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)

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)
Why Do Individuals Participate In The BE?

**High Profits**
- Make more $ 
- More “take home” income than under licit systems

**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

**Opportunity**
- Is it easy to cheat the system?

**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 (i.e., electricity)
- Night lights (energy)
- Waste water (drugs)

Different Economies Have Very Different Levels of BE Activity

<table>
<thead>
<tr>
<th>Regional Average, 2010-15</th>
<th>GDP %</th>
</tr>
</thead>
<tbody>
<tr>
<td>OECD</td>
<td>15.28%</td>
</tr>
<tr>
<td>East Asia</td>
<td>21.24%</td>
</tr>
<tr>
<td>Middle East/North Africa</td>
<td>23.42%</td>
</tr>
<tr>
<td>South Asia</td>
<td>28.11%</td>
</tr>
<tr>
<td>Latin America/Caribbean</td>
<td>33.39%</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>36.16%</td>
</tr>
<tr>
<td>Global Average</td>
<td>31.9%</td>
</tr>
</tbody>
</table>

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

## Best (and worst) Global Performers, 1991-2015

<table>
<thead>
<tr>
<th>Country Average, 1991-2015</th>
<th>GDP %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Switzerland</td>
<td>7.2%</td>
</tr>
<tr>
<td>USA</td>
<td>8.3%</td>
</tr>
<tr>
<td>Austria</td>
<td>8.9%</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>60.6%</td>
</tr>
<tr>
<td>Bolivia</td>
<td>62.3%</td>
</tr>
<tr>
<td>Georgia</td>
<td>64.9%</td>
</tr>
</tbody>
</table>

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

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:
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.

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.

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.

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


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?