

## Referee report

on

"Shadow Economies and Corruption all over the World: What do we really know?"

The main objectives of this paper is to provide measures of the relative importance of underground activities (as a percentage of GDP) for a set of 96 developing, 28 transition, and 21 developed countries during the 1999-2003 period and to infer from observations on these countries the nature of the relationship between this shadow part of the economy and the phenomenon of corruption. The first exercise allows the author to identify the main determinants of the shadow economy. How stringent regulation, in particular, that in the labor market is and how burdensome the fiscal system is are found to be the main factors. The second exercise concludes that shadow economy and corruption are negatively correlated in developed countries and positively correlated in developing countries.

While the economic questions addressed by the author are interesting from both an economic and policy perspective, the paper requires some work to be brought up to the standard of being published in an academic journal. Below, I am providing some comments that I hope will be helpful in improving the paper both in its form and its content.

-The paper needs careful proofreading for the English, but also for the style. Here are some points, but there are others that the authors should find:

.Page 3, first paragraph, second sentence (which, incidentally, is too long as are many other sentences in the article): "..their magnitude.." instead of "..the magnitude of them.."

.Page 3, second paragraph, last sentence: "..developing.." instead of "..development.."

.Page 3, footnote 1: The reference on Kazemier should have 2005a.

.Page 6, title of section 2.2: I would suggest "The main causes of the shadow economy" or "The main determinants of the shadow economy."

.Page 6, first paragraph, last sentence: "..the latter are key features.." instead of "..they are key features.."

.Page 6, third paragraph, the last complete sentence: I would suggest "..found by Schneider (1986).." instead of "..achieved by Schneider (1986).."

.Page 6, footnote 10: "..a similar result on the effects.." instead of "..a similar result of the effects.."

.Page 7, first complete paragraph: need commas after transition in two sentences.

.Page 7, explanation of the regulation index in parentheses: "..with 5 corresponding to the most stringent regulation in a country" instead of "..with 5 being/equaling the most regulation in a country. "

.Page 8, first paragraph of section 2.2.3 (too long.): I would suggest "..regulatory framework.." instead of "framework of regulations."

.Page 9, first paragraph of section 2.2.4 (too long.): I wouldn't use "..reason number 3.. " but "..the third reason.. " and I would put "due to the much higher labour costs in the official economy" between commas.

.Page 10, next to the third sentence from the end of the text: Take out the comma after "say."

.Page 13, third sentence of section 2.2.5: missing "the" before "most."

.Page 13, fourth sentence of section 2.2.5: put "and" instead of "or" and add "respectively" at the end of the sentence.

.Page 14, footnote 14: I must admit that the "innocence" of a variable is not clear to me..

.Page 14, first paragraph of section 3.1: This paragraph definitely needs editing in order to show clearly what the econometrician is doing. Is "the available data situation" proper English?

.Page 15, first paragraph: What is "the employment quota"?

.Page 15, last paragraph (too long..!), last sentence: put in "respectively"

.Page 15, footnote 19: This footnote raises an important question from both an economic - theoretical and an econometric standpoint. It is unfortunate that the author seems to underestimate the importance of this question by not discussing it at all..

.Page 17: Isn't "yield" the proper word instead of "wield"?

.Page 29, last sentence of section 3.2.4: Use "..is found in the Marshall Islands.." instead of "..have the Marshall Islands.. "

.Page 33, second paragraph: third sentence: add "economy variable" after "shadow" at the end of the sentence.

. Make sure you refer to sections rather than chapters (e.g., top of page 37..).

-The paper is a clearly too long: I would suggest taking out the discussion of the various estimation methods. This is not to say that the strength and weaknesses of these methods should be completely ignored in this paper. Rather, the authors should refer to them when discussing the empirical results in order to help the reader properly interpret those results.

-The author should say some words about the comparisons of the magnitudes of the coefficients given the "data situation."

-When estimating the size of the shadow economy doesn't the role of some major activities, e.g., oil exports for some developing countries, deserve a special treatment?..

-When discussing the relationship between the shadow economy and corruption: The terms "substitutes" and "complements" might be misleading. This paper is a reduced-form econometric study which only relies on a discussion of some theoretical implications. A fully blown behavior model would have been necessary to make the reader confident with the statement of such strong structural relationships as substitutability and complementarity.

-The "perceived" versus "actual" corruption issue deserves a clarification.

-It is unfortunate that the policy implications of the empirical results on the relationship between the shadow economy and corruption are not given due attention..