



Global Advanced Research Journal of Management and Business Studies (ISSN: 2315-5086) Vol. 3(6) pp. 230-241, June, 2014
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Review

The Size and Development of the Nigerian Shadow Economy and the Rising Poverty Level: A Comparison with other 37 African Countries in 1999 - 2008

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Accepted 27 June 2014

An exploration and elucidation is given concerning the more particular issues pointedly concerned with the impacts of: underground economy on poverty level in developing economies; this relationship, with a particular linkage to Nigeria economy. Since 1990, the problems caused by the shadow economy activities have become a major concern for government officials and policy makers, which therefore, caused an increased attention among researchers, economic communities, and social scientists. Prior to; it seems that the economic profession, immersed as it was in its theories, could not cope, or was unwilling to cope with the messy world of the shadow economy. However, some researchers have started to go beyond ignoring the topic and begun to be interested in the study of the impacts of shadow economy on the official economy; how it inhibits development, and promote poverty in developing economies. Beginning from 2005, the academic and political debate on development finance and development aid has raised the issue that shadow economy may undermine the ability of countries to finance their public sectors. This view is based, among other things, on the perception that shadow economy in countries is becoming larger than can be imagined. Ever since, the relationship between underground economy and poverty level in developing countries begin to be much more complex than the economic theory of crime suggests.

Keywords: Size and Development, Nigerian Economy, Poverty.

INTRODUCTION

The period after World War II was marked by a rise in migration from the rural to urban areas in both developed and developing countries (Amar, 2004). During this period, colonies of Africa, Asia, and Central America achieved independence during the 1950s and 1960s. Together, these factors contributed to the emergence of what is known as the shadow economy (Afonso, Schuknecht, and Tanzi, 2006; Otusanya, 2008). In those days, the concept of the shadow economy was originally derived from the literature on problems of developing countries (Dell'Anno and Solomon, 2008; Gerxhani, 2004). Researchers in various disciplines determined that large groups of the population in developing countries were not absorbed in the modern economy. In 1963, the eminent cultural anthropologist, Clifford Geertz introduced two terms for this phenomenon: the firm-centered economy and the bazaar economy (Dell'Anno and Solomon, 2008; Geertz, 1978). Since then, underground economy has become a topic for regular academic research (Schneider and Enste, 2003). Over the years, numerous studies have emerged, analyzing it in developing and developed countries, as well as in countries in transition from socialist to market oriented economies (Schneider and Enste, 2000). The term *shadow economy* is variously defined and has been discussed under many different names: informal, unofficial, irregular, parallel second underground, subterranean, hidden, invisible, and unrecorded, or moonlighting (Elijah and Uffort, 2007; Feige and Urban, 2008; Torgler and Schneider, 2007).

The term shadow economy or underground economy refers to unreported or untaxed economic activity (Kelly, 2007). Shadow economy is also defined as the concealment of all market-based legal production of goods and services from public authorities (McGee, 2005; Schneider, 2007). No single definition exists for shadow economy; rather, its definition depends on the purpose of the researcher (Feige and Urban, 2008). The most precise and widely used definition of shadow economy relates the underground economy (unofficial income) to officially measured national income. According to this definition, the shadow economy consists of all currently unrecorded productive or value-adding activities that should be in the gross national product (GNP) (Schneider, 2000; Torgler and Schneider, 2007). This definition allows policy makers and

economists to compare and to add the underground economy to the gross domestic product (GDP).

On the other hand, a cursory review of the required literature demonstrated that poverty in developing countries was influenced by a number of factors such as: underground economy and corruption. For countries all over the world, there are several important reasons for concern about the size, growth, and the impacts of the shadow economy on poverty level (Dreher and Schneider, 2006). Chief among them is that, an increase in the size of the underground economy is mainly caused by a rise in the overall burden of tax and social security payments by taxpayers (Schneider, 2006; Torgler and Schneider, 2007). The increase in shadow economic activities, corruption, and then, poverty level will subsequently, lead; to erosion of the tax and social security bases, and lastly; to decrease in tax receipts for governments (Elijah and Uffort, 2007; Schneider, 2000; 2005). The consequence would be a further increase in the budget deficit or further rise of direct and/or indirect tax rates. Shadow economic activities would then increase (Schneider, 2007).

