

The Experience of the Leading EU Countries in Contention with Shadow Economy: Recommendations for Ukraine

Alexey Diachenko
Alexander Galytskiy
Olena Borzenko

Abstract In modern conditions of global market transformations and change of technological state of Ukraine's perception of itself as a country, which is a component of European integrational processes and an integral part of Europe has received features of the state strategy as a key priority of the stable social and economic development. Herewith one of the main tasks of Ukraine's integration into the European area is the construction of the society oriented economy and implementation into practice of the democratic state standards. The problem of unshadowing of economic relations, which have become the result of market transformation of the national economy due to the great extent and different forms of shadow processes demonstration, essential influence on the economic dynamics, also demands immediate solution. An interesting fact is that unlike Ukraine the shadow economy is almost absent in the EU countries in such sectors as extraction of minerals, electric power industry and finances. Herewith, shadow economy has become a certain balancer of the western countries economy, that is the less is an incremental capacity in the official sector, the higher is the rise in the illegal one and vice versa. At the same time, it is rational to implement recommendations, which were introduced by FATF, World Bank and Transparency International Ukraine, into national social and economic system not only because they are effective, complete each other and are aimed at coping with immediate national economic problems, but firstly because observance of the generally accepted world standards is an important step in acceleration of European integration processes. They increase the level of trust of the foreign partner countries towards Ukraine with the help of transformation of the national economy to the European standards.

1 Introduction

Enhancement of the problem of global shadow markets in terms of the crisis overcoming and assurance of the world and national finance systems have caused topicality of this problem review on the sessions of the Parliament Assembly of the Council of Europe since 2011. The main problems of the economic shadow relations are shadow occupation and shadow financial flows (Gryshova 2015; Mostenska 2015; Moyseyenko and Ryvak 2016; Strielkowski and Gryshova 2017). That is why the investigation of the shadow economy, the determination of peculiarities of its demonstration in different countries and working out of the efficient mechanisms of national economies protection from the negative influence of shadow processes become so actual (Zielińska 2016). Shadow economy transformation and coping with corruption is not only a factor of economic growth, solution of several social issues, but also the primary task on the way of Ukraine's integration with European Union (Gryshova et al. 2017). Collaboration between Ukraine and European Union in the sphere of shadow economy transformation, which is implemented into the Partnership and Collaboration Agreement and common activity plans, may have positive

Alexey Diachenko
Odessa State Agrarian University
Odessa, Ukraine
E-mail: oleksa1983.03@gmail.com,

Alexander Galytskiy
Odessa State Agrarian University
Odessa, Ukraine
E-mail: oleksandrgalickij9@gmail.com

Olena Borzenko
SI Institute for Economics and Forecasting of NAS of Ukraine
Kiev, Ukraine
e-mail: slozko2003@ukr.net

results upon condition of the constant monitoring of this process for and behalf of the international organizations and supranational EU institutions as well as with the thorough fulfilment of obligations taken by Ukraine.

2 Literature Review

While investigating the essence of shadow economy, Weiner reviews it as a global phenomenon, which comes out of the boundaries of one country. He states that “...in most specified definitions shadow market is a group of independent, very wealthy countries and investors, who in fact have the opportunity to manage the world economy through the great supply of stocks, loan stocks, estate property, currency and other financial assets, which are kept by the unstable investment structures (hedge funds, direct investment funds, sovereign investment and stabilization funds) as well as by the huge holding companies” (Gryshova 2015). The investigation of the numerous economic organizations and independent information agencies prove the fact the level of shadow economy in the modern world comprises from 18 to 35 % of the worldwide gross domestic product (GDP). In such a way, according to the accounts of the World bank for the period of 2012 the level of the world GDP comprised 71.66 trillion US dollars. That means that the most pessimistic account proves that nowadays about 26 trillion US dollars are produced in the shadow sector (Global Risks Report 2011). For countries of European Union, Turkey, Norway and Switzerland in 2013 the general level of shadow sector comprised 18.5% of GDP and was equal to 2.15 trillion Euros (Pichugina 2015).

