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The theoretical remarks about the shadow economy

Part III



THE STAGES AND THE SPHERES OF THE SHADOW ECONOMIC ACTIVITY

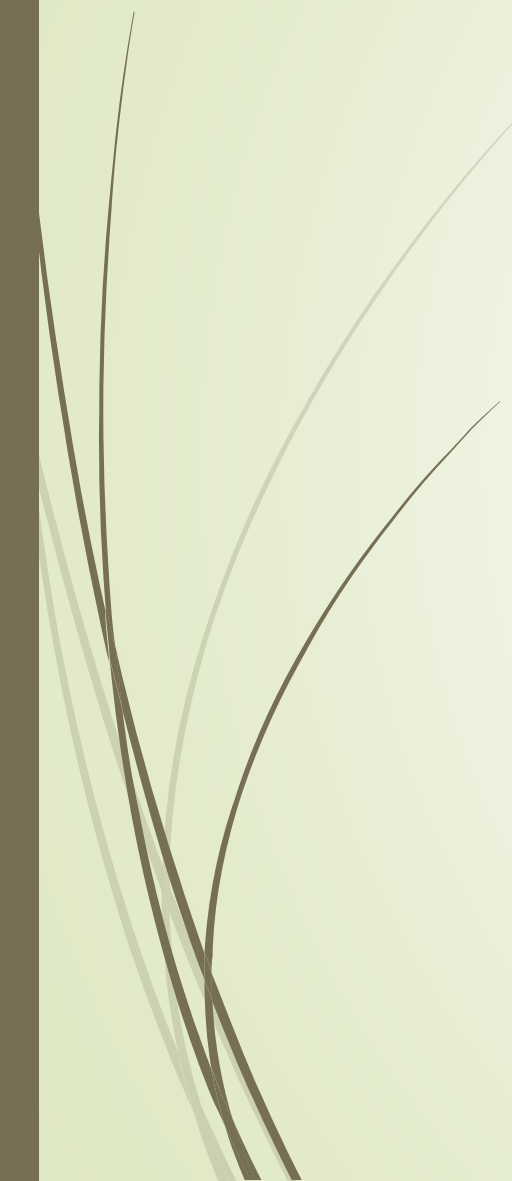


Outline

- 1. The stages of Shadow economy
 - 2. The spheres of Shadow activity in public life
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Goal of this lecture:

- Showing the stages of Shadow economy
 - Defining the role of Shadow economy in National economy
 - Explaining the existence of underground economy
 - Using a special map to describe the causes of underground economy
 - Analyzing the spheres of Shadow activity in public life
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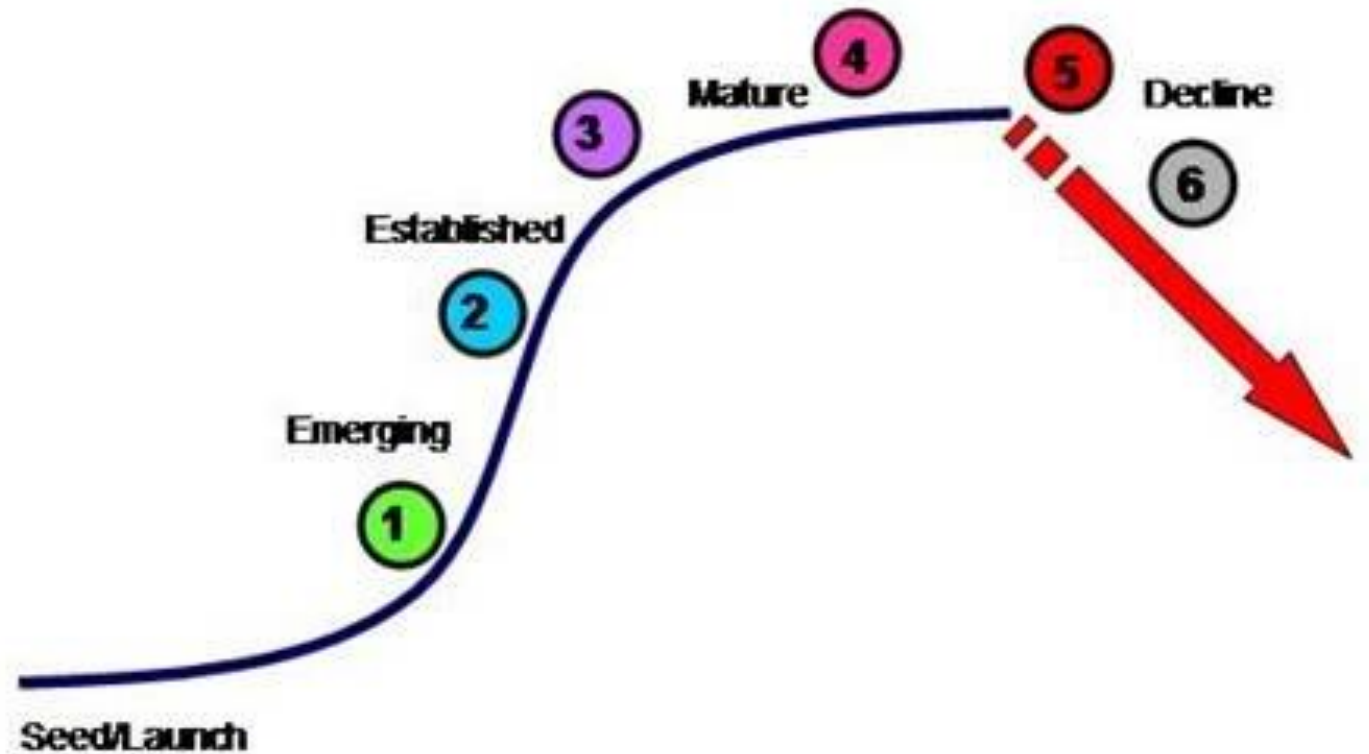


