



THE IMPACT OF THE HIDDEN ECONOMY ON FINANCIAL STABILITY AND ECONOMIC POLICIES

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Article history:	Abstract:
<p>Received: 1st January 2024 Accepted: 20th February 2024</p>	<p>The hidden economy is one of the dangerous economic phenomena that threatens countries of the world, especially developing countries, because this economy constitutes a large percentage of the gross domestic product in those countries. The reasons for the emergence of the hidden economy varied between local reasons and international reasons, and the methods and approaches for estimating the hidden economy varied, including direct measurement methods and indirect measurement methods. This research aims to know the impact of the hidden economy on output fluctuations, as it is the most important macroeconomic fluctuation in Iraq, in addition to important regulatory variables that included financial and commercial integration, monetary and financial policy, and financial development using some statistical methods that included stability tests for the data, and a stability test for the estimated parameters to test the extent of the possibility of existence A relationship between the hidden economy, financial stability, and economic policies. The research relied on the contemporary hypothetical approach and tested the hypothesis of the effect of the hidden economy between the hidden economy, financial stability, and economic policies. The research reached results, the most important of which is the presence of a positive moral impact of the hidden economy (in addition to slowing output fluctuations for two years, fiscal policy, money supply, exchange rate, financial development, trade mergers, and crises) on financial and political fluctuations and stability in Iraq. Thus, the research supports the importance of reducing the hidden economy. To reduce financial, political, and economic stability fluctuations in Iraq. The research concluded with a set of recommendations, the most important of which is adopting a formula for economic treatments and controls and activating laws to provide an effective economic climate</p>

Keywords: The hidden economy, financial stability, political stability, economic stability

1. INTRODUCTION

The phenomenon of the hidden economy is considered one of the phenomena that the economies of the developing and developed world suffer from. Although it differs from one country to another, it differs due to the reasons for its origin, size, and ways to contain it, as well as the economic, social, and political conditions in each country. Studies confirm that the hidden economy is increasing at a large rate that may exceed the growth rate of the formal economy¹. Especially in developing countries, the reason is due to overlapping factors such as existing political and economic systems, taxes, living standards, labor market, and other reasons. The hidden economy represents economic activities practiced by a number of members of society, which

may be legal or illegal, and are not included in the national accounts of countries, because they are practiced in secret, away from official records, with the aim of evading the payment of due entitlements and away from existing regulations, laws, and legislation.² Considering that Iraq is one of the developing countries, there are many indicators that confirm the emergence and growth of the hidden economy in it, which does not contribute to the gross domestic product, but contributes to creating job opportunities for many unemployed people, which helps the labor market in employment.³ The shadow economy is a broad concept. It has different names in economic literature. It is called the hidden, black, or informal economy, and it is not registered and is not involved in economic activities.



The shadow economy is characterized by the efforts made to limit its activity, as it has spread throughout the world, with its impact varying from one country to another, whether in developing or non-developing countries, and it is considered a manifestation of backwardness in societies.⁴ We must focus on its most important negatives, which is the waste of natural and material resources through both planned and unplanned activities, which leads to crises and internal economic problems that many suffer from. Developing countries, especially Iraq, and their impact on the effectiveness of monetary and financial policy have hindered the process of development and economic growth, in addition to the exposure of the Iraqi economy to external shocks due to its dependence on expected oil revenues, which are considered vulnerable to fluctuations in oil prices in the global market, and the government, represented by the Central Bank, uses its monetary tools. Controlling monetary policy in the country by applying indirect quantitative tools to control the volume of funds in circulation using interest rate policy to encourage borrowing and investment and managing foreign currency reserves, and qualitative tools through the advertising tool that provides reports to commercial banks to create a safe environment for investment and direct credit to health halls. That the Iraqi economy reaches the monetary policy goals of achieving economic growth. The shadow economy consists of multiple uninitiated activities, including profits that generate relatively large unreported cash receipts, namely money laundering, corruption, tax evasion, and interventionist activities that leave significant impacts on economic policies due to weak government oversight and regulation. Shadow economy activities vary.⁵⁻⁷ These activities differ from each other in their work and method of performance, to affect the channels through which accuracy in estimates is transmitted to economic growth, as effective monetary and financial policy requires a high level of basic statistics, and the presence of the shadow economy can lead to the suppression of these measures and thus tends to Policy makers base their decisions on inaccurate information, which reduces the efficiency of monetary policy. The shadow economy has serious consequences in affecting individuals' real income, government spending programs and reducing tax revenues⁸.

