

SHADOW FINANCE: PRINCIPAL APPROACHES TO THE RESEARCH

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This article analyzes shadow finance, general characteristics of the shadow financial relations and evaluation approaches to the research work. The article presents the structure of the shadow finance; the impact of the shadow finance on the countries' socio-economic development is examined.

Nowadays, economical shadow processes have become a reality and have acquired the status of the key problem not only on the level of national but also world economy. Shadow economy existence, more or less, is a characteristic feature of every country, while for a transition economy country, such as Russia, the scale of this phenomenon assumes the character of a national problem.

This can be caused by a number of factors that are referred to structural economic backwardness, incompleteness in the processes of property institution formation, unregulated transient processes nature, shock therapy economic reforms, relatively weak governmental authorities, as well as its corruption, utter insufficient measures taken that are focused on organized crime defeat, high criminal influence in the economic sphere.

Shadow economy presence has an impact on the most important national measures, enterprises' performance results and its development prospects. Without taking the shadow constituents into consideration, it is practically impossible to get an objective idea of the national economic scale, its sectors, and the volumes of enterprises' business transactions.

Today shadow economy cannot exist without cost estimates and shadow financial flows, thus, shadow financial relations are supposed to generate its basement.

Shadow economy financial sphere is believed to be both one of the least investigated and at the same time the most suppressed shadow activity sphere. Its structure depends on many factors, such as: shadow organization size, types of shadow activities, illicit market' peculiarities, the status of criminal community members, etc.

In fact, shadow finance corresponds to the complex of economic relations connected with

the funds formation, distribution and redistribution between various economic entities. Such relations are directed to the implementation of economic entities' interests, and, therefore, being conspiratorial, they are neither represented by official statistics nor inspected by the state.

Actually, individuals (individual persons), households, organizations (artificial persons), the state, interstate structures, unions, informal entities (shadow structures) are able to act as shadow finance subjects. In formal finance the subjects have the similar legal status, whereas in shadow finance, as a rule, the first side of relations usually indicates the active subject, the second one - the passive subject.

Shadow finance object includes real gross domestic product and so-called "fictitious" real gross domestic product (distortions to government orders and purchases, speculative transactions, bribery, fraud of various kind connected with money receive and transferal), gross national product (GNP), and sometimes national wealth. In other words, the object corresponds to financial resources that are performed by real and fictitious valuables processing value terms.

Shadow finance comprise:

◆ "latent" finance (based on legal dealership, but illegal in some forms of their appearance, for instance, tax avoidance, illegal earnings concealment, barter),

◆ "unlawful" finance (unarranged by the rule of law, never represented by official statistics, activities unregistered in reports and contracts). Moreover, it can be an activity that disturb with other economic agents' rights and is not law regulated - financial pyramids, the lobbying of particular business entities, the suppressing of important economic information (for instance, about the limitation of participants in a tender, etc.),

◆ fictitious finance (distortions to government orders and purchases, the display of non-

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existent activities in the financial accountability, etc.),

◆ criminal finance (financial activity results prohibited by law that, namely, incorporate drug dealing, racket, prostitution, economic crime, theft, piracy products, illegal weapon turnover, human traffic and public domain embezzlement incomings, etc.).

Criminal finance is different from the other types of shadow finance by the scale and the nature of activity. The turnover of funds in an organized criminal community and their systematic shadow monetary funds replenishment in an immense scale are considered in this article.

All shadow finance types are interrelated and connected with each other. Such a structuring assists in defining of a society's and state's attitude towards shadow finance. Furthermore, it helps to conclude that among the objective factors, generating shadow finance, there are, in fact, some subjective factors that can be marked, when there are constantly reproduced forces in the specific economics using and sometimes even creating the conditions of this or that shadow economic segment existence.

The principal shadow finance signs are monetary nature of relations, illegality (wrongfulness), concealed and hazardous character (the presence of legal and economic hazards).

Shadow finance possesses a unique subject-legal basis that lies in the notions of "illegality" and "latency". Shadow finance illegality implies either their wrongfulness or law abuse of this or that economic entity, whereas latency consists in confidential monetary transactions' character that forms financial secrecy of individuals, organizations, state and interstate structures, unions, informal entities.

Hazards are understood as enhanced legal and economic risks that can be fairly complicated to detect, since business activities are usually held under ambiguous conditions and, therefore, such an activity is believed to be rather risky. Any economic entity participation in shadow finance involves it in the situation of legal inconsistency and contravention.

