

## “Underground” Economy Nature – Conceptual Status

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**Abstract.** *Economical experience is a projection of economic theory. What happens when the unintended consequences are more than those intended? We somehow managed to score the difference between what a science transmits and what we find in reality? We support such that the theory is the source of the crisis of a science? The economic theory of corporate capitalism is now the source of the economics science crisis? Investigations of the above can be multiplied up to a challenge, insufficiently tested, that of demystifying the nature of “underground” economy. Feel more acutely the need to rationally justify a right to conceptualize a reality that, at least statistically, can not be neglected.*

**Keywords:** “underground” economy; economics theory; human nature and human condition; epistemology; conceptualization.

**JEL Codes:** A14, B22, H26.

**REL Code:** 13I.

“I believe that most theorists would support that good economics theory is concerned with the results of interesting models that engage all inputs in maximizing individual behavior.”

George A. Akerlof

This paper does not aim to highlight any pattern of conduct in the “underground” economy, nor intends to give the wall some parts of the “underground” economy which almost gives up to moral. In this respect I propose to follow the invitation of my self conscience to this part of economic life that can not be left behind even more as many countries call for some underground resorts survive, perhaps today more than ever. The origin of writings in “underground” economics dates from 1971, when economic literature reported for the first time the term of “informal economy” used by Keith Hart in a study on the economy of Ghana, to characterize the dual employment model<sup>(1)</sup> from urban environment.

The phenomenon magnitude brings into the current the need for an accurate knowledge of the activities that forms this economical component, and also the need to find ways to counter its negative effects. In this respect, in 1977, Paul Gutmann, in his article “The Subterranean Economy”, published in the Financial Analysis Journal, launched the message that unregistered economic activity, statistically, can not be negligible. The fact that “underground” economy has come to have a considerable share of the economical activity and its growth rate is much higher than that achieved in the visible sector is an indication that we should be given attention to this phenomenon.

The research goal is to improve the understanding of the nature of the “underground” economy through a rational justification of its right to be conceptualized a reality that, at least statistically, can not be neglected anymore. If that has been said, does have “underground” economy the right to exist and to be conceptualized?

This research study falls into the category of conceptual research and methodological research. The subject is generated by the internal logic of research process and supported in the range of interest topics by the faith of a passionate researcher in such a prolific and controversial field. For completeness in analysis I choose an instrument for each objective. The methodology used is deductive and I intend to put the foundation of understanding the need for a theory of “underground” economic through a systematic analysis, comparative and comprehensive approach of the topic investigated, related to the finale and stage considered objectives.

### Unlocking the "underground" economy nature

After the assessment of the theory underlying the "underground" economy study I concluded that a good knowledge of the history of economic thought is a must for any economic analysis paper. History is one that generates rules, specific laws to economic and social system and writes new pages of history for the next generation. A society without rules and without responsibility for the rules is doomed to failure. "Underground" economy is part of the branch of economics sciences, and it is a component that should not be neglected in economic analysis having increasingly strong impact on economic indicators. The subject is spectacular enough by its nature, so I consider it is necessary to bring the scientific perspective on it. In addition, the "underground" economy is an unavoidable ingredient of a country's economy. In most cases the most profitable side of the economy being the "underground" side. Lack of consideration of this component may lead to severe shortfalls of economic analysis leading to the adoption of unrealistic strategies. Since the beginning of the work I sustain that not the quantitative side will be my interest but I'll be essentially concerned with the epistemic logic issues which are specific for "underground" economy. I think the fundamental error in researching this topic is just pulling out of the analyses the human nature. It can be seen in economic theory that humans are out of spiritual record and they are only homo economics seeking for profits<sup>(2)</sup>.

### Sterility of the term without concept

In terms of terminology, there is strong controversy in the literature, meeting over 40 terms that describe "underground" economy behavior. However, the literature leaves enough space for some order and terminological distinctions. The term used in this work is "underground" economy<sup>(3)</sup>, considered adequate to properly express the scope of activities from economic reality.

