

CALL FOR PROPOSALS

Shadow economy in Estonia, Latvia, Lithuania, Georgia, Moldova, Cyprus and Malta: evidence on policy actions

1. Programme summary

The Foreign, Commonwealth and Development Office (FCDO) Research Commissioning Centre (RCC) has been established to effectively commission and manage research to enhance FCDO's development and foreign policy impact. Led by the International Initiative for Impact Evaluation (3ie), the University of Birmingham, and an unmatched consortium of UK and global research partners, the RCC aims to commission different types of high-quality research in FCDO's key priority areas. All FCDO-funded research and development (R&D) investments commissioned by the RCC will be implemented using rigorous and robust research methodologies and quality standards. These R&D standards include meeting the Frascati definition requirements and FCDO's Ethical Guidance for Research Evaluation and Monitoring Activities.¹ For this research, the RCC is working with the British Embassy in Riga.

2. Description of research to be commissioned

Research title: Shadow economy in Estonia, Latvia, Lithuania, Georgia, Moldova, Cyprus and Malta: evidence on policy actions

This call for proposals aims to identify evidence-informed policy options to tackle the shadow economy across Estonia, Latvia, Lithuania, Malta, Cyprus, Georgia, and Moldova. The research is intended to draw lessons from the available evidence on the effectiveness of policies addressed to tackle the grey economy in European countries.

3. Background

The grey or shadow economy represents a relevant share of the economies of countries worldwide. Putting it in perspective, in 2022 the grey economy contributed to 18% of the GDP in Estonia, 26% in Lithuania, and 27% in Latvia. Estimates indicate that the grey economy is equally important in other former Soviet Union (FSU) countries such as Georgia (53% of the GDP in 2015²), and Moldova (31% of the GDP in 2015³); and in Mediterranean island countries like Cyprus (32% of the GDP in 2015⁴); and Malta (21% of the GDP in 2019⁵).

¹See OECD. 2002. *Frascati Manual*. <https://doi.org/10.1787/9789264199040-en>; European Commission, Eurostat. 2014. "Manual on Measuring Research and Development in ESA 2010." Publications Office. <https://data.europa.eu/doi/10.2785/52718>; and the [FCDO Ethical Guidance for Research, Evaluation and Monitoring Activities - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/444444/FCDO_Ethical_Guidance_for_Research_Evaluation_and_Monitoring_Activities_-_GOV.UK.pdf)

² See Medina and Schneider (2021)

³ Ibidem

⁴ Ibidem

⁵ See Gauci and Rapa (2020)

Besides its relevance in terms of size, the grey economy is a double-edged sword. On one hand, it is a source of income and employment for many vulnerable groups and minorities.

On the other hand, a larger-sized grey economy is associated with higher tax avoidance, lower quality of work, and lower quality of institutions.

As Tanzi (1999) pointed out, more accurate estimates of the size of the grey economy could be helpful for policymakers to design more effective and accurate economic policies. Nonetheless, estimating the size of the grey economy is a challenging task (Schneider and Enste 2000) that is addressed with a variety of methods deployed by national statistics agencies and other organisations. The wide range of methods results in a heterogeneity of estimates which makes cross-country comparisons problematic. Estimates for the same country considerably fluctuate depending on the methods deployed for estimating the size of the grey economy (Schneider and Enste 2000). For instance, the size of the grey economy of Cyprus in 2015 ranged between 18.2% of the GDP based on the currency demand approach and 41.1% of the GDP using the modified electricity consumption method⁶, and it is estimated to contribute to 32.2% of the GDP when computed with the MIMIC approach⁷. Thus, the magnitude of the grey economy can vary by more than 20 percentage points for the same country.

The size of the grey economy can be expressed as a share of GDP (gross domestic product) and GVA (gross value added) (Schneider and Enste 2000; Charmes 2012) or in terms of the creation of employment (Chen et al. 2002; Charmes 2012). Additionally, several methods can be used for estimating the relevance of the informal economy and its evolution over time, each one with its own strengths and weaknesses (Gutman 1977; Tanzi et al. 1983; Kaufmann and Kaliberda 1996; Schneider and Enste 2000).

The FCDO has been supporting the development of a Shadow Economy Index for the Baltic States (Estonia, Latvia, and Lithuania) for many years.⁸ The index has taken a comprehensive approach to measuring the shadow economy, emphasising that it cannot be reduced by repressive methods alone. It has highlighted the importance of voluntary tax payment in return for clear benefits deriving from those taxes, without corruption. Without a more transparent and corruption-free approach, coupled with creating a business-friendly environment, a reduction in the shadow economy is unlikely.

