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Towards a Definition of Underground Economies

It is true that unemployment and poverty lead people to seek various working alternatives in order to survive. But it is also true that these are not the only causes of the phenomenon called "underground economy", which is manifested in many forms, from selling french fries in the street, to illegal transactions. Economists Teresa Rendón and Carlos Salas explain the origins of terms such as "informal sector", "underground economy" and "underemployment", criticize their misuse in current language, and generally clarify our ideas about these concepts.

The purpose of this article is to discuss the relevance of the terms "urban informal sector" and "underground economy" to describe the ways that some parts of the population receive an income and work in some type of economic activity. Recently both concepts have been widely used to describe and attempt to explain the employment problem in developing countries. We will demonstrate that these words do not really explain situations to any great extent. Besides, as both definitions are very ambiguous, there is also the problem of an ideological bias.

After examining the origin and development of the term "informal sector", we will undertake a critique of this concept. We will then look at the case of the "underground economy". Throughout this discussion we will show how the phenomena that fall under these two terms may be both described and better understood if we study them with other categories.

Origin of the Term "Informal Sector"

It is evident that there is a heterogeneity in the productive apparatus of many capitalist countries, especially, though not exclusively, in lesser developed countries. Thus there has been the creation and use of concepts that try to express such heterogeneity. The dual models are a

classic example of this: the economic structure is conceived as the union of two sectors - the modern one and the traditional and backward one (identified with agriculture). If we look at the area of employment we can find the counterpart of these models in the concepts of underemployment, informal sector and, more recently, underground economy. Though the main objective is to analyze the term "informal sector", many of the observations and critiques may be easily extended to the other two concepts mentioned above. In the case of the so-called "underground economy" we can also find that, besides the imprecise relationship that can be attributed to the term "informal", there is a strong neoliberal ideological bias to the concept.

In the sixties, empirical evidence questioned the validity of development theories that talked about a growing absorption of the work force by the modern sector (with adequately remunerated employments) as countries advanced in the process of industrialization. The persistence of whole sectors still involved in agricultural activities and also other types of activities with low wages led the International Labor Organization (ILO) to start the World Employment Program towards the end of the sixties. In the first stage there were various missions composed of experts to examine and try to explain the labor situation in different developing countries. As the final result of one of these missions - the one that studied Kenya - we have the book *Employment, Incomes and Equality in Kenya*, 1972. It is on page six of the introduction to this book that we see for the first time the definition of the term "urban informal sector".

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The following are some of the notes taken from this introduction:

We must emphasize that informal activities are not only confined to employment on the periphery of the city, to any particular occupation or even to economic activities. Better said, informal activities are the manner of making things, characterized by:

- a) easy access
- b) support by local resources
- c) family ownership of companies
- d) small scale operations
- e) adapted and labor intensive technology
- f) training acquired outside the formal education system
- g) non-regulated competitive markets

Since that time the original conception has become disfigured, the definitions and especially the way of measuring the informal sector has given us inadequate situations (in terms of a pre-established norm) in talking about the workers or businesses that are included under the broad meaning of the term. The worst of these is that frequently, "informal sector" is an elegant way of referring to poverty.

The term then took root in Latin America. The Regional Program of Employment was the main organization to use the term not only in a descriptive way, but also in an analytical way. In using the informal sector as the official framework of interpretation for the employment problem that exists in the cities of "developing countries", the International Labor Organization spread the concept in many of its documents. Due to this fact, people in academic and official sectors started to take notice of the concept and it is systematically used today.

Another element that explains how it took hold is the apparent simplicity of its application. Originally the basic distinction between "formal" and "informal" was related to the difference between salaried and non-salaried work. This was due to the fact that much unsalaried work in less developed countries is carried out in places similar to those described in the previous definition of the term.

This last point is important. The idea of a "urban informal sector" covers a variety of situations that really exist, are really observable and many of them are also very poignant ones.

This also explains why the use of the word has grown so much.

An Umbrella Concept

Examining the employment situation of a country through the concept "informal sector" has caused difficulties in understanding the reality. A heterogeneous productive structure cannot be understood through the elimination of the differences that exist among all the activities that fall under the term "informal" (without overlooking the

common element of many of these activities: the presence of non-salaried work). This element is much more relevant in understanding and analyzing employment reality.