The results of investigations of shadow economy by the National Institute of strategic research convince that the most meaningful component of shadow economic processes is an illegal activity, particularly economic criminality, the character of which has changed in a quality manner thanks to the production globalization processes (Kapitsa 2014). On the other hand, while investigating the capacity of the markets of certain illegal goods and services, the experts of the world economy fund point at the fact that the particle of fake medicines is evaluated nowadays at the level of 200 billion dollars, the level of prostitution is 190 billion dollars, the level of gage is 140 billion dollars, the level of fake electronic engineering is 100 billion dollars, the level of cocaine is 80 billion dollars, the level of pirated software is 50 billion dollars, the level of human trafficking is 30 billion dollars. At the same time about 20 billion US dollars comprise the crimes in the sphere of environment protection and natural resources trade (Schneider 2013). As a comparison, it is worth stating that the size of some mentioned shadow markets exceeds the annual Ukraine's budget.

Unfortunately, the shadow economy exists in all countries around the world, although it differs according to size, structure and development (Jiroudková et al. 2015) and is quite often reflected in the mass media or mass media also become its part (Čábelková et al. 2015). The extent and peculiarities of shadow economy in different countries and regions of the world are closely connected with national economic models and the level of market relations readiness (Ministry of Economic Development and Trade of Ukraine 2016). For example, much lesser specific weight of the shadow sector in national economy is peculiar for the most developed countries (Chamberlin 2015). According to different estimates it comprises 12-16% of GDP, while in developing countries this rate comprises from 23 to 25% of GDP, in the countries with transition economy it comprises from 30 to 50% of GDP (The shadow economy in EU countries: how to bring workers to the light 2015). Moreover, it is worth noticing that developed countries are also incoherent in this context, as there are representatives with high rates of shadow activity among them. Austria, the USA, Switzerland and Japan have the lowest relative indexes of the shadow sector particle (at the level of 8-10% of GDP). In our opinion, shadow economic relations motivation in developed countries is explained with the mostly oversize tax pressure of the enterprises and oversize regulation of the production relations.

3 Purpose and Methods of Study

The aim of the research is the analysis of the economy shadow sector modern condition of leading countries of European Union and further implementation of their experience in confrontation with corruption and shadow economy in Ukraine. The realization of the research aim is achieved with the help of the following methods: the size measurement of the shadow sector of European countries and their division into 3 groups according to the level of national economies shadowing; research of the shadow economy structure as a whole in the European Union; use of the results of the special questionnaire by the agency “Eurobarometer” (Koretskaya 2011); 2896 respondents, who state that according to the carrying out of shadow economic relations during the last 12 months that by the end of 2014 the greatest amount of the shadow economy in building was 29%, in the service of cars- 22%, agricultural sphere and horticulture -25% (Figure 1 that follows); generalization of the facts, which were received by the famous world agencies for working out of recommendations, preventive measures and so on.

4 Results and Discussions

The last economic crisis has become one of the reasons of shadow processes rollout in the world, particularly in the countries of European Union. From the point of view of shadow sector size, the countries of the European Union can be divided into 3 groups (Kharazishvili 2016).