Other reason for concern about the presence of shadow economy is that when the shadow economy grows, economic policy is based on erroneous official indicators, such as unemployment, official labor force, income, and consumption (Rockwool Foundation, 2008). In such a situation a prospering shadow economy may cause the government severe difficulties, because it provides unreliable official indicators. The very direction of intended policy measures may therefore be questionable. Additionally, a rising underground economy can be seen as a reaction by individuals who feel overburdened by state activities, such as high taxes and an increasing number of regulations (Schneider, 2005).

Furthermore, a growing underground economy may offer strong incentives to attract workers, both domestic and foreign. These workers would then contribute less within the official economy (Dreher and Schneider, 2006; Schneider, 2000). These growing concerns have led many economists to the challenging and difficult task of measuring the size and development of the shadow economy, to trace back its main causes, and to analyze the interactions of the official and unofficial economies (Feige and Urban, 2008; Schneider and Burger, 2005).

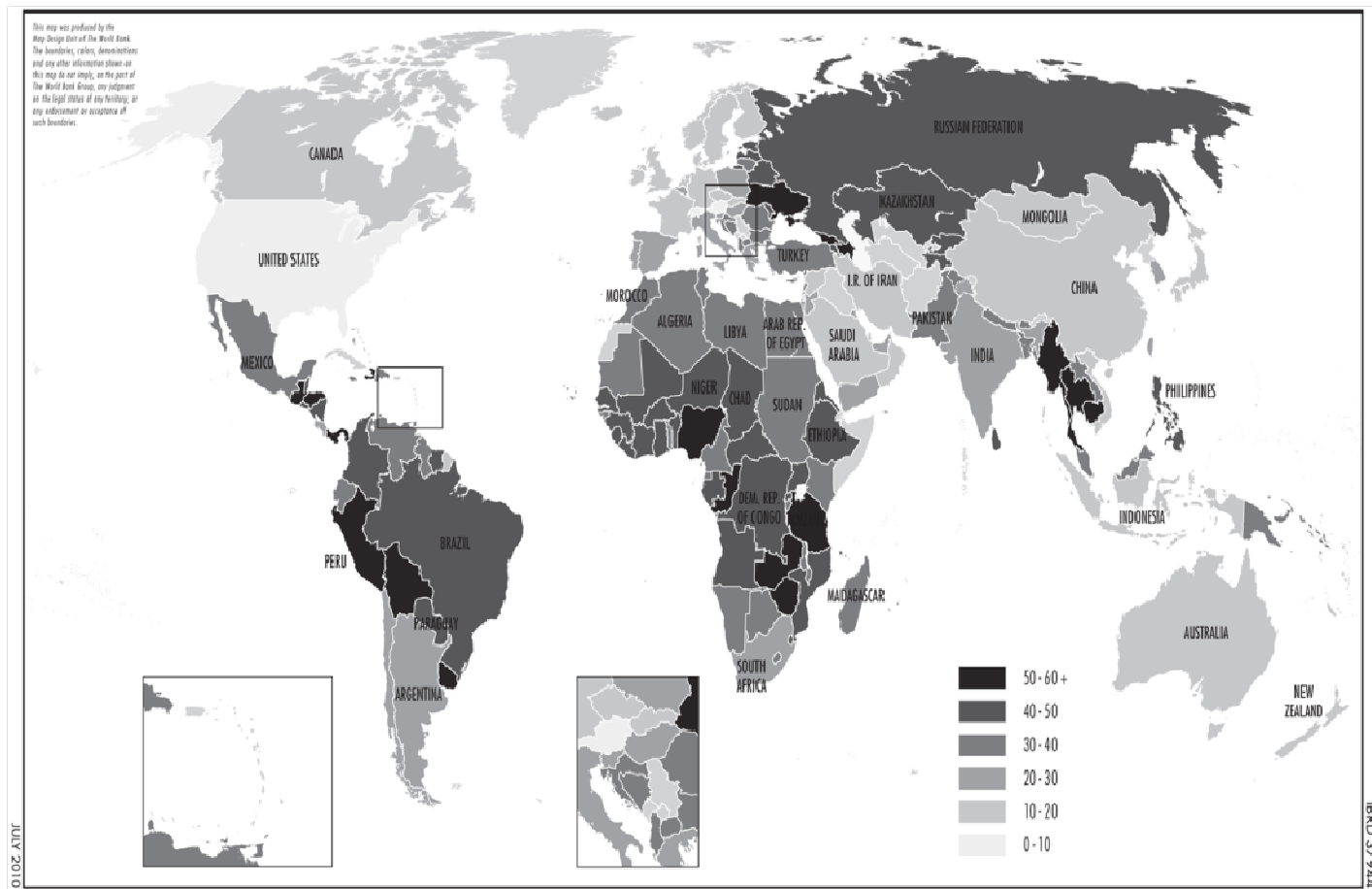
Theoretical Framework

Poverty and underground economy are serious problems with corrosive effects facing many countries (Fisman and Svensson, 2007). Poverty is currently one of the most serious problems in the World. Estimates indicated that about 1.5 billion people live below the poverty line of less than one dollar per day in the whole world. Out of the 1.5 billion people, Africa contributes about 250 million, which is about 17% of the world's total poor population (Elijah and Uffort, 2007; Pickhardt and Shinnick, 2009). According to Elijah and Uffort (2007), the developing countries have the highest and increasing rate of shadow economy and poverty level when compare to the transitional and OECD countries. Figure A1; present the shadow economy measurement country-by-country in a world map view. Countries shown with darker colors in Figure indicate higher levels of informality and higher percentage of poverty to the country's population. Chief among them: Nigeria, Azerbaijan, Bolivia, Georgia, Peru, Panama, Tanzania, and Zimbabwe. Countries shown with lighter colors indicate countries with lower levels of shadow economy and lower poverty rate to the country's population. Among them: Austria, Japan, Luxembourg, Switzerland, the United States, and the United Kingdom. According to the World Bank report (World Bank, 2010), over 70% of Nigeria 170 million people are leaving below poverty level. Poverty is multidimensional phenomenon with physical, economic, social, and psychological dimensions (Whelan and Whelan, 1995; World Bank, 2002; Narayan et al., 2000). Based on its multidimensional scenery, poverty is usually perceived