1. The stages of Shadow economy

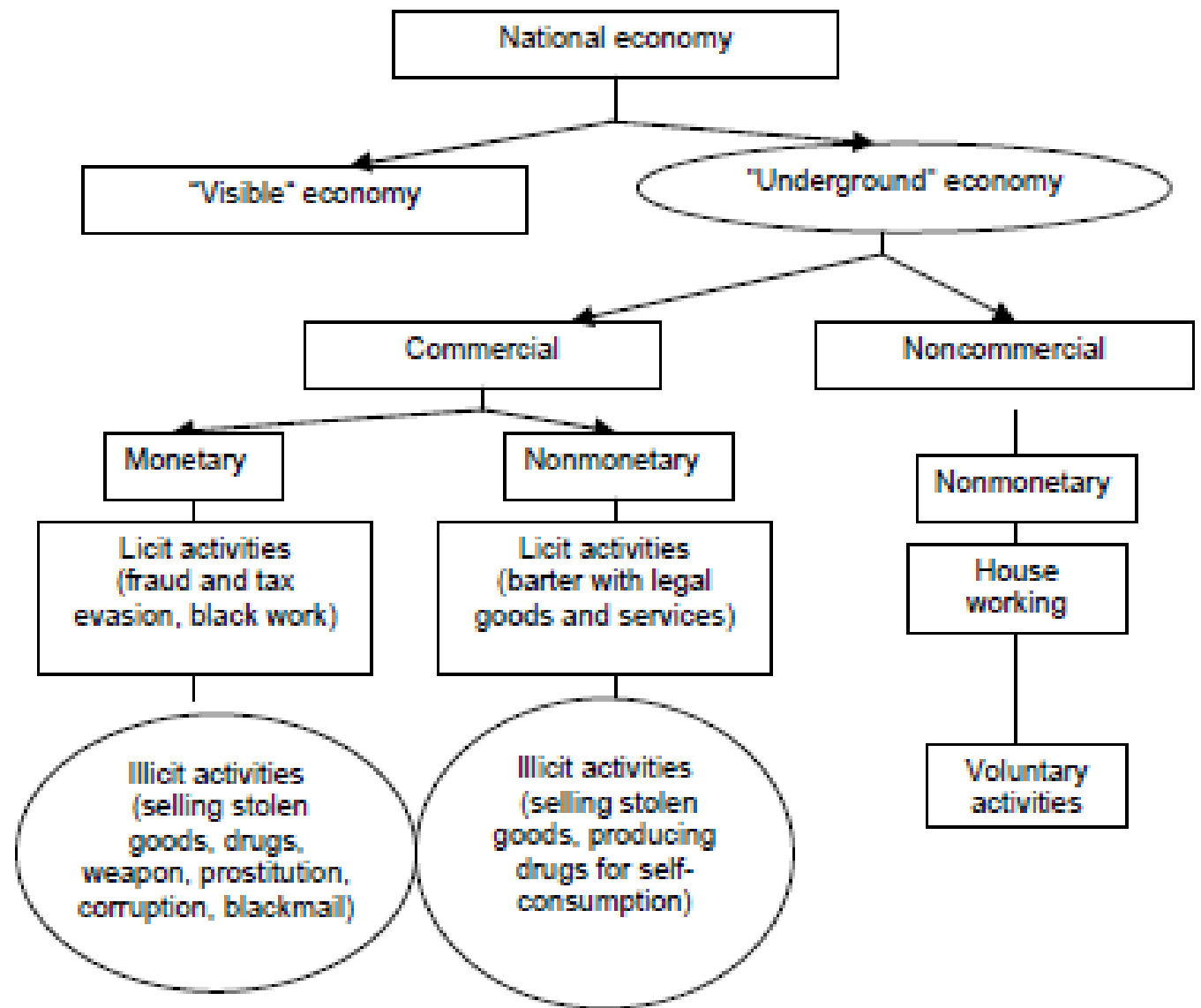
As with any segment (system), the shadow economy can be divided into five main stages of evolution: infancy, development, maturity, decline and death, which reflect the features of both the shadow economy itself and the economic system within which it operates.

