

UNDERGROUND ECONOMY AND MARKETING EXCHANGE: A MACRO PERSPECTIVE

HAERAN JAE, Virginia Commonwealth University

MATTHEW T. SEEVERS, Creighton University

JULE B. GASSENHEIMER, Rollins College

This paper explores marketing exchange in an underground economy (UE). While the economic discipline recognizes the importance of the UE in the allocation of resources, the marketing literature has yet to capture the underlying principles that define the UE. This paper reintroduces the UE to the marketing literature and offers a definition of the UE from the perspective of marketing. Using Bagozzi's (1975) social marketing and complex exchange framework, the authors expand two-party UE exchanges to account for complex exchange, thus reinforcing the potential contribution some forms of underground exchange may offer society.

INTRODUCTION

Global "underground" economic activity has been estimated at more than \$9 trillion – nearly as large as the gross domestic product (GDP) of the United States (Schneider 2006). In the U.S. alone, underground economic activity is estimated to represent as much as \$970 billion (McTague 2005). In developing countries such as Nigeria, Egypt, and Thailand, the "underground economy" (UE) represents as much as two-thirds of their GDP (Schneider 2006). And although an exact measure of the UE – whether in the U.S. or in other countries – is difficult to assess, economists agree that the phenomenon is substantial, widespread, and growing. Furthermore, the size of the UE has become an increasingly relevant issue for economics researchers in that UE growth tends to distort official measures of the over-ground economy (OE) (Tanzi 1999).

A uniform definition of the underground economy has yet to emerge in the literature; however, activities commonly associated with the UE include unrecorded legal income (e.g., tax evasion), exchange of illegal goods and services (e.g., prostitution, drugs), and illegal

personnel (e.g., illegal immigrants). As such, the UE generally carries a negative connotation for citizens and researchers alike, suggesting that the UE potentially creates "an unhealthy state between citizens and governments" (Frey and Schneider 2000, p. 1). Little consideration, however, has been given to the potential benefits of the UE, both economic and social. The use of the UE may reduce labor costs (i.e., more competitive wages), lower costs of goods and services (e.g., unauthorized channels), and/or provide sources of revenue not available in the OE (e.g., gambling) (Balfour 2001; Pozo 2006; Seligman 2002). The UE may also strengthen social relationships among friends and neighbors. Williams (2005), for example, found that 13 percent of all underground work reported among respondents involved either professional crafted skills (plumbers, electricians) charging less than the going rate to those holding close social ties. A number of respondents felt "underground work was thus a way of giving money to kin that avoided all connotations of charity, even if this was their intention" (Williams 2005, p. 13). A failure to understand the positive and negative implications of the UE, as well as factors that drive people to engage in underground activity, may ultimately contribute to uninformed decisions by policy makers.

While economists are concerned with distinctions between the OE and the UE, the

marketing literature on underground exchange remains underdeveloped. With the exception of an emerging interest in gray markets (cf. Antia, Bergen and Dutta 2004; Antia et al. 2006; Berman 2004), investigations of underground activity from a marketing perspective have been dormant for more than a decade. This gives the appearance that marketing scholars view the behaviors and consequences of marketing exchange in the UE to be unimportant to organizations and society. Challenging this notion, we argue that a strict focus on OE exchange with little consideration of exchange behavior in the UE limits the boundaries and scope of the marketing discipline. More specifically, a failure to understand UE exchange may stunt efforts of the field to understand exchange beyond a simplified exchange paradigm (cf. Hirschman 1987). In keeping with Houston and Gassenheimer (1987), we also argue that understanding the negative as well as positive behaviors underlying exchange and their consequences are important to marketing theory development and advancement. And, as suggested by Sherry's (1990) research on informal retailing, the study of the UE holds the potential to "not only extend our understanding of marketplace behavior, but also temper and humanize the formal and economic dimensions of marketing practice" (p. 182).

This paper contributes to the extant literature by broadening our understanding of marketing exchange within the underground economy. We begin with the economic literature to establish a foundation for the UE. Next, we merge the non-economic and economic literatures to capture a broader perspective and establish direction for framing the UE within the overall economy. This path of inquiry allows us to define the UE in terms of marketing exchange and places the UE in both a positive and negative light. In so doing, we offer accounts from the popular press that reveal a counter-intuitive view of UE behaviors and consequences and, thus, suggest that UE activity, in some cases, may stimulate the OE and/or offer positive benefits to society.