1.1 Research objective

The research objective to cover the theoretical aspects of the shadow economy, as well as the extent of its contribution to the labor market and employment, with a focus on this phenomenon in relation to the Iraqi economy, according to previous studies, and despite its

scarcity in analyzing the role of the shadow economy in economic growth in Iraq.

1.2 The importance of the research

The importance of the research stems from clarifying the size of the shadow economy in the Iraqi economy, given the political, economic and social transformations it has undergone and the enormous tension that accompanied them in various fields, openness across borders, the transition to market economies, and the spread of financial and administrative corruption. Therefore, determining the nature of the role of the shadow economy Providing reliable statistics is important in economic planning, the effects of which are reflected in economic growth, which makes economic policies effective in addressing economic imbalances and problems to achieve economic growth and achieve economic growth and stability.

2. PROPOSED METHODOLOGY

2.1 Definition of hidden economy

The hidden economy is defined as the practice by an individual or institutional entity of an activity that is illegal or not included in government statistics and is not included in the calculations of the gross domestic product due to the secrecy and lack of knowledge of the official authorities about its activity, in order to evade taxes or attempt to reduce its true value in the tax records⁹.

There are several different names for the hidden economy, including the informal economy - the unorganized economy - the submerged economy - the shadow economy - the black economy - the bottom economy - the second economy - the invisible economy - the unregistered economy - the parallel economy¹⁰.

2.2 Types of the hidden economy

There are two types of the hidden economy, which we summarize as follows:

First: A legitimate hidden economy: It includes individuals and organizations that produce goods and services and are not officially registered, do not hold licenses for their commercial activity, and practice it far from the eyes of the state, such as slum areas or hidden streets.

Second: Illegal hidden economy: These are individuals and organizations that violate the law and obtain illegal income such as smuggling goods, money laundering, drug trade, and bribes to facilitate illegal businesses.¹¹⁻¹²

2.3 Characteristics of the hidden economy

This means the most important characteristics that distinguish this economy, which are:



1- The activities of the hidden economy are invisible and are carried out far from the eyes of the state.

2- There may be legitimate activities in the production of goods and services and illegal activities such as currency trade, smuggled goods, and drugs.

3- It consists of informal activities in informal areas suffering from poverty and lack of services.

4- Destructive of social values and helps spread negativity and subjective individual interest at the expense of the general interest of society.

5- Activities are increasingly widespread in light of the implementation of capitalist restructuring and economic stabilization programs, especially in developing countries.¹³⁻¹⁶

2.4 Reasons for the spread of the hidden economy

1- Poor educational outcomes, their lack of jobs, and their orientation to informal and illegal activities.

2- Evasion of paying taxes and government fees for the sake of individual interest and increasing income and profits.

3- Excessive interference by some governments in economic activity by imposing administrative systems to become economic rules and laws.

4- High taxes and fees, which forces business owners to turn to the hidden economy to cover and increase income and profits.

5- Commercial concealment and the increase in illegal and illegal labor that works for its benefit in irregular ways.

6- Small enterprises and their role in using cash in transactions and evading unregistered taxes and fees.

7- Weak religious faith and the greed of some merchants to obtain profits free of taxes and fees.

8- The low level of income, the increase in the unemployment rate and the rate of poverty contribute to its spread among low-income people.

9- The absence of the role of some governments in addressing corruption, monitoring price movements, and the shortage of goods in the markets and services provided.