using different criteria (Elijah and Uffort, 2007; Gerring, Bond, Barnst, and Moreno, 2005). This accounts for the copious attempts in defining poverty; each definition tries to capture the perception of the author or the poor as to what the term is. As poverty increases in countries of the world, there also appears a strong indication about the increasing rates of shadow economy around the world (Elijah and Uffort, 2007; Schneider, 2005). Although quite a large amount of literature has been published on single aspects of the shadow economy or underground economy, and a comprehensive survey has been written by Schneider and Enste (1989; 1999; 2002), the subject is still quite controversial with some disagreements about the use of shadow economy estimates in economic analysis and policy aspects as well as causes of shadow economy with regards to poverty (Colin, 2009; Elijah and Uffort, 2007; Obayelu and Uffort, 2007).

There is yet no universally accepted definition of poverty. There is always the difficulty in deciding where to draw the line between the poor and the non-poor (Portes and Haller, 2005). Poverty has been perceived by many as not just lack of money, food and assets but also as lack of access to education and health care and lack of security, dignity and independence (Elijah and Uffort, 2007; Narayan and Petesch, 2002; Portes and Haller, 2005). Narayan and Petesch succinctly posit that, poverty also may look quite different, seen through the eyes of a poor man or a woman. This is reflected in the differences in the various definitions captured from the point of view of the poor in different countries.

Poverty can be categorized as either relative or absolute on one hand, while on another, it can be classified as permanent or transient. Aboyade (1975) explained absolute poverty to be the condition where an individual or group of people are unable to satisfy their basic requirements for human survival in terms of education, health, housing, feeding employment, and transportation. Corroborating Aboyade's meaning of absolute poverty, Aliyu (2003) defined poverty as the insufficient or total lack of necessities and facilities like food, housing, medical care, education, social and environmental service, consumer goods, recreational opportunities, neighbourhood amenities and transport facilities. What is considered poverty level in one country or community may well be the height of well being in another (Elijah and Uffort, 2007). This therefore, infers that poverty may be seen in relative terms. Relative poverty, according to Aliyu (2003) is a situation where an individual or group of people can be said to have access to his/their basic needs, but is comparatively poor among persons or the generality of the community. The people are degraded; they live outside the grades or categories which the community regards as acceptable (Elijah and Uffort, 2007).

