

Fade to Black?

**Get the Gist on the informal,
grey, black, and terrorist economies**

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What is a Gist report?

Gist reports provide a brief overview of the current and future status of each topic and are intended to help readers quickly and conveniently appraise the future of an issue. Each 5 to 10-page Gist report includes an introduction to the topic, a literature review using our auto-extracted Forecasts, and our own method of analysis. The Gists quickly and conveniently get every team member on the same page so that meetings may be conducted more efficiently and with deeper insight. The Gists then become a launching pad for organizations to develop their own analysis and strategy.

The Shadow Economy

Hidden beneath the **formal economy** (economic activity that is taxed and monitored by government and used for national calculations of gross national product [GNP]) are a mass of transactions both monetary and otherwise which go unaccounted for. As a whole, these untaxed and unregulated activities are large enough to be considered an economy of their own, albeit an illegal one. This is generally referred to as the **shadow/underground economy**. The transactions that make up the shadow/underground (or hidden) economy range from untaxed babysitting to drug smuggling, human trafficking and murder for hire and so on. The unreported funds support benign activities (e.g., household livings expenses) to illegal and dangerous ones (e.g., organizations enabling terrorist attacks).

Within this general term there are subcategories of activities. These transactions are under-researched and the terms that describe them are often confused and even misconstrued. Part of the reason these terms are so often confusing is because organizations/academics differ on how to define or even use them.

For the purposes of this Gist, the shadow/underground economy is made up of the **hidden/informal sector**¹ which refers primarily to the same activities as covered off in the formal economy, but performed without taxation (or under-reported income) or regulation (e.g., construction, other fee for services that are available in the formal economy). The **grey/gray market** (unlicensed operations) involves the importing/sale of genuine commodities through channels unintended by the manufacturer and lacking proper control or authorization (e.g., an unauthorized dealer of Coach bags). The **black market/economy** involves illegal activities. This is a vast and highly organized market which consists of the trade of items including: weapons, currency, counterfeit goods, human trafficking, murder for hire etc.

One aspect of the shadow economy as a whole is the difficulty in discovering and measuring its activities. Delineating each activity can be difficult, but doing so is becoming increasingly critical. While

¹ Even in Canada the definitions used will differ. For example, Canada Revenue agency defines the underground economy as [“any legal business activity that is unreported or under-reported for tax purposes”](#). However, [Statistics Canada uses the term underground economy](#) more widely and refers to the legal activities that are not/under-reported as hidden and informal sector activities (depending on the type of activity). Yet, they acknowledge that their measurements are not able to capture black market activities.

the underground economy stunts the formal economy during bullish times, it can also support the formal economy during recessions.

There is a continuing interest in Canada in measuring the activity in the underground economy. A recent release by Statistics Canada indicates that in 2012 the underground economy (not including some grey market activities as well as any black market) was estimated at \$42.4 B or 2.3% of Gross Domestic Product (GDP)². In November 2014 Canada Revenue Agency announced a Strategy to bring activities from the underground economy (the informal and hidden sector) in to the formal economy.

- The continued fallout from the global financial crisis is believed to have driven a dramatic rise in this so called 'informal' – and by definition unreported and untaxed – sector in the mature economies since 2008, and estimates suggest that the total value of the shadow economy could be as high as US\$10Tn annually – making it the second biggest global economy after the USA (US\$14Tn). [The Shadow Economy – The Next Big Crisis?](#)
- The OECD estimates that in 2009 more than half of the global working population –1.8B people – were effectively working 'off grid' in the shadow economy and that this could rise to two thirds of all those considered 'in work' by 2020. [The Shadow Economy – The Next Big Crisis?](#)
- On the other hand, two thirds of the income earned in the shadow economy is immediately spent in the official economy. This can be a boost for the official economy and may lead to additional overall economic growth. [Hiding in the Shadows: The Growth of the Underground Economy](#)
- The driving forces of the shadow economy include an increased burden of taxation, labor market regulations, the quality of public goods and services, and the state of the "official" economy. [Shadow Economies All over the World](#)
- Reducing the tax burden is the best policy measure to reduce the shadow economy, followed by a lessening of fiscal and business regulation. [Shadow Economies All over the World](#)
- Several research studies find that simpler business start-up processes are associated with higher rates of formal entrepreneurship, lesser development of shadow economies, increased tax revenues, and decreased corruption—easy and straightforward business incorporation practices have multiple spillover benefits for the entire economy. [Getting Down to Business](#)
- Transactions in the shadow economy escape taxation, thus keeping tax revenues lower than they otherwise would be. If the tax base or tax compliance is eroded, governments may