To better visualize issues related to the UE, we propose a framework to classify exchange behavior and consequences in the UE and OE. The paper then concludes with a discussion of theoretical and public policy implications.

LITERATURE REVIEW

UE Literature

The common thread running through the economics literature on the underground economy is the focus on unrecorded, unreported, or under-measured economic transactions (e.g., Bhattacharyya 1999; Cebula 1997; Pozo 2006; Rutkowski 1995; Tanzi 1982; Thomas 1990). Keeping with the core foundation of economics – the allocation of resources – these studies focus primarily on tax evasion, the buying and selling of illegal goods and services (e.g., drugs, prostitution), and illegal employment (e.g., illegal immigration) with emphasis on the negative effect of these activities on society's ability to distribute public goods and services (e.g., Feige 1989; Pozo 2006; Pyle 1989; Slemrod 1985). These studies use a variety of labels to describe the UE, which suggests perhaps that the UE involves different facets. Labels most frequently cited include: "Black Economy" (Pyle 1989), "Black Market" (Clinard 1952; Stahl and Alexeev 1985), "Unofficial Market" (Pozo and Wheeler 1999), "Hidden Economy" (Bhattacharyya 1999; Giles 1999), "Shadow Economy" (Schneider and Enste 2002), and "Informal Economy" (Thomas 1992). Table 1 provides examples of UE studies and the various labels applied within these studies.

Merging Economics and Non-economics UE Literature

Understanding the impact the underground economy has on the overall economy and society requires not only the economic perspective to highlight that different types of underground exchange (e.g., black economy, black market, unofficial, hidden economy,

TABLE 1
Summary of Examples of Underground Economy

Underground Economy (Tanzi 1982)

Part of the gross national product but because of non-reporting and or underreporting, is not measured by official statistics.

Underground Economy (Tanzi 1982)

The income generated by activities generally not reported for tax purposes or for the determination of public assistance, social insurance, or other income security benefits.

Underground Economy (Rutkowski 1995)

The production and distribution of goods and services that for the most, are initially undetected (and therefore unrecorded) in the national income and product accounts.

Underground Economy (Cebula 1997)

Underground economy includes the buying and selling of illegal goods and services, as well as unreported economic activities from legal transactions.

Informal Economy (McCrohan and Smith 1986)

All types of market economic activity conceptually in the national accounts that is under measured due to informal business style of vendors.

Informal Economy (Thomas 1991)

Activities that for various reasons are not recorded in the national income accounts of most countries.

Black Economy (Pyle 1989)

Synonymous with tax evasion and excludes criminal activity.

Black Market (Clinard 1952)

Illegal activities occurring under secret conditions.

Black Market (McLaren 1996)

Tax evasion activities through the undeclared transactions and refers to other terms such as "informal", "black", or "second" economy.

Black Market (Pozo and Wheeler 1999)

Unofficial market transactions.

Hidden Economy (Bhattacharyya 1999)

Unrecorded national income, only part of which comes from tax evaded income.

Gray Market (Duhan and Sheffett 1988)

Exchange activity for unauthorized trademarks.

Shadow Economy (Schneider and Enste 2002)

Economic activities concealed from the public and capable of shirking laws and government taxes.

informal economy, shadow economy) be measured, but also the marketing perspective to highlight the underlying behaviors that drive UE exchange. Djajic (1997) provides a behavioral rationale for the UE by explaining that foreign workers lacking legal status evade taxes to protect themselves. This behavioral-based reasoning is of interest to economics and marketing because tax-evading employment keeps illegal immigrants in jobs, fosters growth in the UE, and shifts demand in the OE. Similarly, Bhattacharyya (1999) notes that corrupt behavior, such as bribery, impacts UE growth. It should be noted, however, that in some foreign countries, for example, bribery represents legal behavior and an informal means of competing globally and consummating successful exchanges. Williams (2005) also acknowledges that UE activity can be socially motivated from a “community-building” rationale. Payment between friends and neighbors avoids the obligation to reciprocate a favor and also helps to build closer relationships. As one respondent stated about implicit reciprocation: “I always give people a drink (money) who do me a favor” and “people would never do anything for you again if you didn’t” (Williams 2005, p. 11). Without recognizing the underlying rationale for using the UE or OE and the potential positive or negative consequences, defining the UE solely as unrecorded or under-measured economic activity has limited value for marketers.

