

-
- Visegrad Fund
-
-



Shadow economy in Ukraine: causes and solutions

Ukraine's shadow economy in relation to GDP (%)



Year	Evaluation by the method of the State Statistics Service of Ukraine	“Household expenditure – retail turnover” method	Electricity method	Monetary method	Unprofitable enterprises method	Aggregate demand – aggregate supply method	The Prof. Friedrich Schneider’s method
2004	18,9%	33,5%	28,0%	29,5%	25,0%	39,0%	49,0%
2005	18,1%	46,5%	28,0%	25,0%	24,0%	37,0%	48,0%
2006	17,3%	40,5%	27,5%	24,5%	23,5%	33,5%	47,0%
2007	15,5%	38,0%	27,0%	26,0%	24,0%	34,5%	47,0%
2008	15,1%	40,0%	26,0%	38,0%	30,0%	35,5%	46,0%
2009	16,1%	45,0%	35,0%	40,5%	31,0%	30,0%	46,0%
2010	16,5%	44,0%	37,0%	30,0%	31,0%	33,0%	45,0%
2011	16,0%	44,0%	37,5%	27,0%	31,5%	34,0%	44,1%
2012	-	The integral indicator of the shadow economy – 32%					-
2013	-	The integral indicator of the shadow economy – 35%					-
2014, Ikv	-	The integral indicator of the shadow economy – 40%					-

The share of shadow economy in Ukraine is calculated by various estimation methods according to Ukrainian Ministry for economic development and trade



- The “household expenditure — retail turnover” method is based on the finding to which extent consumer expenditure on commodities surpasses a gross sales volume.
- Electricity method is based on the comparison between the growth of total domestic electricity consumption and GDP growth.
- Monetary method lies in tracking changes in correlation between cash and deposits over a specific period.
- Financial method is based on the measurement of changes in the ratio of the cost of goods, labour and services used in production to the gross profit of enterprises in country in general or in the form of specific economic activity.

According to fiscal bodies estimates, the total size of the shadow economy in Ukraine in 2012 totalled at least UAH 350 billion per year:



- The conversion of non-cash money into cash or FX deposit accounts in foreign banks was worth UAH 100 billion.
- The size of the shadow wage in Ukraine reaches UAH 170 billion.
- Unofficial payments — UAH 35 billion.
- Shadow fixed assets, tangible assets and services — UAH 45 billion.

In 2013, approximately UAH 250 billion of Ukrainian tax payers money was circulating in the shadow economy



- 41% of public procurement was done by state and municipal enterprises without tenders.
- According to the Security Service of Ukraine, 50–75% of public funds during public procurement are allocated with multiple violations.
- Due to corruption schemes in public procurement, financial losses account for 10–15% (UAH 35–53 bln) of budget expenditure annually.



- According to the International Labour Organization, the size of the shadow economy in Ukraine is about 9%.
- According to the Institute for Economics and Forecasting, in 2012 the share of Ukrainian citizens working in the shadow economy was 16.61% of employed population.
- According to the Confederation of employers, 5–7 million Ukrainians work “in the shadow”.
- In January-October 2013 the Ministry of tax and revenues of Ukraine identified more than 80,000 unofficial workers.
- According to trade unions, the size of the shadow wage in Ukraine reaches UAH 200 billion annually, while, according to tax authorities, this figure is UAH 170 billion annually. The size of the shadow wage in Ukraine reaches UAH 170–200 billion annually.

A negative tendency as to the shadow economy is characterized by various international ratings, in which Ukraine has one of the lowest places in various international ratings

	Economic Freedom Index, 2014	Corruption Perception Index, 2013	Doing Business, 2014	World Competitiveness Report, 2014–15	Shadow Economy Index, 1999–07
Ukraine	155 (out of 186)	144 (out of 177)	112 (out of 189)	76 (out of 144)	145 (out of 162)
Source:	Heritage Foundation	Transparency International	World Bank	World Economic Forum	Schneider, Buehn, Montenegro

The most significant factors of shadow economy



- Ineffective state economic regulation.
- Ineffective tax administration.
- Labour market problems associated with low economic incentives for official employment and growing unemployment rate.
- Inadequate monetary regulation.
- Imperfection of budget system, low control over use of budget funds.
- Imperfection of judicial and law enforcement system.
- Crime rate.

Reforms needed to fight against shadow economy in Ukraine



1) The enhancement of market economy regulation and implementation of anti-corruption reform:

- It is necessary to introduce economic regulation with new structure and principles.
- The biggest efforts should be aimed at institutional reform and legal enforcement of special measures aimed at corruption prevention and punishment.
- The enhancement of IT-infrastructure of public administration
- Increase in business confidence in state.



- 2) Tax reform should be directed towards the implementation of the following priorities:**
- Equal tax conditions for all economic agents.
 - Lower tax burden.
 - Effective tax administration and public finances stability.

Reforms needed to fight against shadow economy in Ukraine



3) Measures of tax reform:

- To conduct tax amnesty based on transparent and clear procedure that will increase business confidence in state bodies, and vice versa, and increase budget revenues.
- To enhance the role of electronic systems in tax administration which will allow for less physical contact between tax officers and tax payers, and enhance the transparency of tax control.
- To lower tax burden, decrease the number of obligatory payments and tax privileges which will ensure equal opportunities for all taxpayers and stimuli for tax obligations minimization.
- To reform the simplified system to include only small enterprises and prevent it from being an instrument for shadow financial flows.
- To solve problems with VAT reimbursement to support export and enhance business confidence in state.
- To enhance responsibility for the use of shadow tax schemes and deliberate minimization of tax obligations.



4) Banking system reform

- Promotion of clearing operations will allow for better control over the source of revenues.
- The introduction of amendments to the legislation as to ensuring the disclosure of information about the final bank owners and non-bank financial institutions.
- The enhancement of transparency of the National Bank of Ukraine as to the bank refinancing, floating FX rate, and nationalization of banks, which are commercially frail and may be sold at a fair price.
- The counteraction to the outflow of national capital to low-tax countries, the development of effective system to return money and assets from abroad which were received through illegal practices, such as money laundering and terrorism financing.

Reforms needed to fight against shadow economy in Ukraine



5) Labour market reform

- A pre-condition for fight against shadow labour market is **pension system reform** — the existing pension system does not favour the market coming out of shadow, payments into pension fund are pitched too high, given inadequate pension system.
- **For business**, it is necessary to increase the use of administrative measures, in particular , strengthened accountability for evasion of registration of labour relations between the employee and the employer as well as tax evasion and social security contributions evasion.
- **For employees**, it is necessary to redistribute tax burden between the employee and the employer, to lower tax burden. It can be achieved only if the state changes the Single Social Payment and income tax level, with the enterprise increasing their official average salary.
- **For state bodies**, it is necessary to adhere to the Tax Code provisions. One of the main problems is the excessive frequency and unpredictability of amendments to the Tax Code. For this reason, the adherence to the Tax Code as well as high-quality analysis of draft amendments to the Tax Code will mitigate risks for economic activity and improve the budget planning of the organization. It is necessary to strengthened accountability for evasion of registration of labour relations.



6) Justice reform

- **Justice reform** should be directed at ensuring the fair justice and implementation of decisions of courts of law, protection of property right, fight against raids.
- The implementation of justice reform should result in lower corruption level , increasing professionalism of judges and law enforcement bodies, enhancement of judicial independence from political processes, enhancement of constitutional justice and ensuring of transparency and impartiality of court proceedings.