The index work reports that in Latvia and Estonia, the most important component of the shadow economy in 2022 was envelope wages, which accounted for 46.7% of the total shadow economy in Latvia and 44.5% in Estonia. In 2022, undeclared income made up 29% of the total shadow economy in Latvia, and undeclared employees accounted for 24.3%. In 2022, unreported employees and unreported earnings in Estonia accounted for 28% and 27.5%, respectively, of the total shadow economy. In Lithuania in 2022, the most significant component of the shadow economy was undeclared earnings at 36.5% of the total shadow economy, followed by envelope wages at 34% and unreported employees at 29.5%.

There is a need for a wide range of activities to bring the shadow economy into the regulated economy. Policymakers can deploy a variety of measures ranging from the cost reduction and simplification of the regulatory framework to the increase of enforcement mechanisms,

⁶ See Andreou et al. (2021)

⁷ See Medina and Schneider (2021)

⁸ See: <https://www.sseriga.edu/shadow-economy-index-baltic-countries>

from providing incentives to tax reductions and special legal status. However, research suggests that repressive measures are limited in their effectiveness if not accompanied by positive incentives, including the reduction of corruption, the increase of transparency and the link between paying taxes and perceived benefits (Floridi et al. 2020).

4. Research need

The research is intended to synthesise evidence on the effectiveness of policy interventions tackling the grey economy across Europe, and identify lessons learned, and factors that could facilitate the success of those interventions in the Baltic countries, Malta, Cyprus, Georgia, and Moldova. Further, the research aims to identify considerations that account for the heterogeneity of the size of the grey economy across different estimation methods.

The selected project team should conduct rigorous research to gather and analyse evidence that can inform policy decision-making for taking the necessary steps to:

- Put effective plans into action to tackle and reduce the grey economy.
- Explore factors that determine the variation in estimates across methods.

The selected research team should also identify, and document lessons learned and make recommendations that project partners and stakeholders might use to improve the design and implementation of other related projects and programs.

5. Research questions and approach

The objective of the project is to identify effective policies that contribute to reducing the grey economy in the Baltic countries, Malta, Cyprus, Georgia, and Moldova.

The research should address the following questions:

1. What is the available evidence on the effectiveness of policy interventions deployed to reduce the size of the grey economy?
2. What are the unintended effects of reducing the grey economy?
3. What methodologies are most accurate for measuring the size of the grey economy?
4. Why do grey economy measures diverge and how to account for the differences between measures?

Approach and methodology

The research shall combine different methods for addressing the main questions. Notably, regarding the effectiveness of policy interventions (Q.1) and the unintended effects of grey economy reduction (Q.2), the research shall gather and analyse evidence about the effects of interventions tackling the grey economy across the proposed countries. The geographical scope can be broadened in case the size of the available body of evidence is considered as not satisfactory by the implementing team or by the FCDO.

To this end, the research shall involve conducting a systematic review adhering to international quality standards for the synthesis of evidence. The systematic review should aim to identify studies focusing on interventions implemented in European countries, including but not limited to; academic articles, policy reports, working papers and conference papers, and other grey literature. Changes to the geographical scope of the systematic review can be made upon prior approval by the FCDO.

The review should encompass the following areas representing the pillars of the grey economy:

- Tax evasion
- Informal enterprises registration
- Undeclared and under-declared labour within the formal sector
- Undeclared work within the informal sector

As for the estimation of the grey economy size (Q.3 and Q.4), a comparative analysis of different methods should be carried out. We suggest covering at least the following methods:

- Transaction method (Feige 1979)
- The cash demand method (Gutman 1977; Tanzi et al., 1983)
- The physical input/electricity consumption model (Kaufmann and Kaliberda 1996)
- The latent variable or DYMIMIC model (Schneider and Enste 2000)

There are also other methods that can be used for estimating the size of the informal economy which can be included in the review.

The research team should conduct (online) workshops with experts on the political economy of the grey economy in each of the included countries. This will help to gain insights concerning relevant contextual factors, characterising the grey economy in the considered countries.

We welcome revisions to the proposed research questions, approach, and methods, as long as they effectively respond to the overall objective of this call.

6. Deliverables and timeline

The first step of the research project will be a kick-off meeting between the contracting authority and the successful bidder. Following this meeting, the team will conduct a scoping review to start taking stock of the available evidence. The team will hold online workshops with experts on the political economy of the grey economy in each considered country. The implementing team is then expected to prepare an inception report and deliver a slide presentation of the report.

The presentation of the inception report will be followed by the interim stage, when the synthesis of the evidence will be carried out and the draft of the final report will be prepared. The preliminary findings will then be shared with the main partners in a presentation meeting. Lastly, the team will finish writing the final report and present it in a final meeting with the partners.

The final output of the project will be a report, edited in English. The length of the report should not exceed 50 pages in total (excluding the annexes). The report shall be submitted within 12 weeks after the start of the project.

The report should:

- Provide an executive summary.
- Include a critical review of methods for estimating the size of the grey economy with an emphasis on methodological factors accounting for the heterogeneity of estimates.