A more advanced conceptualization of the UE, useful to marketers, should focus on exchange behavior as well as the consequences of underground exchange (cf. Bagozzi 1974). Thus, a more complete picture of the UE requires not only an economic perspective but also a social one. From a social viewpoint, Hanson (1981) uses the term “black exchange” to describe the illegal or informal, off-the-record trade in a small village in Scandinavia. The study provides a revealing look at the process of UE behaviors as well as exposing the social relationships involved in underground exchange. In another setting, Szykman and Hill

(1993) demonstrate how prison inmates may develop an informal economy to satisfy psychological and social needs. Together, these results suggest that pressure to maintain social relationships may encourage and reinforce informal exchange.

McCrohan and Smith (1986), also interested in the social aspects of the UE, looked at informal exchange behavior characteristics. Results suggest that informal exchange situations, such as garage sales and flea markets, encourage tax evasion behavior but with little criminal intent. In subsequent work, McCrohan and Smith (1987) sought to identify consumer segments more likely to participate in exchange activities with vendors using informal business styles. Within the informal market, they found the number of college-educated, full-time workers with incomes over \$40,000 to be significant. (See also Williams [2005] for a discussion of the affluent consumer segment involved in the UE.) Thus, activity within the UE does not appear to discriminate by social class. Sherry (1990) also examined the practice of informal retailing in a flea market setting with a focus on the behaviors of buyers and sellers. Defining informal marketing as “the less official (often clandestine), less controlled, less rationalized, reactive, and transient aspect of exchange behavior” (p. 182), he suggested that the secretive nature of the informal market often masks the positive or negative consequences, making the exchange decision difficult. As with the OE (Williamson 1985), the UE literature suggests that exchange partners engaging in the UE hold incomplete information about the underpinnings of the exchange, and limited formal guidance to base decisions (Sherry 1990). Some buyers may not be aware of their participation in the UE and, thus, the illegality and consequences of the exchange (see Hill [1992] for an exception). For example, the repair of a car using smuggled car parts (Balfour 2001) or purchasing counterfeit drugs from unbeknownst unlicensed pharmacies (Buzzeo 2005).

“Gray markets” also fit within the UE context, straddling the boundary of formal and informal market activities. Duhan and Sheffet (1988) describe gray marketing as the selling of trademarked products through channels of distribution that are unauthorized by the trademark holder. Gray market activities are reported to be common among various industries including beauty products, pharmaceuticals, textbooks, consumer electronics, photograph equipment, clothing, information technology, automobiles, and industrial equipment (Antia et al. 2006; Berman 2004). Gray market activities may continue to increase given the role of the Internet in the marketing of both foreign and domestic goods (Berman 2004). For example, the increased usage of the Internet could fuel parallel importing activities. Parallel importing refers to transactions in which a buyer (often in a separate country from the seller) purchases trademarked goods not authorized for resale in the buyer’s market (Eagle et al. 2003), yet may in fact be resold in the buyer’s market through legitimate retail outlets (Maskulka and Gulas 1987). The ambiguous and inconclusive formality of parallel importing, for example, represents a potentially important sector of the overall economy since gray market behaviors often carry positive benefits for buyers – although not necessarily for the rightful owner of the intellectual property or trademark/copyright product (Champion 1998; Duhan and Sheffet 1988). From the perspective of a consumer, gray markets are useful; they tend to offer lower-priced substitute products. From a seller’s perspective, however, gray markets weaken a firm’s level of control within a distribution channel, especially when gray market prices are less than wholesale prices quoted to authorized resellers (Berman 2004).

In that UE and OE exchange activity may be legal or illegal, and lead to potentially positive or negative outcomes, we see a need for clearer demarcation of the UE within the marketing literature. We suggest using the formality of exchange (cf. Sherry 1990) – as defined by

whether or not a transaction is regulated – as a means of distinguishing UE and OE exchange. We, therefore, define the underground economy as *exchange activity in which two or more parties agree to and execute a transaction (or transactions) in an “informal” marketing channel, i.e., a marketing channel that is unmonitored, unregulated yet not necessarily illegal, or explicitly outlawed by a legitimate governing authority*. For example, unrecorded transactions in the contexts of garage sales, tipping, flea market, eBay, and babysitting could potentially fall under unmonitored, unregulated, yet not illegal, transactions. Explicitly outlawed activities could encompass transactions such as prostitution and illegal drug trade. The consequences resulting from exchange in an UE context, although unrecorded, could positively or negatively impact the OE and society. We now shift our focus to the exchange itself and broaden the assessment of the UE to reflect the characteristics of such exchange relationships.