Table 1 The dynamics of the shadow economy level in the EU countries

Country	Years						+/- 2015 comparing to 2010
	2010	2011	2012	2013	2014	2015	
Austria	8.2	7.9	7.6	7.5	7.8	8.2	0
Belgium	17.4	17.1	16.8	16.4	16.1	16.2	-1.2
Bulgaria	32.6	32.3	31.9	31.2	31.0	30.6	-2.0
Croatia	29.8	29.5	29.0	28.4	28.0	27.7	-2.1
Czech Republic	16.7	16.4	16.0	15.5	15.3	15.1	-1.6
Denmark	14.0	13.8	13.4	13.0	12.8	12.0	-2.0
Estonia	29.3	28.6	28.2	27.6	27.1	26.2	-3.1
Finland	14.0	13.7	13.3	13.0	12.9	12.4	-1.6
France	11.3	11.0	10.8	9.9	10.8	12.3	+1.0
Germany	13.9	13.2	12.9	12.4	12.2	12.2	-1.7
Greece	25.4	24.3	24.0	23.6	23.3	22.4	-3.0
Hungary	23.3	22.8	22.5	22.1	21.6	21.9	-1.4
Ireland	13.0	12.8	12.7	12.2	11.8	11.3	-1.7
Italy	21.8	21.2	21.6	21.1	20.8	20.6	-1.2
Latvia	27.3	26.5	26.1	25.5	24.7	23.6	-3.7
Lithuania	29.7	29.0	28.5	28.0	27.1	25.6	-4.1
Luxemburg	8.4	8.2	8.2	8.0	8.1	8.3	-0.1
Malta	26.0	25.8	25.3	24.3	24.0	24.3	-1.7
the Netherlands	10.0	9.8	9.5	9.1	9.2	9.0	-1.0
Poland	25.4	25.0	24.4	23.8	23.5	23.3	-2.1
Portugal	19.2	19.4	19.4	19.0	18.7	17.6	-1.6
Romania	29.8	29.6	29.1	28.4	28.1	28.0	-1.8
Slovenia	24.3	24.1	23.6	23.1	23.5	23.3	-1.0
Cyprus	26.2	26.0	25.6	25.2	25.7	24.8	-1.4
Spain	19.4	19.2	19.2	18.6	18.5	18.2	-1.2
Slovakia	16.4	16.0	15.5	15.0	14.6	14.1	-2.3
Sweden	15.0	14.7	14.3	13.9	13.6	13.2	-1.8
Great Britain	10.7	10.5	10.1	9.7	9.6	9.4	-1.3
EU-28 in the average	19.9	19.6	19.3	18.8	18.6	18.3	-1.6

Source: Koretskaya (2011)

The first group consists of 14 states, which have the least sizes of the shadow economy. By the beginning of 2016 several countries belong to this group. They are: Austria and Luxembourg – 8.2-8.3%, the Netherlands – 9.0%, Great Britain – 9.4%, Ireland – 11.3%. The worst rates for this group are basic for Belgium – 16.2% and Portugal – 17.6% (Table 1).

The second group comprises the countries, where the rates of shadow economy are average for all EU countries and are almost 20-25 % of GDP. Several countries belong to this group: Spain – 18,2%, Italy – 20,6%, Hungary – 21.9%, Greece, Poland, Malta, Cyprus – 22,4-24,8%. Lithuania has the worst rates in this group - 25.6%.

The third group comprises the countries, in which shadow economy rates are the highest among all EU countries and amount to the third part of GDP. We have put some countries into this group. They are: Estonia, Croatia, Romania with the shadow level of 26.2-28%. Bulgaria has the worst rates in this group – 30.6% of GDP. It is the state, where over 60 % of shadow economy is engaged in tourism.

The EU as a whole has an interesting structure of shadow economy. According to the investigations of the French magazine LeMonde, it is formed by the illegal labor relations of employers and employees, who are mostly engaged in building, agriculture and house managements. The rest 33.5% are made up with the income, which are hidden from the tax services, often in the sphere of retail business, hospitality industry, payment for a taxi and so on (Kharazishvili 2016).