"Underground" economy asks today, more than ever, the right for conceptualization. This component of economic life can not be ignored, although it was attempted even by simple omission. Shyness and policemen attitude removed us away from a proper understanding and unlocking the nature of "underground" economy phenomenon. Avoiding the subject further deepens us in ignorance the more since the "underground" economy is strongly related with the existence of human existence and even with human nature. Sterility of the term without concept comes up to raise the issue of understanding the nature of the "underground" economy to justify the right to conceptualization.

I think that using only not sterile terminological investigations necessary for a correct understanding of the phenomenon, we can discern the nature of this phenomenon whose existence is guaranteed in any type of economy.

### Existence, development, contextualization, size and consequence

*Existence* of “underground” economy is strongly related to the existence of two essential components of economic activity: individuals (human nature) and state (human condition). A large number of other causes underlying the existence and manifestation of the “underground” economy, of which we present in order of importance the following: psychological causes (mimesis of appropriation); tax burden; inconsistency and incoherence of legislative; bureaucracy; world phenomena such as poverty, wars, globalization; the contribution of transfer pricing; social, economic, political and communitarian causes; local and global causes; non-stimulating business environment; lack of specialization and specialists; increased tolerance to the causes and effects of the “underground” economy; ignoring standards or legal regulations; avoid joining some burden administrative and of course other specific causes. Psychological causes are considered in this paper as the most important motives to act in the sphere of “underground” economic activities. I believe that the essential behaviors are such as: propensity to win immediately; effortlessly; used strictly for personal need; exclusive competition; political, geopolitical and geostrategic interests for global control. The main cause, human nature, is what Rene’ Girard calls mimesis of appropriation or acquisitive imitation<sup>(4)</sup>. This, very clear, justifies the approximation with instinct of childhood, which is preserved in adulthood manifested through a series of circumvention behavior elements. According to R. Girard's conception, imitation of appropriation is the origin of all human behavior. The main interdicts, those on objects such as drugs, sexual interdicts and even some food, always refers to the nearest objects, the most accessible for cohabiting group. Items that are prohibited because every moment are available for all group members, is likely to become destructive for the group harmony. The fundamental cause of the “underground” economy lies in the very structure of the human being. Humanizing process involves also learning, imitation, association, community, reason and rivalry, prohibition, sacrifice and feeling. The failure in combining them can be seen through some of the “underground” economy components that are a natural reaction of mimetic rivalry. “Underground” economy is born from human desire for appropriation and assimilation; hence I sustain its eradication to be impossible. The refuse of accepting this reality comes from contemporary inability to understand that “simplicity” and “clarity”

are key concepts for any scientific exposure. Interestingly, like today "Simplicity and clarity are not fashionable" as Rene' Girard stated in his paper "On the hidden from the world foundation".

*Evolution.* "Underground" economy has made progress on various levels, both at the scale and manifestation level and also of analysis and research level. So today, we are talking about highly refined "underground" economic activities which covered the world economy and the writings in this area begin to feel incomplete with "policeman" approach that they have been used over time and behold a fine and bold analysis on its status and on its right of conceptualizing. An example of this proposals is already existing in the literature<sup>(5)</sup> is not obstinately trying to annihilate "underground" economic component in the economic structure of a country but attempt to determine the natural rate of this component as there is the natural rate of unemployment.