A BROADENED FRAMEWORK FOR MARKET EXCHANGE

In this section, we offer a framework that seeks to capture market exchange relations within an overall economy. Our intention is to broaden our understanding of market exchange by expanding the exchange frontier to include both the OE and the UE. We limit our discussion to macro issues in a parsimonious attempt to establish a framework for policy makers to better assess the legal and illegal, and positive and negative implications of the UE on society. Recognizing the importance of a generalized theory of market exchange applicable to both the OE and UE, we offer Alderson’s (1965) necessary conditions for exchange in a two-person world as a point of departure. According to Alderson:

If X is an element in the assortment A, and Y is an element of the assortment B, then X is exchangeable for Y if, and only if, the following three conditions hold:

- X is different from Y,
- The potency of the assortment A is increased by dropping X and adding Y, and
- The potency of the assortment B is increased by adding X and dropping Y (p. 84).

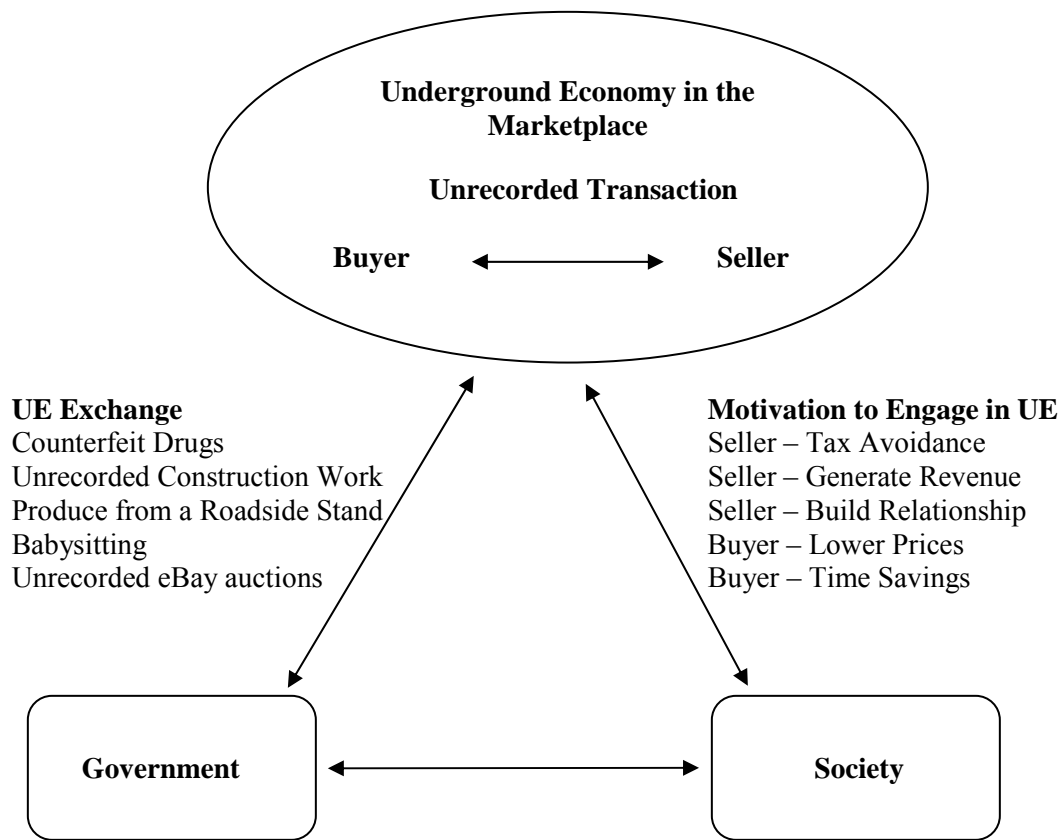
Even when applied to the UE, we argue that exchange will occur if and only if both parties *expect* to yield positive benefits from the exchange. In an exchange involving the sale of illegal drugs, for example, the two parties expect *net positive* outcomes for themselves. In an exchange involving the sale of car repair services using counterfeit parts, the seller knowingly places expectations of personal benefits ahead of the negative consequences to the buyer or other stakeholders, whereas the buyer enters into exchange on the assumption that it is legitimate and acceptable to society. Therefore, even in two party exchanges, considerations of societal values are often brought into the exchange equation, which suggest that transactions within the UE are a form of complex social exchange (cf. Bagozzi 1975).

