



The Underground Economy: Crash Course Econ #32

Crash Course: Economics

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Hi, I'm Adriene Hill. This is Crash Course Economics, and today we're talking about the underground economy, the shadow economy, the informal economy, the black market, the unofficial economy, the hidden economy. Whatever you want to call it, today we're looking off the books, under the table at the underground economy.

(Intro)

So what exactly do we mean when we talk about the underground economy? The first thing that comes to mind is the illegal stuff, bad-guy stuff, like making and dealing drugs or selling kidneys.

But when economists talk about it, they're talking about a much wider, less nefarious group of activities. The informal economy they talk about is all the trade and work that happens off the books, under the table, outside of the sight and reach of government rules and taxes.

And sure, some of these activities are illegal, but a lot of them are completely mundane. Take the mom who cuts hair out of her house without a licence from the state, the guy who sells fruit on the side of the road, the nanny and housekeeper who get paid off the books, or you when you babysit, or sold lemonade on the street corner. All that work, and the money it made, can be considered part of the informal economy.

As you might guess, it's hard to measure exactly how big this underground economy is, which makes some sense. It can be hard to get people who fly under the radar to answer survey questions about their wages.

Excuse me, small child, could you please give me resume estimates for the last four quarters of lemonade sales? I also need the number of hours you worked and the cost of the supplies and equipment, okay?

Also, it's not like tax evaders, and rare animal smugglers, and cocaine dealers are going to want to give a completely honest accounting of their finances.

But economists are a diligent bunch, so they've also come up with indirect, macro-economic ways to try to wrap their head around the informal economy.

Let's go to the thought bubble.

One way economists try to estimate the size of the hidden economy is by looking at the difference between the difference between the total income a country reports and its total expenditures. If there wasn't an underground economy you'd expect the two to be pretty equal, but if people are spending a whole lot more than they're legally making or borrowing, that money has to be coming from somewhere, so the difference between the two might help indicate the size of the informal economy in a given country.

Economists also look at the demand for cash. Since most of the transactions that take place in the underground economy take place in cash. It's not like most street vendors are set up to take Apple Pay, and you probably don't want to write a cheque for an endangered salamander or something. A greater demand for cash in an economy might signal a larger underground economy.

Another way economists attempt to measure the size of the informal economy is by studying electricity use. It turns out electricity is a good indicator of total economic activity. I guess everyone from off the books dishwashers to drug dealers need energy. So if the electricity use is high, and the GDP is relatively low, economists estimate the underground economy is doing pretty

well.

Thanks, Thought Bubble.

So just how big do economists think the informal economy is? Huge! HUGE huge. Trillions of dollars globally.

The underground economy is less active in developed countries, where economists estimate it's between ten and twenty percent of total GDP. But that's still a lot of money. In the US, the underground economy is probably worth somewhere between one and two trillion dollars. And in developing countries, the underground economy accounts for more than a third of economic output. The International Labor Organization says the informal economy also employs half to three-quarters of all non-farm employees in developing countries. In India, for example, as many as ninety percent of workers have jobs off the books, out of reach of the government.

And there have even been places where the entire economy was informal. Seriously. Look up the Kowloon Walled City in Hong Kong. It was amazing! Bad, yes. But amazing.

A lot of work in the informal economy is focused on selling or doing everyday things, just out of sight of the government, but we should take a minute to talk about the illegal trade that goes on around the world. According to the UN, organized crime is an eight hundred seventy billion dollar a year business, about one and a half percent of global GDP. Drug trafficking is the biggest chunk of that - about three hundred twenty billion dollars. Counterfeiting earns about two hundred fifty billion dollars a year for criminal groups. There's also billions getting made from human trafficking - smuggling people across borders.

Exploiting the environment's profitable too. Timber trafficking is a three and a half billion dollar business. Smugglers also kill and sell ivory from elephants, horn from rhinos, bones from tigers.

The European Union recently asked member countries to do a better job counting vice in their GDP totals. According to *The New York Times*, statisticians in Spain tried to pinpoint the average price of a room at a Spanish brothel, and what Spanish prostitutes charged per session.

Britain has also tried to put numbers on its sex and drug trade. It's office of national statistics thinks prostitution and drug sales added about ten billion pounds, that's seventeen billion dollars, to the country's GDP in 2009.

Because illegal markets are, by their nature, illegal, they can often be dangerous places to buy or sell. Take the market for human kidneys. Kidney sellers often get less for their kidney than they agreed to before surgery. They might not get the medical care they were promised. People on the receiving end of the kidney sometimes end up with diseased or non-matching organs, and there's not much you can do if you illegally buy a lousy kidney.

So some ethicists and economists argue the market for kidneys should be legalized. They say it's better to allow the government to set some ground rules, than a market that it seems is going to exist with or without regulation. Allowing people to sell their kidneys could also help solve the supply problem, keeping thousands of people who need new kidneys from dying each year.

But making the kidney market legal, moving it into the official economy, has its own risks. In Iran, where it's actually legal to sell kidneys, the sellers are typically poor. Do we really want poor people selling organs to help provide for their families? Do we want situations where people might be coerced into selling a kidney for



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money?

Let's go back to the broader informal economy. You might be thinking to yourself, okay Adrian, I get that unscrupulous organ traffickers should be put out of business, and I'm against protected rain forests getting chopped down as much as the next person, but what's wrong with people doing legal jobs, just working off the books? And it's a fair question. It depends on who you ask.

Groups like the International Labor Organization point out that workers in the informal economy don't have the same sort of safety net in place as people who work in regulated jobs. They may not get sick time or health insurance. They might not get paid overtime, or get paid at all. They may not get to work with the safety precautions in place that the government would require. And while it's not always true, informal employment often means poor working conditions, and increasing poverty. The people who take this work are often women, and migrant labourers, or people who don't have access to better jobs.

Economists also point out that a big informal economy makes it difficult for the government to get an accurate count of important statistics like unemployment and income. And that might encourage misguided policies. But the underground economy can offer jobs and work where they don't otherwise exist.

Researchers estimate the informal economy doubled during the financial crisis. People who were laid off from their jobs with no prospects for formal employment picked up odd jobs to piece together a living, and they turned around and spent some of that money in the formal economy. Places like the grocery store. The informal economy can serve as a temporary buffer for individuals, and the economy as a whole.

But economists worry that the growth of the underground economy can set off a negative cycle. Basically, as people drop out of the official economy and stop paying taxes, tax revenue falls. Governments are then faced with a couple of choices. They can respond with cuts in spending on things like social safety nets, or they can increase taxes, but that creates a vicious cycle, pushing more people into under-the-table jobs, and on and on.

So the informal economy is complicated. Governments can try to fight it, they can try to integrate it, but they can't ignore it.

Thanks for watching, we'll see you next week.

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