*Contextualization.* "Man (...) imagines that he can arrange the members of society as easily as he arranges pieces on a chessboard. It does not take into account that parts of the chessboard have no other principle of motion than you hand prints, but on the great chessboard of society, each piece has its own principle of motion, quite different than that the legislature choose to print on it ...", says Adam Smith<sup>(6)</sup>. The words mentioned above are essential to highlight the context in which "underground" economy forms and grows. Individual is acting, so it is important to analyze his reactions, which are always accompanied by two restrictions: scarce resources and uncertainty. Most of the times these two determines the individual to act in the "underground" economy area and not in its visible, real surface component. "Underground" economy is seen as resulting from individual behavior. These activities meet with the need of individuals who are motivated to take advantage of some public services while avoiding paying taxes, thus exemplifying "stowaway" behavior<sup>(7)</sup>. It is well known that individuals are sensitive to income and price changes occurred at a time. It is at least as well known that in austere times, as we face today, individuals are looking for increasing their income source and more having "underground" source. It can be both, undeclared or declared fractional work or corruption and financial crime. Human nature is what justifies the behavior of "stowaway". Individual in all he is undertaking is trying, as Adam Smith well says, to maximize human happiness<sup>(8)</sup>. The author explains how the selfish desires of the people have a positive purpose and finality. When man seeks his own interest in the economic area, the society is the biggest beneficiary, because man, natural component of telos, contributing to overall human happiness. In this context, whether for an individual obtaining happiness involves accumulating as much wealth, then it should be left free to exercise and get them, but without altering the rights and freedoms of other people<sup>(9)</sup>.

*Size* of “underground” economy, today more than ever, does not allow us to advance in ignorance. Quantitative estimates of its size make us more responsible to identify the solutions that must be taken. Statistics pull strong alarm signals around world economy in which we deal with huge scale of “underground” economy with estimates of up to half of economic activity carried out. As shown already in my PhD thesis, “underground” economy is an ambiguous concept that is not to be quantified or eradicated. Arguments in favor of incommensurability are just the limitations of previous obsessive attempts to measure the “underground” economy. There is current trend toward global macroeconomic modeling in measurement of “underground” economy. An example that comes to support the above is just our country. Thus, data of National Institute of Statistics shows a percentage of “underground” economy of 20% of Romanian GDP while some experts, including those of the Romanian Intelligence Service estimated 45% of Romanian GDP. The differences are huge and come to broaden the possibility and relevance among the adverse for measuring “underground” economy. “Underground” economy is a ambiguous as the process can not be quantified or empirical tested, being difficult to report. According to previous pleading I disapprove the possibility to combat “underground” economic phenomenon, but I sustain the reduction of it. In conclusion, the “underground” economy can not be measured but only can be approximate, and can not be combated but can be diminished. Obsessive attempts to measure and combat the “underground” economy will only narrow spectrum of topics of scientific research and inevitably lead to distorted results.

*Consequence.* “Underground” economy appears as a parasite in industrialized Western countries, shortages of all kinds of penury at the time of old communist regimes in Eastern countries and development factor for third world countries. Until the collapse of old regimes, Eastern-European countries had their own “underground” economy, a special kind of parallel economy. Today, it seems to survive, in addition adapting on the fly to economic changes on progress from those countries. Developing countries, despite widely different economic situations, is characterized by a traditional sector that extended beyond any control of the state. This type of economy is there in a large number of cases and represents the dominant mode of production, competing registered economic sectors registered, if not in development, at least in terms of survival. In a general perspective, we can say that now, while Western countries tend to account and control a lot from “underground activities”, in developing countries the tendency is to tolerate this

kind of activities. In post-communist countries, at least so far, there is an ambiguous attitude regarding the control of "underground" activities. The estimates shows that the "underground" economy represents only a small part of the economy of Western countries, but in many cases this part exceeds the recorded economy for developing countries. In the case of Eastern countries, there is no clear global estimates within this issue<sup>(10)</sup>. The current System of National Accounts exclude by convention non-tradable "underground", particularly those in the domestic economy. This part of "forgotten accounting" has limited consequences for Western countries, especially European countries where undeclared legal activities represents the most important part of "underground" economy. In Developing countries, self-consumption is still important and non-official production still continues to be the most important part of tradable economy. Hence, "underground" economy is everywhere and there will be, because of its nature and its strong correlation with human nature. A real challenge in terms of scientific analysis is to highlight the impact on the level of economic development and not so obstinately measuring the percentage of its spreading. I believe that economist duty is to analyze economic concepts in terms of individual benefit and not limiting to sterile measurement, action that might is no more than mathematics, statistics and other sciences instrument.