² GDP is the total value of goods produced and services provided in a country during one year.

respond by raising tax rates—encouraging a further flight into the shadow economy that further worsens the budget constraints on the public sector. [Hiding in the Shadows](#)

- Even major reductions in tax rates will not substantially shrink the shadow economy, but they may be able to stabilize it. [Hiding in the Shadows](#)

Informal

The informal sector is essentially a mirror image of the formal economy without regulation or taxation and can include everyone from waiters who do not declare their entire earnings to vendors who sell homemade wares and temporary visitors who work short-term jobs.

- Informal employment is more a way of coping with lack of other employment opportunities than an equivalent or even superior alternative to any legal employment contracts. Those who enter informal employment are much more inclined to cope with their situation by entering some form of self-employment than to stay passive and depend on social assistance. [An Attempt to Measure the Trends in Shadow Employment in Poland](#)
- If a deterrence approach continues, then western governments will, with each step that they take to deter informal employment, destroy with one hand precisely the self-employment and entrepreneurial behavior that they are so desperately seeking to nurture with the other hand. [Is the informal economy going mainstream?](#)
- One possible approach is to see informal activity as an incubator for entrepreneurship in poor areas. Formal and informal firms are also likely to interact along the production process. Local labor market policies could use formal-informal firm networks to give informal firms a way to integrate into the formal sector. [Innovation Policy: A Guide for Developing Countries](#)
- Studies have found that when the opportunities are created, barriers are lowered, and legal rights are guaranteed, up to 25-30 percent of informal firms will move into the formal sector. [Economic Informality Causes, Costs, and Policies—A Literature Survey](#)
- Formal (taxed and regulated) employment is associated with a range of social outcomes and behaviors that are typically associated with higher levels of social cohesion. [Pathways from Jobs to Social Cohesion](#)
- Improving access to health, dental, and disability for those in the informal economy will ensure their future participation in the formal economy while maintaining their quality of life during periods of recession. Policies that allow higher levels of income earning for welfare recipients will facilitate the transfer of skills from the informal economy and open networks and information flow between the formal and informal economies. [The Informal Economy in Rural Canada](#)

- Solving the impending urban crisis will require the promotion of self-help housing and urban services by and for the poor, and a more positive approach to the role of the informal sector, supported by sufficient funds for water supply, sanitation, and other services. Report of the World Commission on Environment and Development
- It is also important to consider the need for finance when developing skills-building programs for the informal sector. Training programs will be much more effective if they are linked with loans to enable the creation or expansion of businesses based on the new skills. Innovation Policy: A Guide for Developing Countries
- Cities must also be careful about policy decisions that may upset an informal recovery economy in the area. For example, in Delhi, it is estimated that changing the type of equipment used to collect, transport and process recyclable materials could improve worker safety, create more stable operating conditions and save money-but at the cost of nearly 70,000 jobs among the most marginalised populations of the city. Cities and Green Growth: A Conceptual Framework
- Informal businesses play an important role in the lives of the poor because these tiny businesses are, and will remain for the foreseeable future, the only way many of the poor can manage to survive. These businesses are unproductive and will remain merely survivalist with limited growth potential. Formal versus informal small businesses

Sharing Economy

The sharing economy is often considered part of the informal economy. It has a broad and changing definition that includes any sharing of information or goods to improve the status of a whole community (e.g. open source software, peer-to-peer file sharing). Collaborative consumption is a subcategory that refers specifically to the sharing of ownership of goods (e.g. a neighbourhood tool chest where any member can borrow a tool much like borrowing books from a library), but often the term sharing economy is used in place of this or any other subcategory term. Ultimately, the sharing aspect means that goods and services are exchanged without taxation.

Initially, the sharing economy grew out of a movement relying largely on the internet and based on several idealistic values such as fairness, openness, trust, collaboration, etc. However, the mainstream use of the term has devolved to mean peer-to-peer renting as seen with AirBnB (a website enabling individuals to rent out rooms or whole houses), Uber (a crowd-sourced taxi service), and Amazon's Mechanical Turk (a platform for temporary employment that is often informal). These applications are little more than informal business, but some participants do pay the taxes.

Since the sharing economy relies on the internet, it could be used to formalize much of the activity that occurs in this category. If the platforms are regulated to report each transaction, these transactions that would normally be hidden could be brought to light. However, any transactions technically part of the sharing economy which occur offline with cash exchanging hands could still evade taxation.

