
Editorial

The "Shadow Economy"

It is strange how legends are born, and even stranger when those legends become elevated to the status of received wisdom, and form the supposedly authoritative basis for debate about public policy. This is what has happened with the so-called "black economy". Until Mrs Thatcher came into office and jacked up the level of unemployment, there was no official estimate of the scale of the black economy. There were plenty of envious and disapproving anecdotes about the fortunes to be made by purveying services on a cash-payment, no-questions-asked basis, but no-one tried to put an exact figure on the scale of the phenomenon. Enter Sir Lawrence Airey, Chairman of the Inland Revenue, who told the Commons' Public Accounts Committee that it was "not implausible" that the black economy amounted to 7½ per cent of the Gross Domestic Product. He admitted that this was a "guestimate", not based on any detailed research, but the figure was accepted as the basis for the PAC's 1981 report on the subject, and subsequently became widely accepted as the authoritative figure.

However, even at the time, there were dissenting voices. One American academic, Professor Edgar Feige, suggested that the real figure was around 15 per cent. The Central Statistical Office calculated it to be a little over 3½ per cent. And the Institute of Fiscal Studies (IFS) put it at no more than 2–3 per cent. The discrepancies reflected the serious problems of definition and measurement. But the quest for quantification remains an important one. The existence of a black economy means a substantial fiscal shortfall (Sir Lawrence Airey's figure implied a tax loss of around £4 billion a year) and a substantial inaccuracy in the economic indicators used by the Treasury as the basis of policy.

The IFS has now returned to the subject in a recent book by Stephen Smith, *The Shadow Economy*, published by Oxford University Press. This estimates the current scale of the black economy to be 3–5 per cent of GDP: it highlights the danger of overstating the problem, thereby encouraging even more people to join the twilight ranks of moonlighters. However, it also refines the concept, by subsuming it under the wider phenomenon, christened "the shadow economy". This includes

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non-taxable work such as DIY and housework — not the sort of activity that appears in official figures about the size of the economy, though it can have significant economic consequences, *eg* if people stop employing professional decorators and decide instead to do-it-themselves. Myth will always surround the black economy. Reliable facts will always be hard to come by. The IFS study does not pretend to tell the whole story, but it shed much needed light on this important and mysterious phenomenon.