10- The economies of some countries and their policies regarding the open economy, economic freedom, anticipatory financial policy, the expansion of their area, and the diversity of their borders with neighboring countries¹⁷⁻²⁰.

2.5 The negative and positive effects of the hidden economy on the state and society

First: The negative effects of the hidden economy: -

1- Reducing the size of the state's tax revenues and its impact on its tax revenues and income.

2- The instability of economic policies due to the growth and spread of the hidden economy and incorrect data that do not identify economic problems and negatively affect the methods of treating them.

3- Impact on the distribution of resources. The rate of returns in the hidden economy is more attractive than the formal economy and contributes to the flow of resources to it, which affects economic efficiency.

4- Increasing the size of the hidden economy leads to an increase in the volume of public spending, which leads to an increase in the state's general budget without sufficient resources to cover this increase.

5- Fluctuations occur in social classes as a result of the increased income of those in the underground economy due to illegal risks and their increased spending capabilities compared to those in the formal economy.

6- Intense competition for those in the formal economy due to the lower price and quality of their official products. This may cause them huge losses that may lead to some of them leaving the market.

7- The decrease in the desire for education for young people and their orientation to the hidden economy due to their feeling of the futility of education and the temptations of hidden economy income for them, which contributes to the spread of ignorance and illiteracy in society.²¹⁻²³

Second: The positive effects of the hidden economy: -

1- Spending the gains of the hidden economy directly in the formal economy, which affects the growth of the economy and the state's tax revenues.

2- Reducing the unemployment rate by providing opportunities to obtain basic or additional income for unemployed members of society.

3- Providing goods and services to low-income people at prices lower than those of the official economy that meet their needs.²⁴⁻²⁶

Our final message is that the hidden economy distorts economic indicators, affects official economic growth rates, and helps tax evasion. The hidden economy is also a fertile environment for money laundering, illicit trade, and the loss of many assets and support provided by countries that go to those who do not deserve them. As the percentage of the hidden economy decreases, the percentage of support increases. The level and efficiency of the formal economy improves, the level of productivity improves, and the economy revives.

2.6 The essence, types and forms of the shadow economy

Many business entities and citizens around the world wish to hide their income (or part of it) from regulators.

However, in some countries favorable conditions exist for the development of shadow companies (widespread corruption, weak management and control systems, inflated tax rates and fees), while in others these conditions are hampered by strict sanctions regimes and inhibited by a lack of systemic bribery. The tax system is flexible and reasonable.

Another important factor in the development of the informal economy is difficult social conditions. Lacking basic means of livelihood, a person is forced to accept unregistered work for dishonest employers.²⁷

The main types and aspects of the shadow activities of statistical and control institutions:

the "second" economy. Hide some trades, trade volume and financial status. Commercial organizations are engaged in officially authorized business activities, do not reflect a certain part of the transportation goods and services provided in accounting, statistics, tax accounting and reports, and hide part of the real income and wages to avoid taxes;

"Black" business: participation in illegal activities (smuggling, drug trafficking, underground trade in counterfeit tobacco and alcohol, arms sales);

"Gray" economy: Earning income through fraud (deceiving customers at business points, registration, theft, bribery), organizing underground workshops, etc. Hidden in the accounting workforce, their real wages and mandatory contributions to social funds and budgets. Suspicious financial transactions intended to transfer funds abroad;

Corruption also permeates the public sector (bribes to officials and representatives of regulatory agencies, as well as "solving problems in health, education, utilities and government services")²⁸

The main areas of the underground economy are underground manufacturing, services and retail trade. As usual organized crime actors participate in the "black" economy. This shadow sector poses the greatest threat to the further development of the country²⁹.