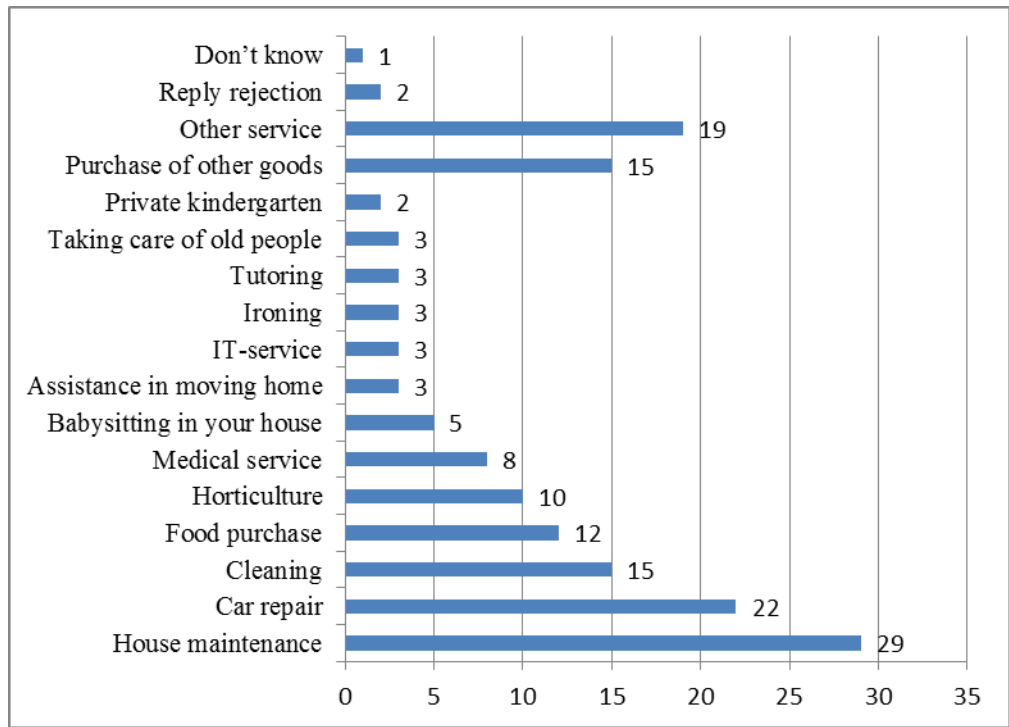


Fig. 1 The structure of the shadow economic activity in the EU countries according to its differentiated types
Source: Kharazishvili (2016)

So, in opinion of Koretska the development of shadow economy in the EU countries is caused first of all by (Kurbanov 2014): the tax pressure and the weight of social insurance; abundant proposal of labor; low economic growth; inequality of income; corruption and non-efficiency of the state adjustment and so on

The leading EU countries with the developed economy pay a lot of attention to reduce of the economic relations shadow level and reduce of corruption. Due to Ukraine's intention to approach European standards, an implementation of EU countries experience not only in the political sphere, but in economic sphere in particular is very important according to the national economy unshadowing.

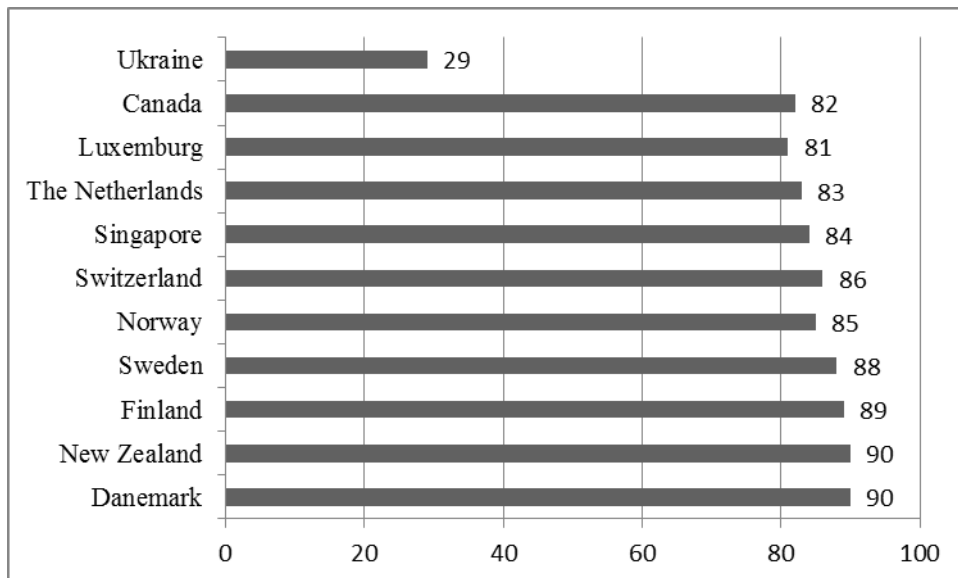


Fig. 2 Rrating of the world leading countries according to the contention with corruption in 2017
Source: Naumov (2017)

