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An econometric analysis of the underground economy and tax evasion in Kuwait

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**Abstract**

Up to now, no individual study on Kuwait with respect to the underground economy and tax evasion has been conducted using the recent adjusted form of currency demand function model (CDFM) before. This paper estimates the size of underground economy behind tax evasion from 1991: Q1 to 2010: Q4. It applies the Zivot-Andrews (ZA) procedure for the stationarity analysis, and Gregory-Hansen (GH) long run cointegrating technique for estimating the underground economy based on the adjusted currency demand function approach. While the general-to-specific technique is used to estimate the short-run error correction model. Toda-Yamamoto test is also used to explore the causal relationship between the underground economy and the non-oil tax revenues' variable. It finds that the averaged sizes of the underground economy and the tax evasion to the official gross domestic product (GDP) in Kuwait constituted about 24.95%, and 2.83% respectively.