the size, trend, characteristics and correlations.

- Quantitative findings are within empirical estimates/characteristics of UE in Malaysia:
 - 5-Model size range cyclical over a period
 - Size of UE between 20% and 50% of the GDP, size of tax loss between 9% and 27% of the GDP
 - Downward trending using time series 1980-2009 statistics
 - Cyclical behaviour in contrast to the Official Economy magnitude, implying a “complementary and shift” phenomenon
 - Characteristics of UE: associates positively with income invisibility and opportunities of private benefits. While, UE associates negatively with law enforcement on violations. Different correlations were observed among various economic sectors/income level/income distribution.
 - In long run, UE correlates with macro variables in “correct” signs. UE increases with CPI, GDP per capita, economic crises, cash in circulation, electricity consumption, and pro-cycle to taxes.
 - Remedial efforts in terms of federal expenditure, suppress UE in relative size and growth. However in terms of amount, UE continue to increase, denoting a trending sizeable budgetary deficit.

Conclusion

- This study indicates a more insightful estimates of UE with characteristics inferring to economic Incidences in Malaysia, perhaps the norm for developing countries.

- The methodology employed contribute to the body of knowledge about estimating the “second economy”.
- The priori UE economic association infers inter-temporal development, for formulating effective national policy measures.
- The characteristics of UE are important information in designing policy and operating measures (efficient monitoring and effective enforcement).

Research Gap

- There may be some sceptical views about the characteristics and size estimates, as findings are unique with respect to (w.r.t) stratified sampling. Correlation between UE and macro variables indicate insignificant causal association, likely due to the complexity of economic interactions. People participate the UE for too many reasons.
- Nevertheless, there is no other choice than making “heroic” assumptions, when analysing an invisible variable using proxy variables, to mirror the population.
- Future studies should include structural measures using recent time series and panel proxy data. It would also be useful to view opinions from the public and authority with regards to perceive of “bucking” the system and “tackling” the constrain, respectively.