Unfortunately, a traditional and modern analysis of enterprise's financial activities doesn't take into consideration the shadow processes' constituents that characterize the productive and financial realities of economic entities. As a rule, experts and researchers treat

productive and financial processes, taking place on the enterprise and around it, as ideal entities.

The strengthening of shadow threat to the national economy, as well as, to the world's economy is conducted against the background of many countries switching over to *innovative development type*. The active innovation technology's promotion becomes the characteristics of the modern economic progress. Innovations turn into the major objective factor of the national and world's progress.

Innovative type of economic development demands special qualities from workers and businessmen. Moreover, the pioneer is to possess of a unique mindset, an ability to see the problems from the other angle. Such a person can be characterized by improvised solutions that will assure timely enterprise conversion, corrections that are preceded from the changing market conditions. What does actually happen with the businessmen that are to act in the network of shadow economic angle? Shadow economics is characterized by closure, and every closure will prevent from innovational development.

In addition, according to the outstanding economists' opinions, day by day the modern economic progress is acquiring more and more financial high-capacity character.

In turn, financial systems are inherently quite *unreliable*; many financial services are risky and correspond to the sphere of suspense. The thing is not only in the fact that the money is transferred under assurance of returning it in the future, but it is also performed in spite of boundedness and inadequacy of information concerning both the counter parties' capabilities (unfavorable choice) and their future behavior. Financial systems are unable to exist without credit, however, credit signifies the usage of loan capital, and the latter implies the bankruptcy risk capable of evoking a chain reaction.

It is necessary to distinguish the following things:

a) a stable growth based on the constant increase of labor productivity and advanced manufacturing sciences usage that are supported by effective financial resources distribution and management monitoring,

b) temporary growth at the expense of unreasonable increase in borrowings.

Financial sphere expansion is restricted from the ambiguity growth and significant risks. There is no doubt that a more intensive financial relations development, not attended by institutional reforms, can lead not to the reduction of financial hazards but, on the contrary, to the fundamental decrease in risks controllability or, generally speaking, to the total impossibility of their managing.

Many countries that have tried to convert financial flows into “an export business”, but haven’t created the required legal, controlling and supervisory structures for it, occurred in the situation when the things generated as world’s financial centers have turned into *the money-laundering centers*.

The increase in the scale of financial sphere indicates the external funds enlargement of a greater number of enterprises and certain economy sectors that, in the conditions of the lack of state financial resources, will bring the economic entities to shadow financial flows, particularly, it is concerned the developing and transition economies. Along with officially organized finance, uncontrolled shadow financial intermediaries are typical representatives of modern national economies.

Practically, it means that a vast shadow finance network exists in many countries. The problem of access to finance is worth-speaking of, at least, due to 2 reasons. Firstly, it is closely connected to the poverty scale. The partial access is the leading factor in poverty preservation, since it restricts the small-scale business possibilities in the development of its entrepreneurial abilities and in the demonstration of its innovative potential.

Secondly, the spillovers may appear for small anedium enterprises in the financial sphere. Every potential small undertaker commences from the idea in itself that can be of innovative character. The small-scale enterprise formation, as a rule, is the only way to implement this idea and is impossible without an access to the essential financial resources. Many of these ideas are believed to be unproductive; nevertheless, some of them by contributing to innovative processes and economic growth will demonstrate their social implication.

There are, actually, two basic obstacles for small-scale enterprises. On the one hand, poor companies and companies on their initial development stage are deprived of an essential credit

support, on the other hand, the fixed-costs scale, including expenses on information obtaining, monitoring, levy and law enforcement assurance, can become defeating for small financial contracts and transactions. When the access to the formal financial sector is restricted, small, poor, isolated enterprises and individuals refer to various shadow financial sources in order to get support and, in addition, use different non-financial means of receiving the required attendance, that formal financial system is unable to provide them with.

Hence, shadow finance is of immense importance for small anedium enterprises and certain population groups, practically, in all the countries with the developing and transient economies.

During the absence of law enforcement gear functioning shadow finance substitutes a number of alternative stimulating and informational gears, including public enforcement to penalties for deliberate default, cover funds and a guaranty type, when the rights for asserts’ possession and their usage are given to the creditor in the capacity of assurance.