- The Sharing Economy trend could transform the informal economy as it enables people to have access to markets, which are generally not accessible to them in a formal set up, US economic analysts have noted. [Sharing Economy can change informal sector](#)
- A home cleaner hired through Homejoy (sharing economy) will have a digital trail and records that cash transactions never allowed. [Policymaking for the Sharing Economy](#)

Bartering

Bartering is another type of activity undertaken under the informal sector, and has been made more popular and wide-spread by the sharing economy and the internet.

In the new economy, we will likely have an abundance of new micro-enterprises, cottage industries, and even smaller “nano-enterprises,” many of which could get started by accident. When there’s no money involved, there could be a vast grey area between having a business and not having one. For example, if you lend your car to a friend, you aren’t a car rental company. But if you lend your car frequently in exchange for some goods and services, have you become a car rental company? [Money Soup: A Legal Guide to Bartering, Giving, and Getting Stuff without Dollars](#)

- Transacting through barter, gifting, time banks, and other creative means will instantly open up potential for strong, localized, and sustainable economies. While you can’t use “Soup Bucks” to shop at Target or Safeway, you may be able to use Soup Bucks to support local crafts people, micro-farmers, small manufacturers, and friends who can help you meet your needs. Rather than struggling to compete with multimillion dollar companies, a new generation of micro-entrepreneurs will thrive on new kinds of transactions. [Money Soup: A Legal Guide to Bartering, Giving, and Getting Stuff without Dollars](#)
- By rewarding and encouraging civic engagement, time banks – a community currency designed for a specific social purpose - could invigorate active citizenship. [Bartering for a better future?](#)
- The labor reduction effect of digitization will make it impossible for increasingly large groups to participate in the traditional economic system — even at lower prices — leading them to look for alternatives such as a bartering-based (sub)society, urging a return to protectionism or resurrecting initiatives like Occupy Wall Street. [Gartner Reveals Top Predictions for IT Organizations and Users for 2014 and Beyond](#)

Grey Market

The grey market focuses mainly on legal products that are sold either through channels unintended by the manufacturer and/ or at destinations unintended by the manufacturer. Parallel imports are a prime example where goods can be purchased at a lower price in a foreign market and then imported from that foreign market or never actually exported from the home market.

Although not expressly illegal, the grey market muddles up the official market in two specific ways. Parallel importing negatively affects branding, pricing, and even Research and Development (R&D)

investment. Second, these goods complicate the identification of counterfeit goods especially if those counterfeit goods are made at the same factory as the brand's official goods. So counterfeit goods can mix into official channels which intensifies the effects on branding and pricing. Some parallel importers operate legally, but often they will operate without paying taxes.

- It should also be noted that an increase in parallel trade does not mean an automatic increase in the trade balance, e.g. products from a firm based in the United States, which are exported to the European Union and then re-exported to for instance Japan, will be registered on both sides of the trade ledger. [Re-importation \(Parallel Trade\) in Pharmaceuticals](#)
- The enforcement of intellectual property rights (IPR) is increasingly challenged on a number of levels around the world. The future of IPRs will largely depend on political decisions governing the tradeoffs between the need to foster innovation by granting just compensation to R&D industries, and the demands for greater access to affordable goods, both in advanced and developing countries. Parallel trade is an important component in this policy debate. [Re-importation \(Parallel Trade\) in Pharmaceuticals](#)
- Producers argue that parallel imports, particularly of "remainders," will destroy India's publishing industry, but consumers argue that the fear of remainders is baseless. [The Impact of Parallel Imports of Books, Films / Music and Software on the Indian Economy](#)

Black Market

The black market is easier to outline since legal restrictions have already been defined. The black market has never respected borders any more than it has laws, regulations, or taxes. As globalization and its relevant technologies have intensified, so too the transnational black market has grown less local, operating on a global scale. [Havocscope](#) currently estimates the global black market at US\$1.81 Tn. Activities in the black market are wide ranging, and have a higher likelihood of being used to support other illegal activities (including terrorism). With the rapid development of the internet, these activities have become more organized and the possibilities for black market activities more varied.