In general, the basic causes of poverty in many countries include: macro-economic distortions or inappropriate macroeconomic policies, low or negative economic growth, effects of globalisation, governance, corruption, debt burden, low productivity and low wages in the informal sector, unemployment or deficiencies in the labour market resulting in limited job growth, high population growth rate and poor human resources development etc (Elijah and Uffort, 2007; Obayelu and Uffort, 2007; Portes and Haller, 2005). These may differ from country to country depending on the level of economic development. Other factors, which have



World Map View of Shadow Economy

New technology also allows us to present the informality measurement country-by-country in a world map view. Countries shown with darker colors in Figure indicate higher levels of informality. Among them: Azerbaijan, Bolivia, Georgia, Peru, Panama, Tanzania, Nigeria, and Zimbabwe. Countries shown with lighter colors indicate countries with lower levels of informality. Among them: Austria, Japan, Luxembourg, Switzerland, the United States, and the United Kingdom. (See, figure A Above).

contributed to a decline in living standards and structural causes or determinants of poverty, include increase in crime and violence, environmental degradation, retrenchment of workers, a fall in the real value of safety nets, and changes in family structures (Elijah and Uffort, 2007; Obayelu and Ogunlade, 2006). In addition, the poor in an attempt to survive due to the failure of government intervention embark on series of strategies to cope, while the urban poor in developing countries like Nigeria, utilize and employ the following strategies: relying on God for provision, Job diversification (old Jobs, multiple Jobs petty trading), resulting to shadow

economic activities, dependent on contribution and loans from churches and other associations, migrating from urban to rural villages, return to farming, borrowing from family, friends and cooperative societies, Sale of farm products, human trafficking, and Sale of own labour (Elijah and Uffort, 2007; Miller, 2007; Obayelu and Uffort, 2007).

Relationship between Shadow Economy and Poverty

On the relationship between shadow economy and

poverty, Obayelu and Uffort (2007) studies indicated there is a causal relationship between shadow economy and poverty in developing countries. Obayelu and Uffort studies found that, lack of job within the formal economy, high rate of corruption, economic hardship, and lack of enough money for a living as the common causes of both poverty and shadow economy in developing countries. Though, other causes such as the government bureaucratic bottlenecks and high tax burden strongly accounts for shadow economy in developing countries, they are however not strong factors affecting poverty in Nigeria (Elijah and Uffort, 2007; Obayelu and Ogunlade, 2006). This shows that factors leading to high level of shadow economy in developed countries does not necessarily account for the high rates of shadow economies in the developing countries like Nigeria with low social security system and burden of taxation not as high as in the highly developed countries but with large shadow economy (Elijah and Uffort, 2007; Fuest and Riedel, 2009; Obayelu and Uffort, 2007; Portes and Haller, 2005).

In their studies, Obayelu and Uffort (2007) compared the size of shadow economies with the rates of poverty in different countries of the World and found that, shadow economy activities form a bigger part of economic activities in developing countries than in developed ones. Obayelu and Uffort also found that in Nigeria, the rate of poverty is going up substantially, while the shadow economy is not increasing as fast. The study shows that, although poverty can cause shadow economy, the factor itself is not sufficient for increasing size of shadow economic activity. In addition, according to these studies, there is no one cause or determinant of poverty, because amalgamation of several complex factors contributed to emergency of poverty, so also there is no one cause for the existence of shadow economy (Elijah and Uffort, 2007; Cusack and Beramendi, 2006; Doessel and Gounder, 1994). There seems to be narrow disagreement on the causes of poverty and shadow economy as against the difficulty encountered in arriving at a universally accepted definition of the two terms (Fuest and Riedel, 2009; Obayelu and Uffort, 2007; Schneider, 2006).

