

# The problem of the underground economy

Forum: The Agenda of Inclusion for Peru

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# Defining underground economy ... various approaches

- According to labor status. Personal account, Family workers without pay, Domestic employees, Employees and employers in companies of up to 5 or 10 workers (IT).
- Workers who make no contributions to health and retirement funds,
- Workers who earn less than the minimum wage
- As regards firms, whose companies not listed in the Trade Register.
- Productive approach, national accounts or econometric estimates. Activities that do not go through the formal business transaction cycle. Normally evaluated as a % of GDP.

... whatever the definition, the problem remains the same: a separation between the State and Society with significant socio-economical implications.

# Why is the underground economy a problem?

- A break between **The State and Society: Contributions in exchange for the fulfillment of State responsibilities** (property rights, *the rule of law*, security, functioning of the market, social and economic policies),
- The underground economy **represents a negative stimulus with respect to the effectiveness of the state and in turn the latter reduces the incentive of operating formally** ("it is not worth it to be formal", "the product is poor")
- The relationship between the underground economy and the State, **has tended to foment wrong decisions by policy makers in their intent to reign in the submerged economy or improve their policies throughout history**: prohibitions and over-regulation; greater bureaucracy, labor laws, tax policies, social programs. **Its intention of solving problems by Law have generated a greater expulsion effect** ("it is not worth it to be formal", "it is very expensive").
- In sum, a high level of underground economy, **limits the growth potential of a country**