One of the main reasons of the shadow economy existence in any country is the corruption of its sectors and the executive bodies. The general level of corruption in Ukraine and several world countries according to the Corruption perceptions index 2016 are represented in Figure 2 (Naumov 2017). Taking it into consideration, we can

make a conclusion about unreasonable level of corruption in Ukraine (the higher is the evaluation, the “clearer” is economy), which is evaluated by 29 points in the general rating and assures the 131st position together with Iran, Kazakhstan, Russia, and Nepal in spite of the rising tendency of +4 points comparing with the level of 2013.

Taking it into account, Transparency International Ukraine suggests the following five steps for the fulfilment of the real anticorruption regeneration:

1. To create an efficient system of the anticorruption justice involving foreign specialists as the active participants of selection of judges for this courts. This and the efficient work of the National Anti-Corruption Bureau of Ukraine will allow making the contention with corruption more active. In particular, it will guarantee the efficiency of electronic declarations checkup.
2. Enhance all the opportunities for the efficient investigation and bringing to court all the defendants of “Yanukovich’s sanction list”. It is important not only to achieve judgement, even indirect, but also to return the stolen money, both offshore and which were left in Ukraine. The same things concern the facts of corruption in the acting government.
3. To involve business, both Ukrainian and international, more actively towards new clear rules regulation of interrelation in the triangle “society-power-business”. To assure stable conditions for business carrying out with the methods of deregulation, tax legislation predictability, change its attitude to Ukraine.
4. To carry out audit and to reduce the level of security in the security and defense sector towards such directions as: the state budget items, annual plans of the state purchases, information about purchases carrying out and conducted contracts.
5. To adjust the system communication with society and international partners according to the anticorruption reform on the basis of real facts and achievements, but not promises. To abide international obligations legibly.

In this context the analysis of the foreign experience of contention with corruption and shadow economic relations in developed countries, especially in the Netherlands, acquires topicality. This analysis is based upon such main principles as:

- Constant accountancy and publicity, particularly the Minister of the Interior reports to the Parliament about the revealed facts of corruption and taken measures;
- Working out of the monitoring system according to different sources of corruption appearance and suspicious people;
- Working out of the anticorruption legislation for civil servants;
- A rough system of punishment, in particular the prohibition to hold the state positions, fines, suspension from duties fulfilment;
- Implementation of subdivisions which monitor the civil servants’ activity in all state bodies; publicity of all materials according to the cases, connected with corruption when it does not damage the system of national safety; civil servants have the right to become familiar with the whole characteristics about themselves;
- Functioning of the system of civil servants’ training, which explains all the peculiarities, connected with their activity;
- Functioning of the system of anti-corruption state security like social policy;
- Assignment for the civil servants of the registration duty of all cases of corruption, which they are aware of; cooperation with mass media (Gryshova et al. 2017)

An effective control and use of high fines for violation of law are very important for the fulfilment of the effective economy unshadowing. The existing in Ukraine system of fines is the lowest in Europe. The size of sanction for labor law violation comprises from 510 to 850 hrivnyas. Nonfulfillment of the inspector’s demands towards corrective actions is fined up in the amount of 850-1700 hrivnyas. Comparing with Eastern European countries minimal penal sanctions for non-formalization of labor contract comprise from 8.3 thousand hrivnyas (Bulgaria) to 100.0 thousand hrivnyas (Czech Republic), maximum – to 2.0 million hrivnyas (Slovakia).