In some form or another, the shadow economy is inherent in any economic system and dies only together with the state that regulates economic relations by legal norms. It is never possible to completely destroy the shadow economy. We can only talk about reducing its scale and destroying the most dangerous forms for society.

The S-Curve



A different view of researchers presents a parallel analysis of "underground" economy and "visible" economy, or in other words of informal economy and formal economy. The natural conclusion to be drawn is that we cannot speak of two types of economy because the economy is only one. The relationship that I think to be true, according to the basic principles of logic, is that between "visible" and "underground" economy there can be a relation as a part to a part, together forming a country's real economy as a whole

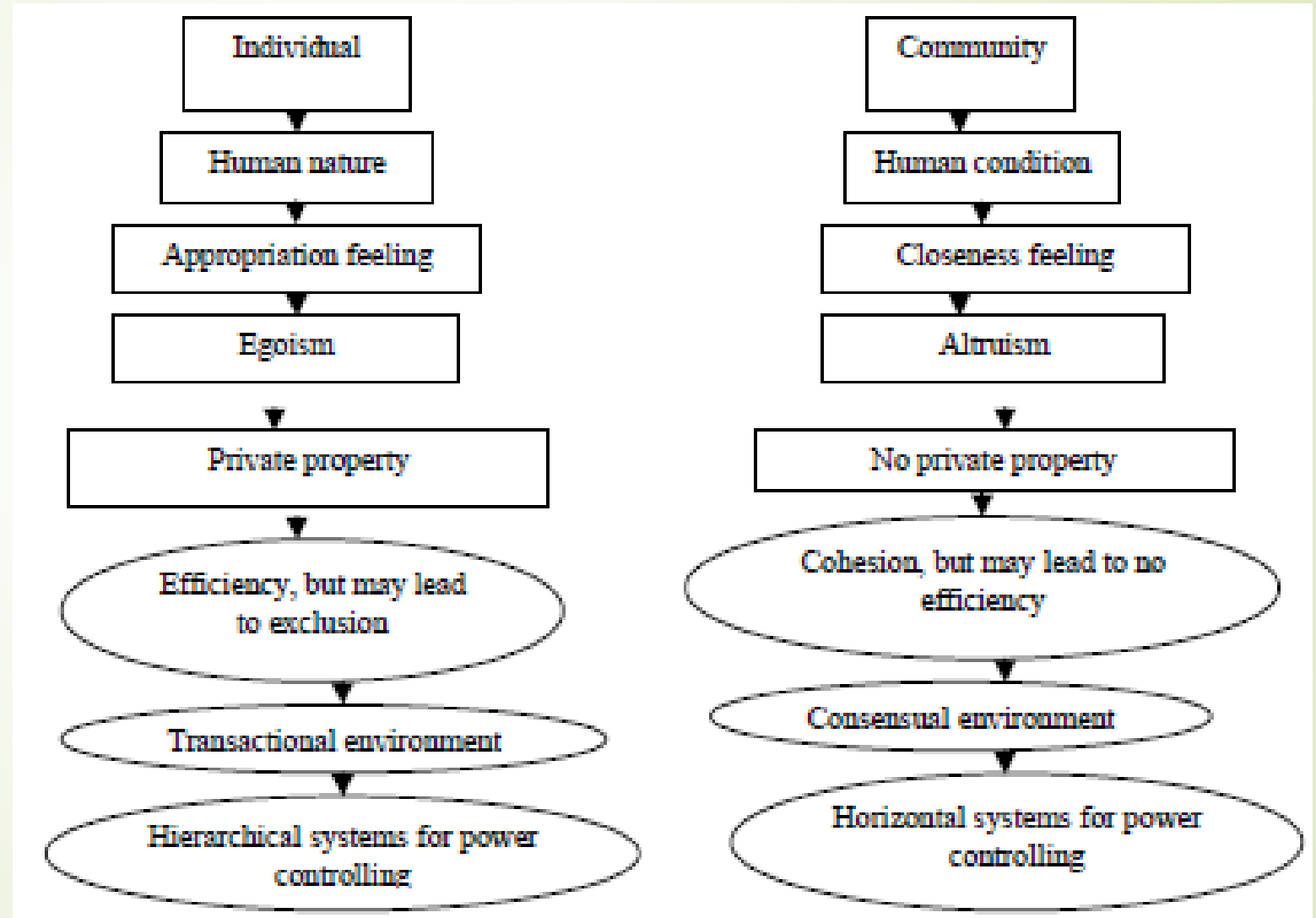


Why *underground* economy exists?

- 1. "Underground" economy exists because it provides economic goods which meet the real needs of society. Without the existence of component demand, bidders in the "underground" market do not exist,
- 2. "Underground" economy exists because there is proved to be an effective method for controlling the global powers. Global power control is achieved more easily through hidden and corrupt operations,
- 3. "Underground" economy that provides opportunities exists for entrepreneurship event in a market economy. Entrepreneurship, needed by any economy that wants to be a developed market economy, is inhibited by tax burden and bureaucratic cluster in a country,
- 4. "Underground" economy exists because it can exist and is encouraged for that purpose. Lack of a very well thought control allows developing economic "underground" activities and the emergence of new ones,
- 5. "Underground" economy exists to provide those to whom the gates are closed by state authorities. Coercion is the mother of ideas, with which barriers are bypassed by the authorities,
- 6. "Underground" economy exists because there is a real source of development, and subsistence and even escape from the periphery to underdeveloped economies.

Arguments map that explain the existence of "underground" economy

The map plays its descriptive role, helping to justify the existence of "underground" economy but it should be noted that scientific analysis of the economy "underground" can be considered only in relation to the human condition since human nature is unknowable and we could not develop a model since we cannot identify a predictable behavior.



2. The spheres of Shadow activity in public life.

- In the sphere of production, there are falsification of products, transferring profits abroad, bribery of politics for obtaining state orders, barter transactions, artificial bankruptcy, the use of illegal migrants' labor, delays in wages.
- In the sphere of trade: sale of counterfeit products, smuggling, shuttle trade
- In the financial and credit sphere: "dirty" money laundering , financial operations under the guise of various non-commercial funds.
- In the sphere of services: one-day firms, artificial consulting services, the connection of security firms with criminal structures.
- In the sphere of education: paid writing of coursework, diplomas, dissertations; illegal tutoring, bribes for admission to the university, the passage of studies, the receipt of a diploma.

To **counterfeit** means to imitate something. Counterfeit products are fakes or unauthorized replicas of the real product. Counterfeit products are often produced with the intent to take advantage of the superior value of the imitated product. The word *counterfeit* frequently describes both the forgeries of currency and documents, as well as the imitations of items such as clothing, handbags, shoes, pharmaceuticals, aviation and automobile parts, watches, electronics (both parts and finished products), software, works of art, toys, and movies.

Counterfeit products tend to have fake company logos and brands (resulting in patent or trademark infringement in the case of goods), have a reputation for being lower quality (sometimes not working at all) and may even include toxic elements such as lead. This has resulted in the deaths of hundreds of thousands of people, due to automobile and aviation accidents, poisoning, or ceasing to take essential compounds (e.g., in the case a person takes non-working medicine).



The counterfeiting of money is usually attacked aggressively by governments worldwide. Paper money is the most popular product counterfeited.



Counterfeiting of consumer goods

The spread of counterfeit goods (commonly called "knock-offs" or "rip-offs") has become global in recent years and the range of goods subject to infringement has increased significantly. Apparel and accessories accounted for over 50 percent of the counterfeit goods seized by U.S Customs and Border Control. According to the study of Counterfeiting Intelligence Bureau (CIB) of the International Chamber of Commerce (ICC), counterfeit goods make up 5 to 7% of World Trade; however, these figures cannot be substantiated due to the secretive nature of the industry.