**The right to conceptualize a statistical reality that can not be neglected anymore**

**Epistemic and methodological elements in analyzing "underground" economy**

The need for economic epistemology lies in the conceptual nature of the "underground" economy. Epistemology refers to the status of a scientific discipline, precisely represented by that critical discourse on scientific knowledge (Pohoată, 2011, p. 11). Etymology of the term epistemology clarifies the necessity and importance of this kind of approach that come unequivocally any critical analysis of a spectrum that is meant to be scientific. We can hardly talk about what the "underground" economy represents without dressing clothes of controversial and critical. Moreover, addressing this component of economic life regardless of methodological parameters will not pick us out of this tangle and obscure path that "underground" economy started. I believe that introducing some epistemic and methodological elements is necessary to complete the construction of "underground" economy nature. Only thus we can

complete the whole arguments map that can win in the court of logics and sustain its right to conceptualize a reality that statistically speaking can not be neglected anymore. Inevitable part of economic life, the “underground” economy must necessarily be conceptualized even more because “the economy as a science remains a form of Euclid, two-dimensional” and “mechanistic manner of levying duties remains the largest epistemic dysfunction of economics...”<sup>(11)</sup>. “Underground” economy is subject of the same risk, especially since we observe the tendency of writings to quantification, measurement, calculation and identification. I have already argued this inconsistency with the “underground” economy since my PhD thesis.

### Causal power of “underground” economy nature

Causal power of “underground” economy nature helps me to additionally justify the right of conceptualization. Relating “underground” economy in the field of economics, at world economic, macroeconomic, microeconomic and institutional level, is imperative for proper understanding of the phenomenon itself. Fundamentally, however, to highlight the causal power of “underground” economy nature is to correlate private and public sector. The link of “underground” economy with the private and public sector is sufficiently marked by Joseph E. Stiglitz who warns us that one of the main choices that any society faces is related to the role of government in the economy. He argues that “economic success requires a balance between government and market”. Balance, which Stiglitz points out, is different from one country to another and from one period to another, it could be the reason for which it leaves expected in most nations. Moreover, the author even blame globalization, which if is not implemented correctly can cause severe damage, making it difficult to establish that balance.

On the one hand, reality shows us that: “*Underground economy* is the first and most important sign of government failure.” As time has repeatedly demonstrated the most significant organization within a society is the state, stating in defense that it is concerned with social interest. What would be the reason why individuals should consider their contribution to be justified? Inequality of taxation and redistribution will always exist, regardless of the types of reforms implemented by the state. I believe that social inequality will exist as long as “Neither executive nor the legislative ... are not really what the theory says it should be, namely pure organs of the community, with no



other thought than to promote general welfare”, said Wicksell in his paper “A New Principle of Just Taxation”.

On the other hand, creating a competitive private sector is considered to be the correct solution for most professionals because the state is the most vulnerable in front of the mechanisms of “State Capture” when economic power is concentrated in only a few companies or industries or when competitive economic interests has no real access to political decision-making. Price liberalization, increased transparency of ownership and management structure of firms, introducing more competition can keep control of economic interest groups. Although the private sector is far more competitive than the public sector, does not mean that it is protected from the temptation of corruption. Reality shows that over time the private sector economy has brought new forms of “underground” economy.