An illegal labor market gains great development in the EU countries. The situation becomes even worse due to illegal migration and the difference in the amount of salary in the neighboring transitional states and EU countries. The growth of the unemployment level and, as a consequence, pressure strengthening of social benefits on the budget of the countries took place in the result of enlargement of illegal labor market.

On the basis of the conducted research of the foreign means of economy unshadowing and with the aim to resist shadow economic relations in Ukraine we propose their implementation according to the spheres of use.

4.1 Administrative-Legal Sphere

- taking into account the efficiency of organization of specialized services on corruption contention in the countries with a low level of shadow economy it is necessary to found Financial control services like Anti cheat bureau at the local level, by the regional deputy councils with the state financing, which will function

at the local level and will include deputies of the local councils and different spheres specialists: economy, law, computer studies, financial policy. Due to the existing experience of contention with financial flows shadowing, it is worth to involve the specialists of the National Bank of Ukraine, State Fiscal Service of Ukraine, State Audit Service of Ukraine and Department of Treasury of Ukraine etc.;

- to implement differentiated penal sanctions for the enterprises, which encourage the development of shadow labor relations taking into account the sizes of their activity. For instance, penal sanctions in proportion with the quantity of illegal employers and the time of their occupation, if it can be counted, can be used for small enterprises and local enterprises. Withdrawal from the list of the state purchases or disposal of the foreign investment for a certain period of time may be used for large enterprises as a sanction. Such changes will allow reducing the number of illegal employers and make up the budget losses from an illegal employment;
- implement an increased responsibility of the subjects of economic affairs for the shadow business and corruption activity in the sphere of illegal employment and manipulations connected with the salary and allocations to the social insurance funds;
- to prohibit financing of the political parties for the costs of private or legal entities by law and to implement the control for the money flows, which are available for the latter during their election campaign;
- to carry out in the court of law nationalization of property, money on the bank accounts and other material values of corrupt officials, economic criminals and their groupings for the benefit of local communities in the case of the crime reveal and proving and with the aim to warn other demonstrations of shadow affairs and corruption;
- to limit the marginal cost in cash equivalent, according to which a gift for the civil servant can be made and to limit the annual quantity of such gifts with the aim of bribery demonstration thickening and avoidance of the great part of protectionism in the legislative and executive authority;
- to implement a compulsory registration of the new corruption actions and shadow economic activity of the subjects of social affairs at the local, regional and national level; their publicity in the mass media as well as the working out of the tough sanction system taking into account frequency and difficulty of the law violation towards civil servants and officials;
- to raise the knowledge of citizens according to the corruption and shadow economy demonstration and the criminal responsibility (punishment) for the definite crimes commitment;
- to carry out from time to time the civil servants' and officials' training according to the rules and ethic norms of behavior, anti-corruption legislation and effective systems of control and sanctions;
- with the aim of strategic priorities realization of the state policy formation to resist national economy shadow process and society corrupt practice, for assurance of scientific working out of these issues it is worth to create the department of economic unshadowing and society corruption problems. There should be such tasks as: 1) coordination and carrying out of research of the forms, methods and mechanisms of economy shadow sector functioning and corruption development; 2) carrying out of the monitoring of the volume, dynamics and structural changes of the economy shadow sector and corruption demonstration, definition of its influence on the social and economic situation in the country; 3) carrying out of the long term forecasting and working out of managerial and legal recommendations towards the methods of sources localization of the social and economic affairs shadow processes, etc. (Gryshova et al. 2017)
- with the aim to increase information and communication (IT) safety : 1) to improve the formation of the means of prevention, detection, delay and investigation of crimes in the cyber space, legal responsibility for such crimes and mechanisms of bringing them to justice, regulated by the law; 2) to provide effective hardware and software for detection and prevention of cyber-crimes as well as the means of crypto protection of information with the limited access; 3) to create the state services intended to direct resistance of cybercrimes, fulfil the training of the highly qualified specialists in the sphere of cybercrimes resistance with the highest level of their information and technological assurance.