A report by the Organization for Economic Co-operation and Development indicates that up to US\$200 Billion of international trade could have been in counterfeit and illegally copied goods in 2005.^[4] In November 2009, the OECD updated these estimates, concluding that the share of counterfeit and illegitimate goods in world trade had increased from 1.85% in 2000 to 1.95% in 2007. That represents an increase to US\$250 billion worldwide.

Some see the rise in counterfeiting of goods as being related to globalisation. As more and more companies, in an effort to increase profits, move manufacturing to the cheaper labour markets of the third world, areas with weaker labour laws or environmental regulations, they give the means of production to foreign workers. These new managers of production have little or no loyalty to the original corporation. They see that profits are being made by the global brand for doing little (other than advertising) and see the possibilities of removing the middle men (i.e. the parent corporation) and marketing directly to the consumer. This can result in counterfeit products being virtually indistinguishable from original products, as they are being produced in the same company, and in damage to the parent corporation due to copyright infringement.

Shuttle trading

Shuttle trading is a practice of the second economy of the Soviet Union in which traders shuttle backwards and forwards across the country buying goods from cheap sources at major port cities or outside Soviet Union and selling them in the interior. One of the larger commodities traded in this way is cars. Originated during the *perestroika* times, it extended well beyond time of the collapse of the Soviet Union.

The OECD defines **shuttle trade** as *the activity in which individual entrepreneurs buy goods abroad and import them for resale in street markets or small shops. Often the goods are imported without full declaration in order to avoid import duties.*



FORMS OF SHUTTLE TRADE

► Goods accompanied by traveler

One form of shuttle trade occurs when the trader carries cash from his country to a second country, buys goods in that second country, and then carries the goods back to his own country where these goods are sold. This form of shuttle trade is very common in the Commonwealth of Independent States (CIS) countries. A large portion of the goods sold in the CIS are purchased in the Peoples Republic of China, Turkey and the United Arab Emirates, with lesser amounts purchased in India, Israel, Pakistan and the Syrian Arab Republic. A common variant is for the trader to be from a third country (in the CIS states the traders are frequently from the Caucasus region). A less common variant is where the traveler brings the goods from his country to the second country and returns with cash.

Another form of shuttle trade is that undertaken by individuals living near a border (border trade). This trade has been seen throughout the world, where certain goods are less expensive on one side of a border than on the other.

FORMS OF SHUTTLE TRADE


► **Goods not accompanied by traveler**

As the volumes of shuttle trade increased, the carriage of these goods by the traveler posed increasing problems. In the CIS countries these travelers began to have the goods shipped as unaccompanied luggage, as this luggage was accorded the same treatment as accompanied luggage by customs authorities. This development created a market opportunity for freight forwarding organizations to take over the shipping of the goods. These companies have evolved over the past several years into sophisticated full service providers of freight forwarding services. For example they pick up goods at the seller's warehouse, package it for international shipment, handle customs processing at the origin and destination countries, and take total responsibility for the goods until they are collected by the buyer in the destination country.

Money Laundering

- Money laundering is the process of creating the appearance that large amounts of money obtained from criminal activity, such as drug trafficking or terrorist activity, originated from a legitimate source. The money from the illicit activity is considered dirty, and the process "launders" the money to make it look clean.





Money laundering is essential for criminal organizations who wish to use illegally earned money effectively. Dealing in large amounts of illegal cash is inefficient and dangerous. The criminals need a way to deposit the money in financial institutions, yet they can only do so if the money appears to come from legitimate sources.

There are three steps involved in the process of laundering money: placement, layering and integration. Placement refers to the act of introducing "dirty money" (money obtained through illegitimate, criminal means) into the financial system in some way. Layering is the act of concealing the source of that money by way of a series of complex transactions and bookkeeping tricks. Integration refers to the act of acquiring that money in purportedly legitimate means.

While traditional money-laundering methods are still used, the internet has put a new spin on an old crime. The use of the internet allows money launderers to easily avoid detection. The rise of online banking institutions, anonymous online payment services, peer-to-peer transfers using mobile phones and the use of virtual currencies such as [Bitcoin](#) have made detecting the illegal transfer of money even more difficult. Moreover, the use of proxy servers and anonymizing software makes the third component of money laundering, integration, almost impossible to detect, as money can be transferred or withdrawn leaving little or no trace of an IP address.

