SHADOW ECONOMY, TAX POLICIES, INSTITUTIONAL WEAKNESS AND FINANCIAL STABILITY IN SELECTED OECD COUNTRIES

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Abstract:
We investigate the effect of taxation, corruption and financial stability on the shadow economy in 23 OECD countries. For this purpose, we use a panel framework and a difference-in-difference system-GMM model over the period 2001 to 2013. While the taxation effects are assessed through the corporate income tax and the average tax wedge, the banking sector Z-score computed based on four different models represents our proxy for the financial system stability. Our results show that only the average tax wedge by family has a positive influence on the shadow economy dynamics, whereas the effect of corporate income tax proves insignificant. Further, our findings indicate a negative influence of the financial stability on the shadow economy, but the significant effect depends on how the Z-score is calculated. Finally, the corruption perception positively impacts the shadow economy dynamics. All in all, our outcomes support the idea that excessive tax burden, financial instability and institutional weaknesses range amongst the factors influencing the shadow economy.

Keywords: shadow economy, tax policies, financial stability, Z-score, GMM model, OECD countries