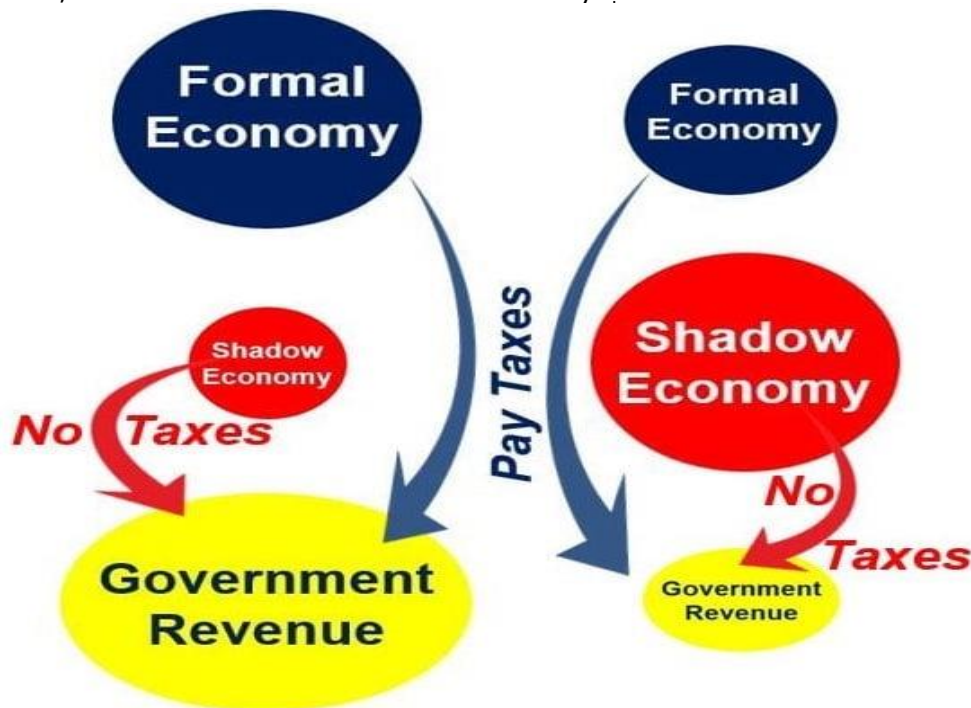


Figure (1): Types and characteristics

The fertile ground for "black" The case was fueled by law enforcement corruption and links between the shadow economy and organized crime. These two negative factors require government officials to use ruthless warfare of principles and strong sanctions to protect the national economy from destruction.

It is possible to indirectly influence "gray" and "secondary" (or "white collar") economies using financial leverage. It should become unprofitable for business entities to risk their business in order to hide

taxes with a corresponding reduction in the tax burden and improvement of economic indicators and business climate in the country.³⁰

2.7 Signs of the shadow economy

The main indicators that show the extent of the shadow economy in the country are:

The difference between the actual level of consumption and official income;



Excessive demand for money compared to the systematic calculations of central banks; changes in the consumption of electricity and other essential resources used in the manufacturing and service sectors; The difference between labor statistics indicators and their quantities is determined through sample observations and demographic and social surveys.

The large skewness of the index indicates that a large part of the transaction status between entrepreneurs and firms is ambiguous underestimation of the real level of income³¹.

2.8 Methods for evaluating shadow strength

Scientists have studied many pollutants and key influencing factors and have developed methods for economic "shadow" quantification.