The inherent difficulties of applying the concept of "informal" in trying to measure the size of the sector leads to a broadening of the original term. Thus the productive entities that do not conform to certain legal characteristics are included under the term "informal". For example, if a production unit pays less than the minimum wage, does not enroll its workers in the Social Security organization or does not pay taxes, then it is considered as an establishment of the "informal sector". Secondary aspects are the ones really being taken into account.

They are being contrasted with an ideal norm (in this case, the regulations and obligations of typically capitalist production units). In this sense they do not emphasize the essence of an "informal" production unit in the original sense of the word (the lack or absence of capital).

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Child toasts pumpkin seeds on the street. Photo by Angeles Torrejón/Imagenlatina

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The broadening of the original concept implies another important point. We refer to the transformation of the "informal sector" into a type of "umbrella" concept. This then puts very different situations into the same compartment: people working in their own "family businesses", very primitive forms of capitalist business, illegal activities, even begging and in general all types of survival strategies. By including survival strategies in the framework of the "informal sector" we can see just how far the broadening of the term has gone. In this sense it is no longer describing certain production units with low levels of invested capital (and the consequences for the persons involved in this). Rather, it is covering activities which contribute to the survival of individuals, but which cannot be considered as economic activities. This is explained by the way the International Labor Organization talks about the concept of "work" in the sense that it emphasizes only the idea of obtaining an income. This is not how we traditionally understood the word: an activity destined to generate or distribute some type of merchandise.



Musicians earning their living in Jerez, Zacatecas. Photo by Angeles Torrejón/Imagenlatina

There is also an additional problem. When we speak of "informal", a series of wrong connotations arise. For example, traditionally informal activities are identified with precarious activities with low incomes. But if we examine the income of certain commercial activities -that generally don't comply with the regulations of labor legislation- and where family labor is abundant, we can see that the wages are higher than those that come from salaried jobs in the same sector and also in certain branches of the manufacturing sector.

Employment and Labor Market

We must also add another element of a technical nature to this discussion: the generalized use of the concept "informal labor market". By examining this concept we will be able to get to the nucleus of the confusion that is inherent in the generalized uncritical use of the idea of "informal".

If we really want to examine the terms "informal sector" and "underground economy," then we must start by looking at the two terms which are used indistinctly as if they were synonymous: labor market and employment. Thus we have in Tockman and Sousa's well known work¹, (that marks the beginning of the use of the term "informal sector" in Latin America), the chapter entitled "The Formal and Informal Sector of the Labor Market". This identification enables the authors to divide the economic activities of the population into two sectors, introducing a dualistic understanding into the interpretation of the problem of employment in our economies.

There is also a false analogy with the dualistic conception or the trend known as segmentationalist, originated in the work of Anglo-Saxon authors, and which tries to explain the persistent wage differences between workers, particularly in the United States.

According to this theory, the wage differences are explained by the existence of segments in the labor markets. A segment is integrated by the specific activities of a company (the so-called "internal market"), while the other segment (the "external market") is composed of low salaried occupations in general.

It is pertinent to indicate the conceptual mistake implied in identifying employment and labor market. When we speak of a market we are referring to the sale-purchase of a specific commodity. Therefore, the term labor market has the connotation of the sale-purchase of labor. If we see this from the perspective of employment, we are referring to salaried employment. Instead, when we speak of employment, this term encompasses the whole population involved in the production of goods and services, which are the object of commercial exchange, regardless of the production relations through which this productive activity takes place. Thus, employment and labor market are not exchangeable concepts, since the amount of employment is always larger than the salaried part of the population.

1) Víctor Tockman & Paulo Renato Sousa, (1975): "El sector informal urbano" en: *El empleo en América Latina* ("The Informal Urban Sector" in *Employment in Latin America*), CLASCO/Siglo XXI, México.

This last statement is valid even in the most advanced forms of capitalism, since there are in its midst some occupations that are not salaried (direct producers who sell the product of their work and not their labor force). Due to the fact that in advanced capitalist countries a large proportion of those employed are wage earners (this proportion fluctuates between 75% and 92%), the near identification in them between labor market and employment is justified. But this is not the case in developing countries.

Likewise, the concept of economically active population, on which conventional statistics of employment are based, implies the idea of labor force. And it is precisely the lack of precision of this term in situations where there is an important presence of non-salaried work that limits its application for the purposes of explanation.

The term "informal" was originally intended to account for certain characteristics of production units where non-salaried work predominates, as well as for the impact that they have on the personnel they employ. Nevertheless, the concept is widened to cover even the survival strategies of certain social groups. The main weakness of the term lies in the broad range of activities that fall under the term "informal".