In many ways, the new frontier of money laundering and criminal activity lays in [cryptocurrencies](#). While not totally anonymous, these forms of currencies are increasingly being used in currency blackmailing schemes, drug trade and other criminal activities due to their anonymity compared to other forms of currency. Money can also be laundered through online auctions and sales, gambling websites and even virtual gaming sites, where ill-gotten money is converted into gaming currency, then transferred back into real, usable and untraceable "clean" money.



Illegal (criminal) financial transactions

- (1)** Apart from the “official” economy there exists an “Underground Economy”, which characterizes an illegal economy including all sorts of criminal activities, which are in conflict with the legal system, e.g. organized crime or drug dealing.
- (2)** Opposite to these classical criminal activities, shadow economy activities mean the production of (in principle) legal goods and services with an value added for the official economy and where the illegality comes from avoiding taxes and social security payments and violating labour market regulations.
- (3)** Shadow economy and underground (criminal) economy are quite different activities, which can not be summed up to one underground economy because the latter usually produces no positive value added for an economy.



Table 1: Quantification of Money Laundering Volume – Part 1

Origin/Study	Year	Volume (worldwide)
Worldwide turnover of Organised Crime: Range: 500 billion USD – 2.1 trillion USD		
National Criminal Intelligence Service (NCIS; Washington D.C.; USA)	1998	1.3 trillion USD
	2001	1.9 trillion USD
	2003	2.1 trillion USD
UN-Estimates (New York; USA)	1994/98	700 billion to 1 trillion USD
International Monetary Fund and Interpol (Washington D.C; USA)	1996	500 billion USD
Friedrich Schneider (University of Linz)	2001	800 billion USD
	2002	960 billion USD
	2003	1.2 trillion USD
	2004	1.4 trillion USD
	2005	1.5 trillion USD
	2006	1.7 trillion USD

Table 2: Quantification of Money Laundering Volume – Part 2

Worldwide money laundering turnover, as measured by drug total revenue: 400 billion – 2.85 trillion USD		
The Economist (London)	1997	400 billion USD
	2001	600 billion USD
Friedrich Schneider (University of Linz)	2001	700 billion USD
	2002	750 billion USD
	2003	810 billion USD
	2004	850 billion USD
	2005	870 billion USD
	2006	910 billion USD
Kerry	1997	420 billion -1 trillion USD
Michael Schuster	1994	500-800 billion USD
Walker	1998	2.85 trillion USD
<p>→ <i>Estimates are afflicted with great uncertainties.</i></p> <p>→ <i>Problems due to an ambiguous classification and a small databases regarding direct methods.</i></p> <p>→ <i>Dubiously potentiated estimates concerning indirect methods.</i></p>		

Impact of Money Laundering

According to a [2016 survey from PwC](#), global money laundering transactions account for roughly 2% to 5% of global GDP, or roughly \$1 trillion to \$2 trillion annually.

Although the act of money laundering itself is a victimless, [white-collar crime](#), it is often connected to serious and sometimes violent criminal activity. Being able to stop money laundering is, in effect, being able to stop the cash flows of criminals, including international organized crime.

Money laundering also impacts legitimate business interests by making it much more difficult for honest businesses to compete in the market since money launderers often provide products or services at less than market value. Where a financial institution or business is also regulated by the government, money laundering, or a failure to put reasonable anti-laundering policies in place, can result in a revocation of a business charter or government licenses.

Businesses that associate with people, countries or entities that launder money face the possibility of fines. Deutsche Bank, ING, the Royal Bank of Scotland, [Barclays](#) and Lloyds Banking Group are among institutions that have been fined for being involved with transactions associated with money-laundering activities in countries such as Iran, Libya, Sudan and Russia.