We have enough reasons to believe that the economy “underground” can be studied only in relation to the private sector. “Underground” activities considered are mainly those that are subject of theft actions from “tax plucking”, so we believe that the state, through its agents, would have no interest based on the principles of rationality of auto circumvention. From the above considerations I sustain that “underground” economy can be studied especially in relation to private agents because they are most concerned to protect their own resources used in the business, not state agents that operate with attracted resources. Human nature is built so that it tries to create as many means to satisfy his needs. Collective needs require contribution from the individual agent, who feels attacked when he is deprived of resources purchased with their own efforts. The more individual will feel that his contribution is not effectively used, the more he will consider this effort as unjustified and will try to escape taxes. Therefore, I consider the level of “underground” economy as fragility in the relationship between state and citizen, and so we strongly feel the need to improve it.

Hence the above, there is no reason to stand the test of rationality, for which “underground” economy has no independent right to exist and thus to be conceptualized, but more all these efforts are designed to serve man, for as Ragnar Frisch sais “I would not be happy if I did not believe that, ultimately, the results of our endeavors will be used in any way to improve the lives of common man.”

## Acknowledgements

This work received financial support through the project “Postdoctoral Studies in Economics: training program for elite researchers – SPODE” co-financed by European Social Fund, Operational Programme Resources Development Human 2007-2013, contract no. POSDRU/89/1.5/S/61755.

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## Notes

- (1) When I say dual employment model, I expect on its formal or informal character.
- (2) It is true that, as Ion Pohoata said in his paper “Epistemic and Methodological Fundamentals of Economic Science”, “the supreme task of economics and economist must be limited to what A. Smith stated” the author sustains that all “The purpose of economics is to learn how to get faster and more effectively to wealth”. Moreover, I believe in case of economic science the purpose should not justify the means in all circumstances. Today, more than ever, efficiency and wealth are inevitable for any economic activity, I believe, however, that these two are inconsistent in the absence of the concern for human nature.
- (3) I justify using this term, which I consider to properly and fully describe the concept investigated in my PhD thesis entitled “Quantitative and Qualitative Analysis of the Underground economy. The case of Romania”, Bucharest, 2009.
- (4) This principle is very simple presented by the author with a very handy example. It is presented an experiment that if we place more children with many toys around them, they will try each to approach (claim) as many toys and certainly those beautiful, similarly the adults in the real economy shall be surrounded by things needed will try to buy as much for himself. This example is based on a natural explanation feature supported by the selfish side of human nature.
- (5) Emil Dinga proposal in the paper “Studies of Economics. Contributions of logical analysis, Epistemological and Methodological”, Economical Publishing House, Bucharest, 2009.
- (6) The words of Adam Smith, in his paper “The Theory of Moral Sentiments”, 1982, Publishing House DD Raphael and A.L. Macfie, Glasgow Edition I of the works and correspondence of Adam Smith (Indianapolis: Liberty Fund).
- (7) Expression used to describe the behavior of a person who wants to gain an advantage without providing something in return, for example, a person who travels without a ticket. Such behavior is especially related to public goods whose consumption can be performed simultaneously by several individuals, without the utility felt by each one to be evaluated. The definition is taken from the Dictionary of Economics, Department of Economics and Economic Policy, Second Edition, Economical Publishing House, 2001, p. 326.
- (8) Today “Unusual nature of wealth was imposed in two versions: as illusion of equality of opportunity and support in statistical access of power.” (Marin Dinu, “Recharging the economy”, Theoretical and Applied Economics, no. 6 / 2011, 559).
- (9) For as J. S Mill argued: “The only freedom worthy of the name is to follow your own good in your own way, as long as you don’t try to deprive others of their good or to prevent them

from and to acquire it. Each is the true guardian of their health, whether bodily, mental or spiritual. Humanity has won more than leaving everyone to live as he thinks it's better than forcing everyone to live as others think would be good".

<sup>(10)</sup> This is mainly due to the lack of data on the size of "underground" economy. During the communist regimes the subject was forbidden, while today the lack of relevant aggregate information is partly explained by the accelerated process of reforms, including in national accounting and tax laws.

<sup>(11)</sup> See Marin Dinu 11, 2009, "The Reconstruction of Economics", Theoretical and Applied Economics, no. 12/2009, p. 541.

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