In view of the reviews and findings from other works on shadow economy and poverty, there is a causal link between shadow economy and poverty especially in the developing and transition countries (Elijah and Uffort, 2007; Obayelu and Uffort, 2007; Schneider, 2006). While high tax burden, excessive government

regulation of economic activities, high social security system, and bureaucracy are some of factors leading to high shadow economy in the highly developed countries, high unemployment rates, corruption that causes poverty are some of the factors accounting for large shadow economies in the developing, and transition countries (Elijah and Uffort, 2007; Kirchler, 2007). According to Elijah and Uffort (2007), the developing countries have the highest and increasing rate of shadow economy and poverty level when compare to the transitional and OECD countries. Putting all the factors above into consideration, complete eradication of the incidence of poverty and shadow economy in our society may not be easily achieved (Elijah and Uffort, 2007; Obayelu and Uffort, 2007). The common opinion is that, most informal sector activities in many countries can neither be term shadow economy nor illegal, as they represent simply a survival strategy by those involved in them (Elijah and Uffort, 2007; Cusack and Beramendi, 2006; Obayelu and Uffort, 2007; Schneider, 2005).

The size of shadow economies for developing African countries

The results for the size of the shadow economies for developing countries by Schneider and Schneider et al. are divided by continent into Africa, Asia, and Central and South America (Schneider, 2007; Schneider et al., 2010). Considering the development of the shadow economies in 37 African countries from 1999/2000 to 2007/2008, Schneider et al. (2010) found that shadow economies in African nations have increased. These African countries; were noted to have experienced increases in the level of poverty during the same period. On average, the size of 37 countries' shadow economies was 41.3% (of official GDP) in 1999-2000, and increased to over 48% in 2007/2008 but highest average value with 49.2% occurred in the years 2002/03 and 2003/04, from 2003/2004 there were slight decrease to 42.8% in 2004/05 in the size of the shadow economy and then increased to 48.5% in 2007/2008 (Buehn and Schneider, 2009; Schneider, 2007; Schneider et al., 2010). Turning to the country average for the size of the shadow economy from the 1999/2000 to 2007/2008 period, Tanzania, Nigeria, and Zimbabwe (with 60.2, 59.7, and 57.0% respectively) have by far the largest shadow economies, and the country in the median position is Madagascar with 38.5% of shadow economy to the

The Size of Shadow Economies

Table B1

The Size of the Shadow Economy in 37 African Countries

Shadow Economy (in % of official GDP) using the DYMIMIC and Currency Demand Method											
No.	Country	1999/00	2000/01	2001/02	02/03	2003/04	2004/05	2005/06	2006/07	2007/08	Country Average
1	Algeria	34.0	34.1	34.4	34.9	35.8	36.6	37.3	37.3	37.1	35.7
2	Angola	41.6	41.6	41.9	42.8	43.0	43.1	45.0	45.9	37.1	35.7
3	Benin	48.5	49.4	49.8	50.0	50.2	50.1	49.8	50.0	50.4	49.8
4	Botswana	33.0	33.4	33.6	33.5	33.8	34.0	34.1	34.5	34.8	33.9
5	Burkina Faso	41.5	441.4	41.5	41.4	42.4	42.7	43.0	43.0	43.1	42.2
6	Burundi	40.4	40.0	39.8	40.0	39.8	39.8	39.7	39.8	39.8	39.9
7	Cameroon	32.3	32.8	33.2	33.4	33.9	34.0	33.9	34.2	34.2	33.5
8	Central African Republic	51.5	51.7	51.2	50.1	46.9	46.5	46.9	48.1	48.9	49.1
9	Chad	46.1	46.2	46.9	47.4	48.4	51.2	51.6	51.0	50.5	49.1
10	Congo, Dem. Rep.	48.8	48.0	47.8	47.9	49.0	49.2	49.3	49.3	49.4	48.7
11	Republic of Congo	46.8	48.2	49.2	49.7	49.7	50.3	51.9	53.3	52.0	50.1
12	Cote d'Ivoire	44.9	43.2	42.1	41.0	40.5	40.4	40.2	39.7	39.6	41.3
13	Egypt, Arabian Republic	34.7	35.1	35.0	34.5	34.8	35.2	35.4	35.4	36.1	35.5
14	Ethiopia	39.9	40.3	41.2	41.0	40.5	42.0	43.1	44.5	45.7	42.0
15	Ghana	41.8	41.9	42.0	42.2	42.5	42.9	44.3	45.3	45.6	43.2
16	Guinea	39.5	39.6	39.9	40.4	40.4	40.6	40.8	40.3	40.0	40.2
17	Kenya	35.0	34.3	34.7	33.8	33.9	34.9	36.0	37.7	39.4	35.5
18	Lesotho	30.9	31.3	31.5	31.6	31.9	32.5	32.4	33.3	33.8	32.1
19	Madagascar	39.1	39.6	40.4	34.7	36.0	37.7	38.5	39.5	40.5	38.5
20	Malawi	40.7	40.3	38.3	36.5	37.5	38.3	38.2	39.4	41.1	38.9
21	Mali	42.1	42.3	43.8	44.4	44.7	44.0	44.5	44.7	44.7	43.9