Figure 5: Organized Crime and their main areas in Central Europe

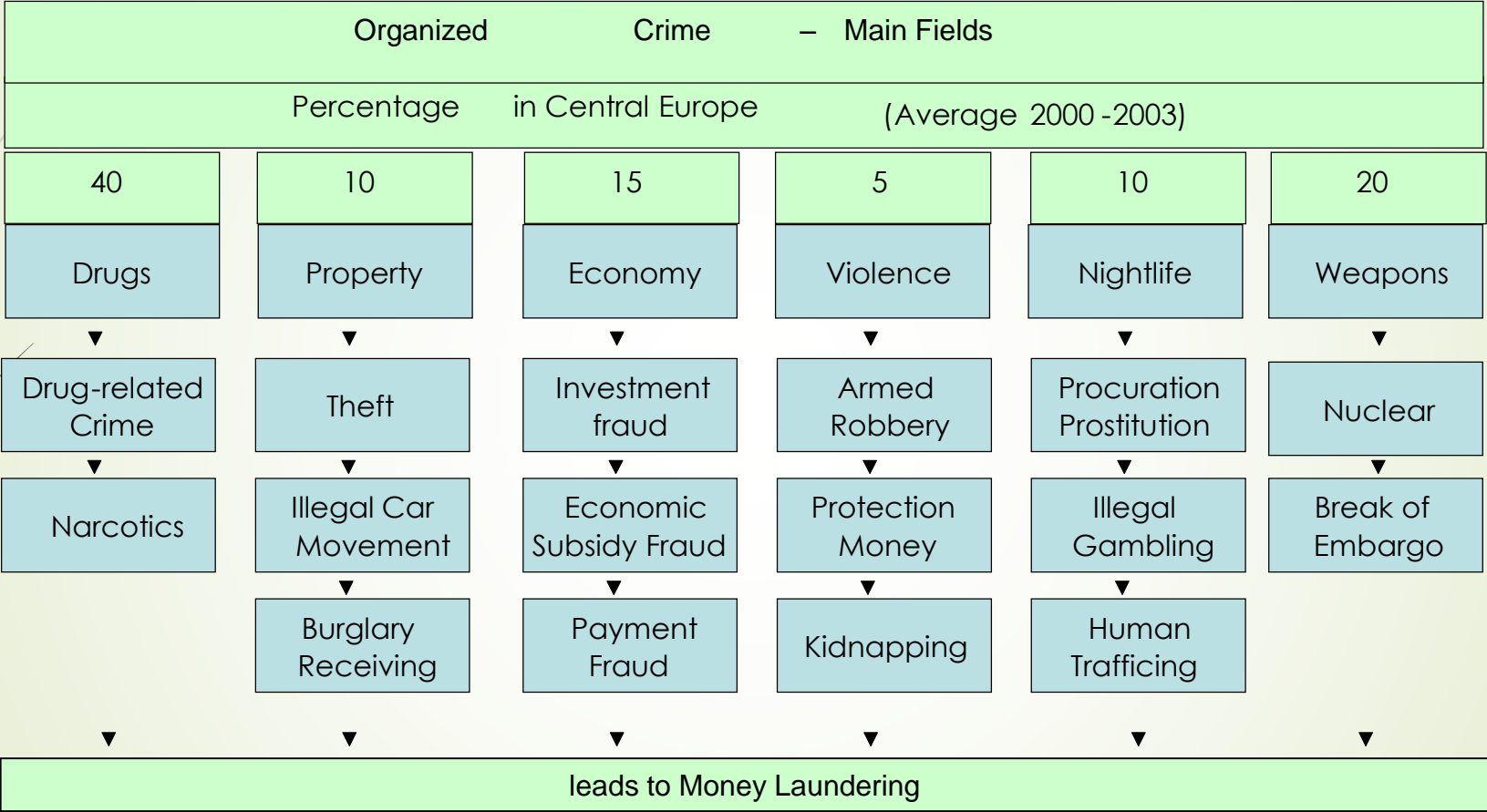
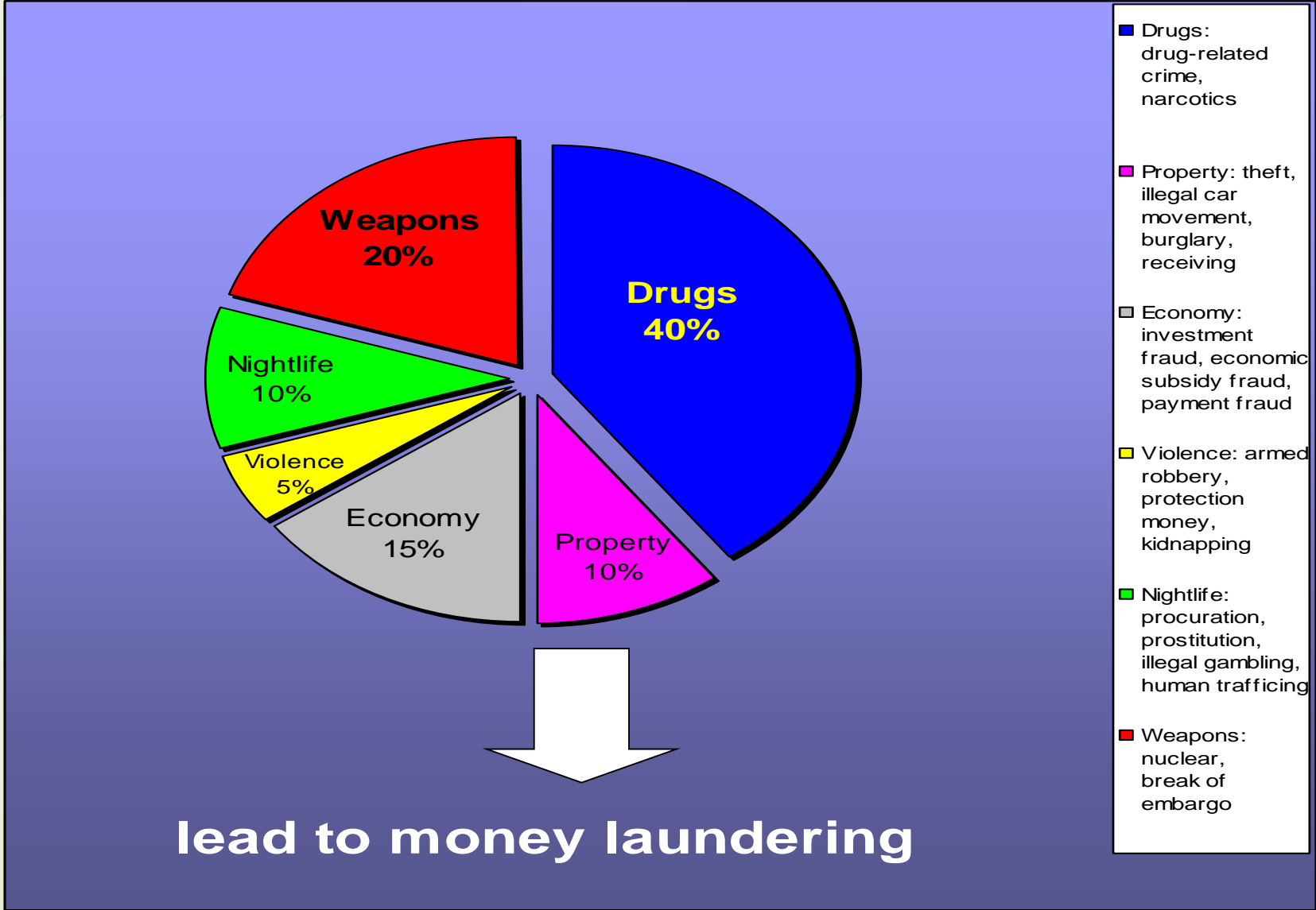