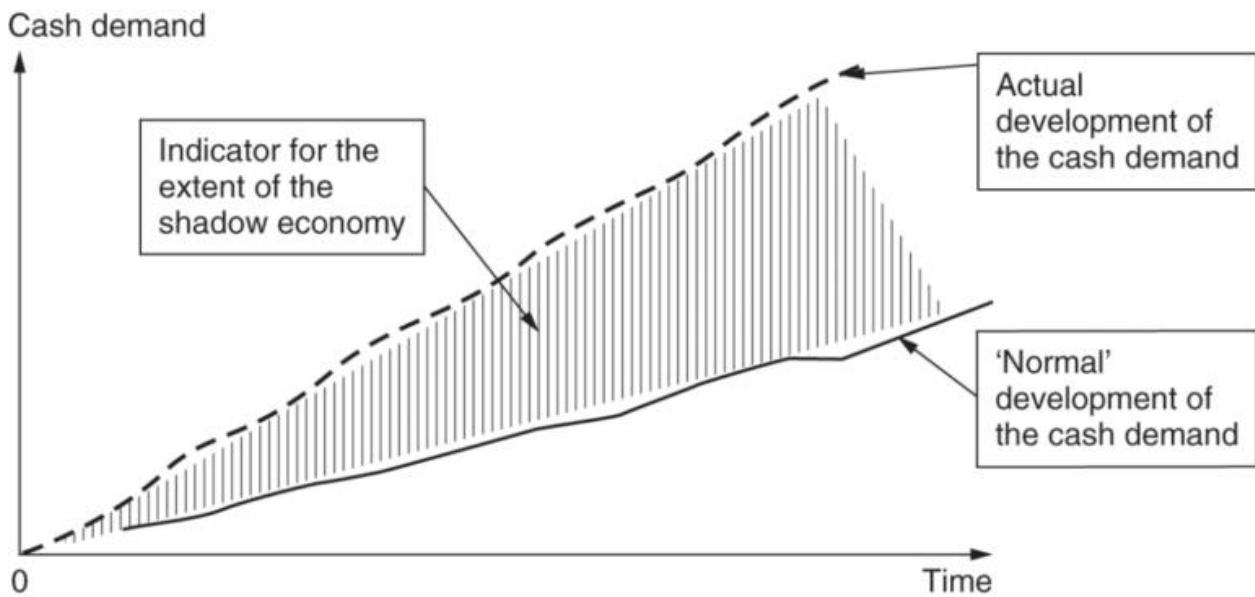


Figure (2): Methods for evaluating shadow strength

The direct method is the analysis of information obtained from surveys, observations and ad hoc audits in the areas of income and expenditure of business entities, healthy citizens and their actual employment. Indirect methods include a comprehensive analysis of the differences between calculated and actual data on commodity flows and consumption of major production resources.

The monetary approach is based on comparison and analysis of the usage of cash in circulation. structural approach aim to study the share of hidden sales in key areas of the shadow economy³².

3.RESULT DISCUSSION

Comments from a sample of experts in the economic field were collected and data were collected to achieve the research objectives.

Research Method: This study adopted a descriptive approach to describe the research variables and analyze relationships to achieve the research objectives. Descriptive analysis methods were also used to confirm the research hypotheses.

The sample size was 435 people to obtain the information required for the study, which included discussion by asking a set of questions to confirm or deny the research hypothesis. Data were analyzed using SPSS and percentages and ratios were calculated using analytical statistics. Arithmetic and semantic differences in sample members' opinions.

3.1 Describe sample responses to study variables personal data

Table No. (1) Showing the number of arts studies by gender diversity

Male to female frequency ratio	No.	frequency ratio
male	291	%67
Females	144	%33
the total	435	%100



From Table No. (1), We note that within the study sample size, the number of men is approximately twice the number of women. Men constituted 67% of the total sample size, and women constituted 33% of size.

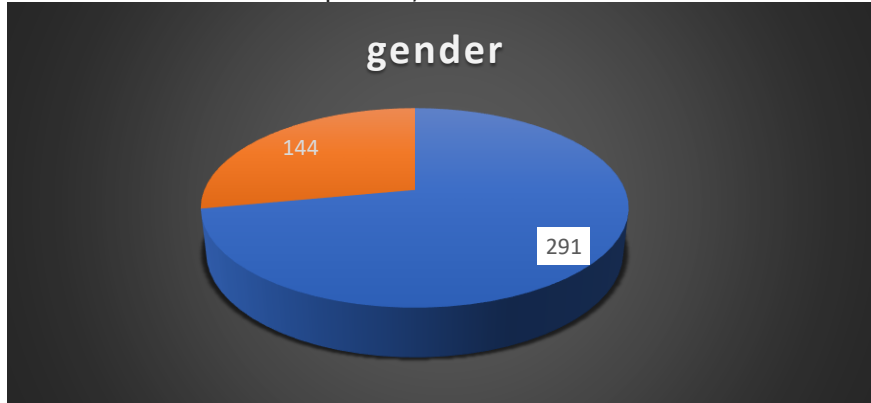


Figure (3) shows the study sample size according to the gender variable.