- Incorporate a systematic review of policy interventions targeted to the grey economy in Europe (with a focus on Estonia, Latvia, Lithuania, Malta, Cyprus, Georgia, and Moldova).
- Hold (online) workshops with experts on the political economy of the grey economy in each considered country.
- Highlight issues and related findings/lessons learned.
- Include conclusions.
- Draw recommendations for policymaking.

7. Preferred expertise and skills of the team

The team members should have the following qualifications and expertise:

- Excellent knowledge and experience in informal economy with practical experience in advising national governments (and affiliated agencies) on designing and implementing policy interventions (possibly in FSU countries).
- Understanding of public sector reform issues as related to the implementation of policies addressed to the grey economy.
- Understanding of the specifics of the current governance systems and a knowledge of the dynamics of political, economic, social and technological transition.
- Proven experience in conducting systematic reviews or other methods for the rigorous synthesis of evidence will be considered an asset.
- Research experience in FSU countries.
- Excellent writing skills.
- Fluency in English.

8. Estimated budget

The estimated budget limit of the project is £100,000.

Table 1: Deliverables and disbursements schedule

Milestone	Timeline or target date
Satisfactory delivery of inception report and initial slide presentation	Within one month
Satisfactory delivery of final report and slide presentation	Within three months

- Payments will be made upon delivery of outputs and 3ie's confirmation of receipts and utilisation of the resources.
- The process for budget and technical scope virement (i.e. any changes between project lines or to technical scope) will need to be discussed with 3ie and approved by the FCDO.
- Engagement arrangements with FCDO and a reporting schedule will be agreed upon with 3ie upon the commencement of the commissioned research. This may include touchpoints on key areas such as delivery/progress, financial management and risk.

9. Page limits and criteria for selection

The CVs should not exceed two pages. The proposals will be appraised based on the criteria summarised in the table below.

FCDO claims the rights to use the results and the deliverables of the research project. The selected team must ensure the confidentiality of information and anonymity of research participants.

Table2: Criteria for selection

#	Criterion	Description	Maximum score
1	Understanding of the call for proposals	The extent to which the application reflects the call for proposals. The application shall address important aspects of the objectives of the project, directly tackle the issue to be solved, and embrace a critical approach to solve the question.	15
2	Methodological approach and academic rigour	The overall quality of the methodological approach. This includes but is not limited to: the logical and theoretical coherence of the proposal, the design, the proposed methods and technical instruments, innovative components of the research, and stakeholder engagement.	15
3	Proposed team	The overall quality of the proposed team against the required expertise. This includes expertise and experience in the relevant fields of the project; proven experience in development projects, and in advising governments and affiliated agencies; expertise in using the required research methods; and team experience in the geographical area.	15
4	Equity and inclusion	To what extent the proposal takes into consideration cross-cutting issues, including aspects such as stakeholders' involvement and participation, gender issues, safeguarding of minorities and vulnerable groups, and protection of participants and/or respondents from risks or any harmful activity.	15
5	Financial feasibility and value for money	To what extent the proposed methodology and the expected outcomes justify the budget request. This includes the potential societal impact, clarity and organisation of activities and planning feasibility, the alignment of ambition of resources.	15
6	Research uptake plan	The overall quality of the research uptake plan. This includes the clarity of the influence goals and their consistency in relation to the uptake objectives;	15

		whether the proposal specifies strategies that will encourage the active use of the research findings; and the feasibility of the research plan along all stages of the research: design, implementation, and dissemination strategies.	
7	Overall evaluation of the project	To what extent the project, as a whole, provides a good approach to solving the critical elements of the research questions	10

An organisation that believes it can conduct high-quality research is likely to qualify, either independently or in collaboration with a partner. Only legally registered organisations and/or their consortia of registered organisations, not individuals, may apply.

Proposals will be assessed in order to ensure optimal value for money whilst balancing both costs and quality. Proposals that have clear pathways to meaningful impact will be looked upon favourably.

10. Deadline

Completed proposals should be submitted to rcc@3ieimpact.org by **12am GMT on 10 April 2024**.

11. Competition process and timeline

Stage	Target dates
Call for proposal launched	6 March 2024
Deadline for queries	13 March 2024
FAQs posted	20 March 2024
Proposal submission deadline	10 April 2024
Proposals moderation	11-12 April 2024
Selection committee meetings	15-16 April 2024
Outcome decided and bidders notified	17 April 2024
Due diligence completed	1 May 2024
Signing of the accountable grant	3 May 2024

12. Q&A and contact

This project is managed by the FCDO Research Commissioning Centre. If you have any questions related to this opportunity, please submit these to the rcc@3ieimpact.org mailbox including "RCC Grey Economy Request for Clarification" in the subject line. In the interest of fairness and transparency, all questions and answers, will be published on the [FCDO Research Commissioning Centre page](#) alongside other information on how to apply.

References

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