- The decline of traditional hierarchical criminal networks will be accompanied by the emergence of individual criminal entrepreneurs. [Crime-as-a-Service: pay-as-you-blow with #bitcoin](#)
- Profits from crime-as-a-service will rise as expert hackers use cloud technology themselves to offer illegal services to the highest bidder. [Look-ahead 2015: Fly into the future and other predictions](#)
- Internet security will become absolutely critical in 2015 as malicious individuals, organized crime and state-sponsored hacks seek out every hole and vulnerability they can find. [Look-ahead 2015: Fly into the future and other predictions](#)

- Further diffusion of high speed internet and advances in internet technology that increase download speed will likely increase digital piracy. [Piracy of intellectual property](#)
- Both buyers and suppliers of many illegal goods and services will increasingly avail themselves of the security and ease of access that is provided by the smart use of information technology. [The future and crime : challenges for law enforcement](#)
- An increase in opium cultivation and heroin production in China could be related to a combination of increased ethnic unrest in China. [The future and crime : challenges for law enforcement](#)

Terrorism

Terrorism is a far cry from unreported income for babysitting, but it is still part of the shadow economy – the black market/illegal sector. Afghan terrorists are infamous for using the sale of opium to fund their activities, and terrorists have been shown to meet in the same circles as other types of black market criminals. Indeed, activities performed within the shadow economy could conceivably support terrorist activities. This may affect countries with higher income more strongly (there is more potential for generating vast sums to support terrorist activities).

Technology

Technology and innovation spur economic growth in the formal economy, and the same happens in the shadow economy. While connecting the informal, grey, and black markets to each other may still be difficult, the technology which helps one often helps the others. Craigslist has helped informal workers find cash jobs or trade goods, and similar sites have also been used to help criminals find customers. Cloud computing has been used to store all manner of digital goods from purchased music to child pornography. Similar issues are arising with the Internet of Things³ and 3D printing which are bringing the digital into the real world.

3D printing could enable peer-to-peer sharing of physical goods including patented items, drugs, and weapons. Dark net (websites that are not easily found through search engines or other conventional means) websites could hide any shadow transaction at least until law enforcement and revenue agencies can catch up.

- 3D printing technology enabling consumers to copy functional objects could mean that companies will need extra protection in form of design patents. [The Intellectual Property Right Implications of Consumer 3D Printing](#)
- 3D printing could result in millions of jobs being lost and a sharp decline in taxable revenues. [A real Industrial Revolution: 3D printing and the impact on jobs](#)

³ The interconnection via the Internet of computing devices embedded in everyday objects, enabling them to send and receive data.

- Public initiatives to regulate Internet pharmacies will only work through enhanced cooperation with private sector actors such as Internet Service Providers. [Transnational Organized Crime in East Asia and the Pacific](#)
- Profits from crime-as-a-service will rise as expert hackers use cloud technology themselves to offer illegal services to the highest bidder, while the least competent take advantage of easy-to-use cloud crime tools. [Look-ahead 2015: Fly into the future and other predictions](#)
- Bad actors will explore even more the dark web to hide their identity and increase their business opportunities. [The Dark Web thrives despite Operation Onymous](#)
- Facebook's Tor may be the next basic privacy protection Silicon Valley companies will be expected to offer their users. [Why Facebook Just Launched Its Own 'Dark Web' Site](#) (Privacy in the internet age is at a premium even for official economy participants [e.g. [2014 Sony hacks](#), [revenge porn](#)], and many official economy companies may recognize a market demand for a dark web presence. If official economy companies supply a platform for dark net transactions, what are the implications? Could official economy companies evade taxes through the dark net? Would official economy companies have higher risk of tax auditing if they host such a platform? If Tor becomes something more regulated, then it will no longer be a dark net. If it is no longer a dark net, customers may flee and demand the company to open a less regulated version of the same website. Such actions could intensify the existing and never ending game of hide and seek between authorities and shadow economy participants.)

Digital currency

Digital currencies such as Bitcoin are a type of alternative currency that are treated much like physical currencies. Since these currencies can be exchanged for cash, using digital currencies is more like using cash than bartering.

Digital currencies have been embraced by informal workers and criminals alike because they are difficult to trace. However, they do not offer any real secrecy by themselves because the technology they rely on keeps a record of all transactions. Criminals and informal workers can cover their tracks using other means such as Tor or other dark nets, but even these are vulnerable to attacks that can reveal identities if used by cunning law enforcement. Just as no security system on the visible internet is 100% effective, so security systems attempting covert transactions are vulnerable too if laws and regulations are open enough to allow it.