Table (2) shows the study sample size according to the age variable.

age	male	ratio	Females	ratio
Less than 20 years	112	%38	88	%61
From 21-30 years old	102	%35	45	%32
From 31-40 years old	55	%19	8	%5
More than 40 years	22	%8	3	%2
the total	291	%100	144	%100

Through Table No. (2), we notice that the youth group is more knowledgeable about the external effects of capital on economic growth for the age group between less than 21 years and 30 years, especially among males, as the percentage of the employment age group from 21 years - 30 years has exceeded 35%.

Table (3) shows the sample size according to academic achievement variables.

Educational level	male	ratio	Females	ratio
Bachelor's	177	61%	122	85%
Higher Diploma	89	31%	22	15%
Master's	20	%6	0	0%
Ph.D	5	%2	0	0%
the total	291	%100	144	%100

From Table No. (3), we notice that the percentage of males who hold a bachelor's degree reached 85%, while the number of females reached 61%, while the number of holders of a certificate and master's degrees reached 31%, while the number of females reached 15%.

Table No. (4) shows Cronbach's alpha coefficient.

Axis items	Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
1	0.786	.798	10
2	0.877	.890	5
3	0.834	.822	10
4	0.982	0.988	5

From the table above, you can clearly see that the lowest alpha ratio is (0.786), which That's a pretty high percentage. It was confirmed that the survey achieved good results, demonstrating the validity and stability of the results.

Research hypothesis



The hypothesis: There is a statistically significant relationship between the impact of the hidden economy on financial stability and economic policies in Iraq.

Table No. (5) shows the analysis of variance to test the hypothesis

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	66.99	85	.0321	.0723	.0049 ^b
	Residual	39.585	115	.0435		
	Total	106.575	200			

We observe in the previous regression analysis table that there is a statistically significant relationship between impact of the implicit economy on financial stability and Iraq's economic policies.

At the significance level of (0.01), indicating that it has a high moral impact, the null hypothesis is accepted, which states that (the impact of implicit economics is on financial stability and economic policies in Iraq.

That is, there is an impact of the hidden economy on financial stability and economic policies.

Table No. (6) shows the analysis of variance to test the hypothesis

correlation coefficient	corrected	coefficient of determination	Standard error
0.883	0.874	0.902	0.545

reached (0.883), meaning that the hidden economy on financial stability and economic policies.

Its value is (0.883) and the remainder (0.117) is due to variables outside the studied elements.

4. CONCLUSION

1- The shadow economy affects societies greatly from a moral and social standpoint, as dealings between members of society must be based on sound moral and religious motives stemming from the self-monitoring of the conscience of individuals.

2- The shadow economy is a manifestation of backwardness in societies, as one of its most prominent negatives is the process of wasting human energies and material resources in terms of their misuse and thus high unemployment rates.

3- Influencing the fair distribution of income, and redistributing income towards unproductive groups through their obtaining illegal income, which widens the gap between the upper and lower classes in the distribution of income, and the rise of undeserving groups at the expense of deserving groups, as income and wealth are concentrated in the hands of immoral groups, and thus Higher, negative values are entrenched in society, despair spreads among honest people, and as a result society decomposes and collapses internally

4- It affects the national income of the formal economy because of the money going abroad as a result of money laundering operations.

5- Economic instability as a result of shadow economy activities being reflected in the estimates of state statistical agencies, which has a negative impact on the accuracy of the information and data that decision-makers rely on in formulating overall policies.

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