Table Continue

22	Mauritania	36.7	36.1	36.2	36.4	36.4	37.2	37.9	40.8	-	37.2
23	Morocco	36.3	36.4	37.1	37.3	37.8	38.7	37.9	39.8	39.8	37.9
24	Mozambique	39.5	40.3	40.2	40.8	40.8	40.9	41.6	42.0	-	40.8
25	Namibia	31.4	31.4	31.6	31.5	32.2	33.1	33.3	34.1	34.4	32.6
26	Niger	42.1	41.9	43.0	43.7	44.4	43.2	44.4	45.6	-	43.5
27	Nigeria	57.8	57.9	58.0	58.2	59.5	60.8	62.1	62.9	-	59.7
28	Rwanda	40.1	40.3	40.0	40.7	39.9	40.4	41.4	41.5	-	40.5
29	Senegal	45.2	45.1	45.6	45.1	45.8	46.9	47.8	47.8	48.4	46.4
30	Sierra Leone	40.3	40.2	41.2	43.3	43.8	44.2	44.3	45.0	45.6	43.1
31	South Africa	28.4	28.4	28.4	28.8	29.0	29.7	30.4	30.9	31.7	29.5
32	Tanzania	58.0	58.3	58.9	59.7	60.1	60.6	61.3	61.9	63.0	60.2
33	Togo	35.8	35.1	34.8	35.7	35.3	35.2	35.2	35.6	-	35.3
34	Tunisia	38.1	38.4	38.9	39.0	39.4	39.9	40.0	40.9	41.4	39.6
35	Uganda	42.7	43.1	43.3	43.3	43.7	43.8	44.0	45.1	45.8	43.9
36	Zambia	48.5	48.9	59.5	49.7	50.4	51.2	51.7	53.1	54.3	50.8
37	Zimbabwe	59.2	59.5	57.4	56.1	55.2	56.6	56.8	56.6	56.1	57.0

Adapted from Schneider, Buehn, & Montenegro (2010)

official GDP. South Africa has the lowest shadow economy, with 29.5%, followed by Lesotho with 32.1%, and Namibia with 32.6% (Schneider, 2007; Schneider et al., 2010). The large shadow economy in Africa (and in other developing countries) is only to some extent an issue of tax burdens, corrupt practices, and regulation, given the simple fact that the limited local economy means that citizens are often unable to earn a living wage in a legitimate manner (Obayelu, and

Uffort, 2007; Pickhardt and Shinnick, 2009; Richardson, 2006). Therefore, working in the shadow economy is often the only way of achieving a minimal standard of living (Obayelu and Ogunlade, 2006; Schneider, 2006; 2007; Schneider et al., 2010). Table B1 (see Appendix B) shows the size of shadow economies for developing African countries for period 1999/2000 to 2007/2008 with the country average measure for the nine years. To this end, the link between

underground economy and poverty has been conclusively established and was demonstrated to be particularly tied to the corrupt practices in those economies.