Figure 6: Organized Crime – Main Fields (Central Europe, av. 2000-2003)



Political corruption

- ▶ Political corruption is the use of powers by government officials for illegitimate private gain. An illegal act by an officeholder constitutes political corruption only if the act is directly related to their official duties, is done under of law or involves trading in influence.
- ▶ Forms of corruption vary but include bribery, extortion, cronyism, nepotism, parochialism, patronage, influence peddling, graft, and embezzlement. Corruption may facilitate criminal enterprise such as drug trafficking, money laundering, and human trafficking, though is not restricted to these activities. Misuse of government power for other purposes, such as repression of political opponents and general police brutality, is also considered political corruption.
- ▶ The activities that constitute illegal corruption differ depending on the country or jurisdiction. For instance, some political funding practices that are legal in one place may be illegal in another. In some cases, government officials have broad or ill-defined powers, which make it difficult to distinguish between legal and illegal actions. Worldwide, bribery alone is estimated to involve over 1 trillion US dollars annually. A state of unrestrained political corruption is known as a kleptocracy, literally meaning "rule by thieves".
- ▶ Some forms of corruption – now called "institutional corruption"– are distinguished from bribery and other kinds of obvious personal gain. A similar problem of corruption arises in any institution that depends on financial support from people who have interests that may conflict with the primary purpose of the institution.

Smuggling is the illegal transportation of objects, substances, information or people, such as out of a house or buildings, into a prison, or across an international border, in violation of applicable laws or other regulations.



There are various motivations to smuggle. These include the participation in illegal trade, such as in the drug trade, illegal weapons trade, exotic wildlife trade, illegal immigration or illegal emigration, tax evasion, providing contraband to a prison inmate, or the theft of the items being smuggled. Examples of non-financial motivations include bringing banned items past a security checkpoint (such as airline security) or the removal of classified documents from a government or corporate office.



Thank
you