Nowadays, the concept of informal urban sector tends to be displaced by another more spectacular one, but not radically different in essence: that of underground economy. This concept, as well as the previous one, is scarcely useful in understanding the occupational problems of a country such as Mexico, insofar as it encompasses drug dealers, peddlers of all types, including home service personnel, freelance professionals and tax evading companies.

The following section explains the origin and diffusion of the term, and shows the insufficiency of attempts to measure it, carried out in Mexico to date.

The So-called "Underground Economy"

The existence of economic activities that are not registered in the national records of countries, is an idea present since the origin of national accounting systems, in the early post-war years. Perhaps the first important attempt to measure the non-registered contribution of certain activities was in a paper by J.A. Dowie, from 1970². In this article he attempted to measure the contribution to the United States' Gross Internal Product, of certain activities outside the law, that are not accounted for in national records. Little by little, the idea of measuring the size of economic activities that are not registered as part of the GNP, began to gain strength.

The sector of the economy that is not accounted for this way gets different names: black, illegal, covert, non-declared, non-measured economy. The term most widely used today was coined in 1977: underground economy. The term was reclaimed by the ILO since 1980 and the most accepted definition today is the following: "The underground economy encompasses illegal transactions (in currency or in kind), fiscal frauds (evasion, understatement) and clandestine work. This last term includes

2) J.A. Dowie (1970): "Illegal Activities - As Measured and As Not". *The Economic Record*, Vol 46 (November). pp517-519.



Music to sell virgins. Photo by Heron Alemán/Imagenlatina

The term underground economy generally refers to activities not registered in national accounting systems

non-registered workers, non-registered crafts makers and non-registered multiple employment."

The ILO adopts the term due to the fact that it apparently makes it possible to explain the rise in economies such as the Italian one, characterized by an economic takeoff not accounted for in the official records of the GNP.

Now, the generalized use of the concept is a consequence of an offensive by the most conservative sectors, both in Academia and in business organizations. The reason for this is that the existence of non-declared activities is explained in terms of an excessive presence of government in economic activity or in its regulation.

Legal regulations as well as the tax burden are emphasized. This last item is always considered excessive. And therefore, the diffusion of the term has gone hand in hand with the offensive against state intervention in the economy, which has characterized the position of orthodox economic circles since the end of the last decade.

In Mexico, the first attempt to measure the size of the "underground economy" was made by the Centro de Estudios Económicos del Sector Privado (CEESP) (Center for Economic Studies of the Private Sector), in a book titled, precisely, *La economía subterránea en México* (The Underground Economy in Mexico), published in 1987. Two methods are employed for quantification: the so called "physical input" and "cash demand". The conclusions of this book are illustrating. The size of non-declared activities is explained, according to the text, by the excessive tax burden, by the suffocating bureaucracy and by corruption.

It has been conclusively shown that the econometric results shown in the book lack technical precision. Furthermore, as these deficiencies are corrected, the results show blatant contradictions between the two methods used by the Center to measure the size of the so-called "underground economy".

Final Comments

The concepts we have examined (informal sector and underground economy) have as a precedent the old concept of "underemployment" or "subemployment", from which they differ neither essentially nor in their explanatory potential.

We have tried to prove in this paper that the application of both concepts omits traits that are important for the explanation of the occupational structure of our country. Moreover, they cannot explain the origins of the occupational problems presently faced by an important part of the population.

They emphasize secondary elements which emerge -implicitly- from opposing the characteristics in which non-salaried work is carried out, to those of capitalist



Three of the millions of children who live on the streets of Latin America. Photo by Angeles Torrejón/Imagenlatina

production and salaried work. For instance, they forget that labor legislation serves to regulate the relations between labor and capital in conditions of salaried employment, and pretend the inclusion of all workers, wage earners or not, under this legislation. This is an argument that may be valid, but labor laws are not intended to have such a wide range in their application.

Similarly, to speak of activities carried out beyond the legal criteria, is only a description and not an explanation of the underlying causes for their appearance or their proliferation. This, without forgetting the role that both concepts have played in the conservative offensive against state intervention in the economy.

If we wish to advance in understanding the occupational problems in the country -a necessary starting point for any strategy to solve them- it is necessary to redefine or even to abandon both concepts. We believe that the activities now encompassed under the heading "informal sector" or "underground economy", can be described and explained using other already existing categories, which do indeed have a precise definition. As an example we can mention the category of non-salaried work, spoken about previously. ■