

# Bloomberg Businessweek

## More Americans Work in the Underground Economy

By Joshua Zumbrun on March 28, 2013

When Kevin Kalmes received a foreclosure notice on her home after being unemployed for more than two years, she says she started selling the contents of her basement. “Then I just kept the basement sale open, forever, without getting permits,” says Kalmes, 61, who lives in Chicago. She started selling items on behalf of family, friends, and neighbors in what she dubbed the “Little Shop of Hoarders.”

Kalmes is among the 4.8 million Americans—40 percent of all those unemployed—who have been out of work for more than 27 weeks. With her jobless benefits exhausted, Kalmes has entered the informal economy. It includes activities that are illicit—prostitution and drug dealing—and more routine jobs such as working construction for a day for cash, or even walking kids to the bus, as Kalmes does for \$2 per child. Added together, economists estimate that the income generated by the underground economy in the U.S. could be \$2 trillion.

Such arrangements, while providing a safety net of last resort, also may provide answers to puzzling discrepancies in economic data. Retail sales have outpaced gains in reported income for almost four years, says **Bernard Baumohl, chief global economist at the Economic Outlook Group**. “There could very well be a much larger than expected underground economy at work here that is making a contribution,” he says.

Kalmes’s entry into the shadow economy came after losing her job of 13 years as a production manager for Paris Presents, a distributor of bath and beauty products in Gurnee, Ill. Kalmes says she oversaw the assembly of “all those gels and lotions and refreshers and gift baskets.” She even flew to China to train workers in a factory. On March 17, 2010, her job was outsourced to the people she’d trained, she says. The company confirms Kalmes worked there.

Mitchell Hirsch, an advocate for unemployed workers with the New York-based National Employment Law Project, has heard stories of the unemployed entering the shadow economy with increasing frequency. Such informal work “is definitely more significant than before the recession,” he says. “They’re finding in some cases very creative ways to get some kind of income legally.”

In a paper last year, two economists estimated that 18 percent to 19 percent of income nationwide is not reported to the Internal Revenue Service. “The estimated \$2 trillion of unreported income gives rise to an annual tax gap of \$450 billion to \$500 billion,” wrote Richard Cebula, a professor of finance at Jacksonville University in Florida, and Edgar Feige, a professor of economics at the University of Wisconsin at Madison.

The underground economy runs on cash, which can’t be traced. The total number of physical bills has surged since the onset of the recession, reaching a record \$1.18 trillion on March 13, up from \$803 billion in 2007, according to the Federal Reserve. More than half of that cash may be held in other countries. Still, even if part of this cash hoard remains in the U.S., it illustrates the informal economy’s growth.

A robust economy that operates on the books is the best way to shrink the economy that doesn’t. “As consumers continue to increase spending, companies will see their sales increase, earnings will rise, hopefully it will generate more hiring that will bring in some of the people stuck in the shadow economy,” **Baumohl** says.

For her part, Kalmes won’t be able to save her house: She’s trying to avoid foreclosure by unloading it in a short sale. She just wants to bring her basement shop out of the shadows. “I’m hoping to incorporate the business,” she says, perhaps covering the incorporation costs with the money she’ll start to receive when she becomes eligible for Social Security in August. “I’m looking for a tiny storefront, maybe 900 small feet. It could be something little and wonderful for the neighborhood.”

*The bottom line: The \$2 trillion in unreported income from the underground economy results in unpaid taxes of as much as \$500 billion.*

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