Due to the investigated foreign experience of economy unshadowing of the countries at the level of 5-17 % and taking into account the high level of economic affairs shadowing in Ukraine, it is worth, in our opinion, to wait for the reduce of the shadow activity to 7-10% even with the less effect of the mentioned measures.

4.2 Banking Sphere

With the aim to advance the development of the cashless transfers as the key measures according to the shadow turn out reduce in the financial sector it is necessary to take the following system measures:

- the creation of the mechanisms of information cooperation of the tax authority with monitoring bodies according to the suspicious financial operations;
- return of costs by the banks of the second level to clients in cases of the illegal use of the non-cash resources by swindlers;

- carrying out measurements on the increase of the level of population knowledge about the existing system of non-cash payments and the use of the payment cards together with banks of the second level in the mass media and Internet resources;
- introduction of amendments to legislation on the assurance of information disclosure according to the ultimate owners of banks and non-bank financial institutions;
- resistance of the assets flow off to the low tax countries, the construction of the effective system of return of costs and assets from abroad, which were received by illegal means in the result of operations of costs legalization (money laundering) and terrorism financing;
- the improvement of the system of plastic cards protection with microchips will be rational in the modern conditions, as it will help to reduce the level of economic cybercrimes greatly etc.

Due to the fact that Ukraine is the leader among the world states in the sphere of wire fraud, the realization of the mentioned measurements will encourage an essential limit of their demonstration, according to our forecasts up to 10-15%.

4.3 Tax Sphere

With the aim to increase the efficiency of the fiscal administration it is necessary to assure the realization of the following measurements:

- To carry out tax amnesty on the basis of the clear and distinct procedure, which will allow raising the trust of business towards the state and vice versa and increase income to the state budget;
- to increase the role of electronic systems in tax administration, that will allow reducing physical contact of taxmen with taxpayers and will improve clarity of tax monitoring;
- to reduce tax pressure and shorten the quantity of obligatory payments of tax allowances, which will assure equal conditions for all taxpayers and reduce motivation towards decrease of cases of tax obligations minimization;
- to reform reduced system, so that it would include only small enterprises and wouldn't be the instrument for financial flows minimization;
- to solve the problems of debts according to the return of VAT in order to support export and raise of trust of business towards the state;
- to intensify responsibility for the use of shadow tax schemes during business operations and purposeful minimization of tax obligations.

Due to the experience and efficiency of these measurements in Germany, they may lead to reduce of about 4-5% of shadow affairs in Ukraine.

In such a way, observation of recommendations of international experts and organizations as well as foreign experience implementation towards economy shadow process is rational upon condition of their analysis, combination and modelling. Only taking into account evaluation of efficiency and adaptation to Ukrainian reality, these or those recommendations may be implemented, as not all of them are effective.

5 Conclusions

The generalization of the existing measurements of contention with shadow economy development of the leading EU countries allowed distinguishing the following:

First and foremost, it seems that the resistance of economy shadow process is realized at the following levels: national, regional (in terms of union) and international (in terms of international organizations, which include EU countries). Furthermore, it also appears that the main ways of contention with shadow economy are: contention with corruption, changes in tax policy; limit of shadow market of labor power in EU; contention with black money laundering; contention with the criminal sector of shadow economy, first of all with the drug industry.

Moreover, it appears that the contention with shadow economy in the EU has a complex character. From the point of view of methods, the resistance of negative aspects of shadow economy is not limited only with sanctions for violation of terms of prohibition (as a great amount of budget assets is necessary for the effective sanctions implementation).

Finally, it becomes clear that the main weapon in the EU governments' arsenal in contention with shadow economy is a clear tax, criminal and civil right; high level of payment for labor of civil servants; high quality of state service for population; effective mechanism of citizens' rights and freedoms defense before invasion of the state structures; efficient market mechanism and a high level of competitiveness.

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