



Tax Foundation Counts All Income Except Underground

Not one single word of the 10-page report [“Sources of Personal Income”](#) released by the Tax Foundation mentioned the “black market” — that vast swirling uncounted (and largely uncountable) part of the U.S. economy that some estimate in the trillions. Accordingly, that throws off the foundation’s attempt to draw any more than tentative conclusions about how much the average taxpayer earns.



According to the foundation, Americans reported a total of \$9.2 trillion in income in 2012, the latest year for which numbers are available, with \$6.3 trillion of it coming from “wages, salaries, tips” and “other” compensation. They get those numbers mostly from the infamous W-2 withholding form, that shows the amount first levied on wages and salaries in 1943 during the height of WWII and every year since. Almost three-quarters of the taxes collected by the federal government come from withholding.

That may be one of the many reasons so much of “wages, salaries,” and especially “other” compensation never shows up in either the Tax Foundation’s report or the coffers of the Internal Revenue Service. The perception of the black market is that it is somehow “illegal,” and since it remains untaxed, the burden of the government (according to apologists explaining it on Wikipedia) falls on those caught in the withholding trap. Says Wiki:

The goods and services may or may not [in] themselves be illegal to own or to trade ... [but] because the transactions are illegal, the market itself is forced to operate outside the formal economy that is supported by the established state power.

Thus the terms “black market” along with “underground economy” have assumed a pejorative taint. Other descriptors are “subterranean,” “hidden,” “shadow,” “informal,” “clandestine,” “illegal,” “unobserved,” “unreported,” “unrecorded,” and “second.” This “parallel” market operates, according to Wiki, outside the “institutional system of rules, rights, regulations and enforcement penalties” imposed by the state, and may include illegal drugs, illegal guns, prostitution, alcohol, tobacco, racketeering, housing rentals, counterfeited car parts, and DVDs, films, and computer software.

It also likely includes marijuana, cocaine, heroin, and gasoline.

From the viewpoint of free market economist Hans Sennholz, however, there is a sharp distinction between the “underground” economy and underworld “criminal” activities. In his 1984 book, *The Underground Economy*, written while he was a professor at Grove City College, Sennholz explains:

The underground economy must be distinguished clearly and unmistakably from the criminal activities of the underworld. Government officials and agents are ever eager to lump both together, the criminals and their organization, with the producers in the underground.

Both groups are knowingly violating laws and regulations and defying political authority. But they differ radically in the role they play in society.

The underworld comprises criminals who are committing acts of bribery, fraud and racketeering,



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and willfully inflicting wrongs on society.

The underground economy [on the other hand] involves otherwise law-abiding citizens who are seeking refuge from the wrongs inflicted on them by government. They are employers and employees who are rendering valuable services without a license or inspection sticker, or failing to report their productive activities to the political authorities.

Examples abound. One will suffice: flipping cars on Craigslist. The concept is simple: Buy cheap, sell dear; wash, rinse, repeat. A virtual cottage industry has sprung up in the publishing of operations manuals written by those who have successfully met the needs of people looking for inexpensive cars and trucks, to teach others how to do likewise by advertising on Craigslist.

But the new and used car industry has moved heaven and earth to remove the incentive, or threaten with such penalties, as to force that nascent industry underground. In Colorado, for example, a citizen is free to buy and sell as many personal cars as he wishes. But once that number exceeds three in a 12-month period, eyebrows may be raised at the Department of Motor Vehicles. The miscreant, if found to be guilty of buying and selling more than three personal vehicles in that time period, is offered an option: Instead of having to pay penalties, he is invited to become a used car dealer

But Colorado's requirements (as is the case in nearly every other state in the union, thanks to the retail auto cartel) are so onerous as to discourage all but the most well-financed and determined individual to come in from the cold and place himself under the aegis of the state. There's a hefty fee to apply, a daunting application numbering many pages, the demand for a criminal background check complete with fingerprints and photographs, and the requirement that the new used-car dealer rent a space that provides places to park his inventory and a building with heat and water and room for a desk along with restrooms for his customers. In addition to giving the authorities proof of such a lease, he must also purchase a \$50,000 bond to ensure that he won't run off with the customers' funds. He is required to take many hours of classroom study and to pass a test based upon that study. Then he is put on probation for a period of time, and once granted, his license to buy and sell cars comes with the predictable unannounced inspections by various government agents of all records of autos and customers with whom he has dealt.

In other words, in Colorado, "flipping cars on Craigslist" is impossible.

Estimates as to the size of the underground economy vary widely, but some numbers keep coming up in the literature. According to CNBC, it exceeds \$2 trillion globally — about twice what it was in 2009. Since the U.S. economy is such a large part of the world's "above-ground" economy, that black market in the United States could easily exceed \$1 trillion. Alexandre Padilla, a professor at Denver's Metropolitan State University who has studied the matter, observed,

I think the underground economy is quite big in the U.S. Whether it's using undocumented workers or those here legally, it's pretty large.

Business [owners] are not angels, and they exist to make a profit. They are going to do everything they can to keep costs down, and if it means paying people off the books, they will do it.

The government doesn't really have the resources to track down every business that does this.

Other economists surveyed by *U.S. News & World Report* estimate the size of the underground economy at between eight and 14 percent of the above-ground economy, which is now estimated at \$18 trillion annually. That puts the shadow economy at between \$1.4 trillion and \$2.5 trillion.



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This is having an unexpectedly positive impact on the regular economy: Customers are spending more money than they should, based upon their declared incomes. As Bernard Baumohl of the Economic Outlook Group noted, “Severe recessions have historically driven jobless Americans into the shadow economy. We suspect the destructive nature of the last downturn and the prolonged weak recovery pushed a record number of people into that murky world of cash transactions.” But their spending still shows up in the retail sales and personal consumption data tracked by economists and government officials.

When Chicago’s Kevin Kalmes received a foreclosure notice, she started selling the contents of her basement. It worked so well that she turned it into an underground business (literally and figuratively): “I just kept the basement sale open, forever, without getting permits,” she explained.

Informally calling it her “Little Shop of Hoarders,” Kalmes sells items for friends and neighbors, and occasionally something from a local flea market. During the week she walks her neighbors’ kids to the bus for \$2 each, and helps out with home remodeling projects for her friends, being paid cash for her efforts.

Putting aside concerns that the underground economy isn’t “paying its fair share” (partially offset of course by the taxes generated in the regular economy when those funds surface), there are numerous advantages that statist commentators fail to mention. Aside from operating largely tax free, the underground is also where basic free market principles are working: Deals are made, cash is king, handshakes are bonds, and there’s the taste of freedom — the appreciation for the right to own (and buy and sell) property — and especially the realization of how large government at any level really is, and how little of it is needed to keep things clean and tidy.

There are some who think that every student— before entering the regular economy with its attendant demands, limits, regulations, and penalties — should take six months off to learn how the free market really works without all those encumbrances. That taste of freedom might just become addictive.

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