

# TAX EVASION IN THE CONTEXT OF THE SHADOW ECONOMY. EVIDENCE FOR THE EUROPEAN UNION COUNTRIES

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***Abstract:** In the literature, often the size of the shadow economy is considered equivalent to the size of tax evasion. This is a misunderstanding of the two concepts. This paper shows that the two concepts are related, are correlated, and congruent, but are not identical. To do so, in the current paper we highlight the differences and the similarities between the two phenomena and we present the actual relationship between them. We then present the different type of methodologies used to estimate the size of the two concepts. In the end, we present estimates of the shadow economy using the physical input approach and analyze different levels of the indicator in various areas of the European Union. The estimations show a higher level of shadow economy in the Central East European countries and a lower level in the Western European countries. The results also show a flourishing shadow economy in the European Union, the unweighted average size of the shadow economy ranging from 23,7% of the official GDP in 2007. to 21,3 % of the official GDP in 2013. To reduce tax evasion and the shadow economy is needed a multifaceted policy approach that includes enforcement, the improvement of public services and trust. Knowing the size and distribution of the shadow economy and tax evasion and the differences between them can help to develop more efficient strategies at the government level.*

**Keywords:** Shadow economy, tax evasion, estimation methods

**JEL classification:** E26, O17, D69, H53, C23

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pp.80-96