Conclusion

Estimates of the size of the Nigeria shadow economy contained in many studies over the last

17 years have ranged from 43% to over 62% of gross domestic product (GDP). One prominent finding from studies on the size of shadow economy is that, from 1999 to 2007, shadow economies appear to be on the rise in Nigeria in the same proportion as poverty level (Schneider; 2009, 2010). For example, Nigeria's shadow economy in 2004 was 59.5 percent of the GDP, and 62.1 percent in 2006. This climbed to 62.9 percent of GDP in 2007. See Table B 1 (Appendix B). Nigeria's official GDP, according to the World Bank (2013) was \$262.61 billion US Dollar for 2012, representing only about 37.1 percent of Nigeria's GDP, but if the shadow economy (62.9%) were added, it could potentially be as much as **\$707.84 billion** or more. This figure translated into a loss of income and commodity tax revenues of about **\$445.23 billion U.S Dollars (about N4.76 trillion naira)**, for 2012 alone. Therefore, the shadow economy is a problem that required urgent attention to solve since the size of the tax loss is significant to the Nigeria economy. Consequently, the problem of shadow economy requires continuous attention and continuous efforts from policymakers, FIRS, and all Nigerian which includes, the recommendations detailed below.

Findings in this study have implications outside of Nigeria as well. Undoubtedly, most policy actions that strengthen economic growth of the official economy will have an effect of encouraging businesses to move out of the shadow economy. The question is whether, in addition to these, there are actions Nigeria policymakers could pursue whose main purpose would be to frankly influence the size of the underground economy. The following are some of the several types of actions that may be considered by Nigeria's policymakers in this regard.

Discourage the use of barter system

The use of barter facilitates underground economic activities. Nigeria governments, uses barter to pay for services when their tax receipts do not cover expenditure commitments. This sends erroneous signals to the private sector and eventually creates an environment that encourages business in the underground economy and reduces any stigma associated with it. To the extent that this practice leads the private sector to engage in further barter, the government's use of barter carries a negative unintentional or concealed cost and therefore should be strongly discouraged in any economy.

Encourage dynamic tax system

One of the main motivations of underground activity is to evade taxes. Tax reform can directly address this. Such reform should comprise several components. First, improved administration would comprise better supervision mechanisms, tax compliance audits, and additional funding for staff that are more qualified and their training. Second, an improved tax code by revenue agencies would address simplifying the number of exceptions and exclusions and would lower tax rates. One way to lower tax rates are to increase the tax base by using a greater diversity of tax instruments and by introducing; a self enforcing VAT. One example of a powerful tax reform is the computerization of revenue agency operations, together by a reduction in the number of tariff categories.

Promote institutional strengthening

It is not enough to design good policy in order to reduce regulatory avoidance as a reason to operate in the underground economy. Three other aspects must be addressed. First, there should be civil service reform in Nigeria. This requires retiring the old-style bureaucrats that see enterprise control (and corruption) as their *raison d'être*, hiring improved well-informed replacements using a system based on objective testing and other relevant job criteria, improving management structures and incentives, and better public service salaries. Second, the new staff should be trained together with general capacity building. Carrying out this second step without also implementing a civil service reform may be self-defeating in the end. Providing ministry staff with marketable skills while paying them a below-the-market salary leads them to *take their training and run*, leaving the ministry as weak as ever. Third, imposing a regulatory mandate on an underfunded regulatory body is a recipe for inefficiency, rent seeking, and corruption leading to greater underground economic activity. Unfunded regulatory mandates should be discouraged. Any law that adds to a regulatory body's responsibilities should also identify feasible and sufficient funding sources. This is not always easy since there will be strong (and necessary) forces at the ministry of finance to reduce the number of special funds and earmarking as part of a budgetary reform.

Promote robust banking services

One factor that would persuade a business to remain official is the accessibility of banking services. Therefore, banking sector privatization and restructuring that would improve such services through increased competition, financial deepening, and increased intermediation will tend to reduce underground economic activities. In an economy, with full privatized banking sector, firms in need of credit cannot rely on political ties and will make their activities more transparent, which tends to reduce their underground economy activities. Finally, bank privatization will encourage foreign firms to enter Nigeria market. Foreign banks tend to be less open to bribery. A similar set of arguments can be made for capital market reforms and especially the prudential regulation that such markets require all these will reduce the activities in the shadow economy and therefore, reduce Nigeria poverty level.

