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Tax Reform in Georgia and the Size of the Shadow Economy

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Abstract:
This paper applies three different methods widely used in the literature to track changes in shadow economic activity in Georgia following a drastic tax reform in 2005. The first method is a currency demand approach based on macro level data. The second and third methods rely on micro data from household surveys. Overall, we find evidence that the amount of income underreporting decreased in the years following the reform. The biggest change is observed for households headed by a farmer, followed by "other" types of households where the head does not report any working status. Employed and self-employed households appear very similar before the tax reform and show minimal adjustment in income reporting in the post-reform period. Results, however, suggest that much of any difference may have come from increased enforcement efforts rather than rate changes.

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