A possible short-range positive effect from getting access to shadow finance can lead in a long-term outlook to major negative consequences for the business entities using these sources. For the current enterprises there is no point in the distribution of their progress because of shadow finance latency factor. This situation can occur under favorable circumstances, whereas, a more typical case consists in inclusion of a greater number of small anedium enterprises into a shadow production, shadow finance networks and, in the sequel, the impossibility of their functioning in legal economic sphere.

One of the most important features of microenvironment, defining qualitative difference in the conditions of the enterprises’ development in Russia, is the formation of the coexisting institutional systems, which are spread on all the spheres, and guaranteeing of their relatively stable reproduction. The ignorance of economics dissimilarity leads to serious failures in the state deal (economic policy) both on macro and micro-levels. Thus, economics and enterprises respond to control actions by unexpected and undesirable qualitative and quantitative results.

Financial management is considered to be almost the most complicated task for the majority of enterprises interested in an effective financial resources accumulating and distribution, financial flows managing and keeping up the key financial-economic rates on the required level.

Shadow financial policy is reckoned while considering shadow economic enterprises' activities. Nowadays, shadow financial policy, in which the protection principles and the principle of pecuniary interest implementation of one economic entity in opposition to the other are reflected, has become a matter of great significance.

Among the principal external factors that generate shadow financial policy are the reinforcement of financial performance differentiation between the economic entities, globalization of financial relations, growing financial markets' risks, ubiquitous intensification of business competition and a struggle for economic business security.

The fundamental internal tools of shadow financial politics are as follows:

- ◆ shadow management usage - suppressed financial management system, flow of costs and slush funds;
- ◆ the lack of system of obligatory correlation and relations between legal support and financial management;
- ◆ confidential and subjective character of informational and standardized support, the usage of latent power tools;
- ◆ the usage of pressure tactics while considering the question of financial enterprise management;
- ◆ the usage of shadow accounting system (double-entry book-keeping)
- ◆ the planning of shadow financial flows and slush funds;
- ◆ shadow financial plans and prognoses that define the processes, forms and methods of the generation and the usage of shadow enterprises' receipts and expenditures;
- ◆ unlawful character and high shadow investment risks ;
- ◆ tax avoidance;
- ◆ enterprises' registration subject to the reception of various benefits;
- ◆ shadow sales of products;
- ◆ purposeful and "fictitious" bankruptcies;
- ◆ corporative fraud;

- ◆ unauthorized business organization.

Shadow financial politics is conducted by shadow management that differs from the classical (legal) management by the lack of system of obligatory correlation and relations between legal support and financial management. Formal law is substituted here by the financial actions with the elements of pressure tactics; latent character of informational support and subjective confidential character of normative support take place in here; suppressed power tools are used (financial-economic spying, the structures of informational financial safety, law enforcement agencies).

Shadow finance functioning is a negative influence on the social-economic development of every country.

1. The situation with financial and economic safety of economic entities is becoming more and more aggravated that can lead to bankruptcy. Moreover, looking both from the theoretical and practical angles it can be concluded, that not only an enterprise but also a state can declare itself a bankrupt.

2. Legal and individual persons avoid tax payment in growing scales.

3. Accounting system is strained on the reason of expenses' reduction and changes in the budget's structure. The scale of ineffective budget resources' distribution is quite immense because of corruption and illegal lobbying, money redistribution at the expense of illegal exemption, licenses, quotas and other benefits.

4. The number of macroeconomics' management mistakes is constantly increasing that is connected with the lack of reliable data on the scale, structure and dynamics of the suppressed part of economic-financial and productive activities of economic entities.

5. Financial system destabilizes, risks grow, credit institutes, investors, depositors, shareholders and society in general are influenced by the damage.

6. The legalization of criminal gainings and capital export are embodied.

7. Expenses on safety assurance grow considerably.

8. Market mechanisms, competition on the national level and in the network of world's economic system are strained.

It should be pointed, that, along with the negative shadow finance influence on the soci-

ety, the existence of such type of finance has some moments which can't be treated by all means as negative. They are:

◆ the possibility of survival for the underprivileged society members, especially, in the rural areas (in Russia totally support makes out 15-20% of the population, and shadow finance considerable or partial support makes out 15-20%);

◆ the expansion of financial possibilities for business activities and economical growth, especially in the sphere of a small and medium enterprise;

◆ the employment provision of the significant part of the population.

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