In addition to the above policies recommendations to address shadow activity, there are several general concerns that Nigerian policymakers should take into consideration, these includes:

Discourage activities that will promote market exit

The choice confronting a business is not just whether to operate in the underground or official economy. Here Nigeria policymakers should be careful not to *throw the baby with the bath water*. Thus, in designing policies that can directly combat the underground economy, the policymakers should be careful that the incentives only push unofficial activities from the shadow into the official economy (desired) and not cause them to stop operation completely (undesired) or be performed with more social waste as the business hides itself even further. For instance, a harsh penalty for operating in the underground economy or tax evasion may fright a firm into declaring its activity, drive underground activities even deeper into the underground in order to avoid detection, or even cause the activity to be eliminated altogether.

Nigeria Policymakers should promote dynamic considerations in combating shadow economy activities

Some policy measures to combat activities of the shadow

economy may be effective only if they are credible. Therefore, issues of time-consistency should be considered in particular. For instance, if the government of Nigeria or its agent announces a tax amnesty to be followed by a crackdown on tax evasion, the crackdown had better occur or the next time the amnesty will not be credible and business will increase in the shadow economy and tax evasion, expecting another amnesty to follow. A better policy to combat activities in the shadow economy would be policy coordination: announce a tax amnesty as part of a serious tax reform. This lowers the cost of returning to the official economy as it removes a (re-)entry barrier. Another even trickier dynamic issue concerns the question of pre-commitment and credibility. For example, when a firm is considering whether to enter the official economy, government should let it know that the barriers to returning to the shadow economy are low. This would have two effects. It would make it less risky for a firm to try out the official economy and it would increase the pressure on the government to pre-commit to more sensible regulation and higher quality implementation and administration.

Nations' tax administration should be decentralized

Decentralization issues are extremely complex. Nevertheless, there are still some simple lessons to emphasize. First, in a large country such as Russia or United States, local administrations will be suspicious of revenue devices applied at the local level that are intended to raise funds for the central government. This is the case even if these funds are theoretically returned to the local level authorities in the form of services or even grants. Localities may see transfer of resources to the central government level as a one-way-street and not cooperate much with their implementation that is intended to combat shadow activities. They may even tacitly encourage local underground activity. Second, where possible, consumers of public services at the local level should pay local service providers directly without funds passing through the federal government, which payers see as a black box. For these services the federal government's role then becomes one of supervision. Third, decentralizing functions to the right jurisdictional level can promote efficiency and supervision, besides better funding. These will work to improve the quality of public services and therefore the benefits of operating in the official economy.

Enhancement of the rule of law

It is generally noted that government failures are what stimulate the growth of the underground economy. These can be errors of commission (e.g., corruption, inappropriate regulation) as well as of omission. Key among this latter group is adequate protection of property rights (e.g., enforcement of contracts). A primary benefit of being official is access to the legal system. A dysfunctional judicial system, however, reduces the cost of such loss of access. This reduces the value of being official and, thereby, makes the benefits of operating in the underground economy more attractive.

Other policy recommendations for shadow economy management in Nigeria

The incidence of shadow economy has different root causes in the various countries. Shadow economy characteristics even differ within countries. Accordingly, different approaches towards the underground economy should be used in different states. In addition, policy measures to combat shadow economy should be robust. Therefore, constant adjustment should not be necessary for successful operation. Rather, the measures should contain a broad selection of implements and models, which can be used in different situations and circumstances as they appear.

Additionally, a key element in any policy for combating underground economy in countries should be the strengthening of trust in government and government agencies. This must be done based on long-term efforts that are designed to strengthen community morale and increase confidence in public agencies saddle with tax collection responsibilities. Changing attitudes is another essential tool in the struggle against shadow economy activities, since control measures, *inter alia* due to deficient resources, can never by themselves eradicate the problem associated with the shadow economy.

Incentives for transformation of shadow economy into formality should be enhanced

Voluntarily transformation of shadow activities into official economy should be attractive, in the sense of not posing a risk or cost. Nigeria policymakers should thus be encouraged to develop forms of formalization, general or targeted, allowing shadow workers and shadow

employers to make themselves known, along the lines of the Italian example (Schneider, 2006; Tanaka, 2009). Therefore, individuals and businesses can be given a sort of amnesty for a specified period, offering them incorporation into the official economy without fear of retribution.

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