- Cryptocurrencies are the economic layer the web never had, and can facilitate not just remuneration, but also the communication, coordination, and tracking of all machine-to-machine and machine-to-human interactions. [Top 5 Immediate Money-Making Applications of Blockchain Technology](#)
- You may be able to use cryptocurrencies in a revolving credit and debit scheme bilaterally but, as soon as you try to cash out or put cash into the scheme, the national jurisdictions will

make the transaction subject to national laws. [Crime-as-a-Service: pay-as-you-blow with #bitcoin](#)

- Bitcoin will lose its lustre as a means to evade taxes when it becomes a currency for the masses. [Barter, Bearer, and Bitcoin: The Likely Future of Stateless Virtual Money](#)
- Last year, for example, the IRS declared that "virtual currency" like bitcoin will be treated as property for tax purposes. [Is Bitcoin's Blockchain the New Internet?](#)
- Bitcoin's historical association with - and continued use by - criminals for illegal purchases and money laundering is likely a further deterrent to mass adoption. [The Future of Cryptocurrency in Online eCommerce](#)
- The main use for digital cryptocurrencies has been for purchasing illegal goods and services from markets in the dark net, such as Silk Road. This makes it difficult for an exchange to identify a "suspicious transaction". Consumer protection measures could be brought in by the introduction of a US-style licensing system for digital currency exchanges. [Governments want to regulate bitcoin - is that even possible?](#)
- The blockchain, the public ledger of all Bitcoin transactions, has all kinds of uses outside of providing stability for the world's most popular cryptocurrency, from decentralised data storage to super-flexible email, and it could be abused to store malware control mechanisms or provide access to illicit content such as child abuse images that would be extremely difficult to take down. [Bitcoin's Blockchain Offers Safe Haven For Malware And Child Abuse, Warns Interpol](#)
- Financial and terror experts are concerned about the ability to move cash around national borders which could help ISIS fund attacks in the West. [Terrorism finance: experts worry ISIS already using Bitcoin](#)

Where's the link?

The link between the informal market, the grey market, the black market, and terrorism is tenuous, but the lack of research in the area may hide these connections. The larger a nation's informal economy, the greater the opportunity for unlicensed workers to exploit the black market or be exploited by those in the black market.

Since the informal market operates "under the table" without taxation, workers are a good target for money laundering or even counterfeit money distribution. What is considered merely the informal economy may play a role in enabling or supporting darker deeds such as money laundering. Informal employment might also be a gateway to the black market especially as the wealth gap widens. Undocumented migrants may use black market connections to get through a border, and those same connections could kidnap them and sell them into slavery. Often these migrants are treated as second

class citizens and paid next to nothing because their work and their existence in the country go unreported.

- An effective understanding of the linkages between migrant smuggling and trafficking in persons is critical to ensure appropriate and proper responses to the broad range of situations encountered in the workplace. [Transnational Organized Crime in East Asia and the Pacific](#)
- Connected to all crime is the threat and existence of money laundering which amounts to billions of US dollars worldwide. [Transnational Organized Crime in East Asia and the Pacific](#)
- Local anti-money laundering (AML) rules will include tax avoidance (and indeed aiding tax avoidance) as a money laundering offence, so asset managers' customer handling teams will be required to be trained to spot and test for investor's wealth to determine it has been generated by tax avoidance. [Asset Management 2020 - A Brave New World](#)
- Burgeoning U.S. space-monitoring capabilities could one day be used to protect orbiting money laundering satellites from Chinese rockets. [The Air Force Might Have To Protect Money Laundering in Space](#)

Strategic Questions

- Where should the lines be drawn between the informal economy, the grey market, the black market, and terrorism? How might formalizing such lines affect the benefits brought by the informal economy? What role could a more regulated sharing economy play?
- The informal sector is likely to subside as the economy strengthens, but how could it morph into something even less discoverable due to emerging technologies? To what degree can digital currencies be legally tracked for tax purposes?
- Should parallel importers be outlawed? Would continued leniency spur the economy while directing law enforcement toward more critical concerns?
- Does intellectual piracy negatively affect the legitimate producers enough to enforce intellectual property laws? Should they learn to adapt, or does piracy impair the overall economy?
- How serious is the impact of the shadow economy, and how can it be contained or possibly marginalized? How does the shadow economy benefit the formal economy? Do the negative impacts outweigh the benefits?
- What relationship do non-criminal members of the shadow economy have with crime syndicates?
- How are crime syndicates adapting to new technologies? What technologies will emerge in the next five to ten years that they can exploit?
- What role will space based technologies play in the broader shadow economy, and how can they be regulated?