Bagozzi (1975) provides a fundamental building block for understanding exchange within the UE by defining complex exchange as “a system of mutual relationships between at least three entities. Each social actor is involved in at least one direct exchange while the entire system is organized by an interconnecting web of relationships” (p. 33). Despite the interconnection, each actor (exchange party) need not be aware of all of the social and economic relationships involved in the exchange. The coordination of exchange activities may also be covert and driven by the pursuit of self-interest (Bagozzi 1975). This interconnecting web of relationships could include participants such as customers, suppliers, competing sellers, trade associations, stockholders, and – from a macro perspective – government or society as a whole.

A complex exchange in the UE could, for example, involve covert activities that avoid the recording of transactions and payment of taxes. A reduction in taxes may help the individual but also affects the resources the government has available to support the welfare of society, and creates a disproportionate tax burden on law-abiding citizens (Frey and Schneider 2000). Conversely, a complex exchange of a similar nature in the OE, for example, would be cooperatives. As a legal, IRS-sanctioned entity, cooperatives have created their own tax-avoiding complex exchange environment through over-ground informal consolidation. Despite the reduction of taxes, society benefits through lower prices and a more competitive marketplace (Inc. 2001). Society may also benefit from buyers gaining access to a diverse selection of unique products; strengthening interpersonal relationships among buyers, sellers, and other stakeholders; and building a more general sense of “community” when the marketplace consists of, for example, the seller’s garage or a neighborhood clubhouse (Thomas and Peters 2006).

Figure 1 takes a macro perspective and seeks to capture the complexity of exchange relationships in the UE sector. Regardless of the transaction type (e.g., illegal drugs, babysitting service, selling tomatoes from a roadside stand), a commonality among all types is that none of the providers pay taxes on at least part of their earnings. What distinguishes each transaction, and enables these examples to be seen from a marketing perspective, is the rationale or motives for engaging in UE transactions. Following Alderson (1965), the basic two party rules of exchange hold true for each. The potency of the exchange is perceived to contribute to the overall well-being of the two parties initiating the exchange, whether for the purpose of tax avoidance, lower prices, time savings, or to foster social ties. Importantly, we recognize that the residual effect – that is, the effect to entities beyond any two parties directly involved in an UE transaction – could be positive or negative depending on the

FIGURE 1
Complex Exchange Relationship in Society with the Underground Economy Sector



Benefits to Society

- Competitive pricing
- Greater consumption opportunities
- Socialization/mutual aid
- Marketplace efficiency
- Economic stability in certain regions

Detriment to Society

- Lack of funding to support societal causes
- Disproportionate tax burden on law-abiding citizen
- Unregulated/dangerous drugs
- Crime infiltration
- Higher taxes to compensate for reduction in tax revenues
- Reduced social insurance and welfare
- Greater regulation/penalty

calculus of benefits offered or damages done to society.

As our examples have suggested, these complex exchanges may include positive and/or negative consequences, causing a ripple effect throughout the OE and society as a whole. Next, to fully capture the social complexities and societal implications of exchange within the UE, we consider the formality of underground exchange activities and the consequences of these exchanges for the OE and society.

UE Exchange Framework

Using the formality of behaviors to further conceptualize the overall economy, we assess the consequences of underground and over-ground exchange for a society. We begin by proposing a classification schema. Others have recognized the value of classification schemas and have offered direction for establishing a position for the underground economy in the context of the overall economy. Alm (1985), for example, in examining the U.S. economy, segments the economy into three sectors: (1) aboveground, or taxed, output; (2) underground output that is a substitute for taxed output (e.g., off-the-books employment, illegal alien employment, barter transactions); and (3) traditional criminal activities (e.g., prostitution, gambling, drug trafficking). Alternatively, Robles and El-Ansary (1989) classified the overall economy according to activity (legality vs. criminality), tax status (declared vs. undeclared), nature of transaction (market vs. nonmarket, substance vs. exchange), impact on national output, and the occupational status of transactors.

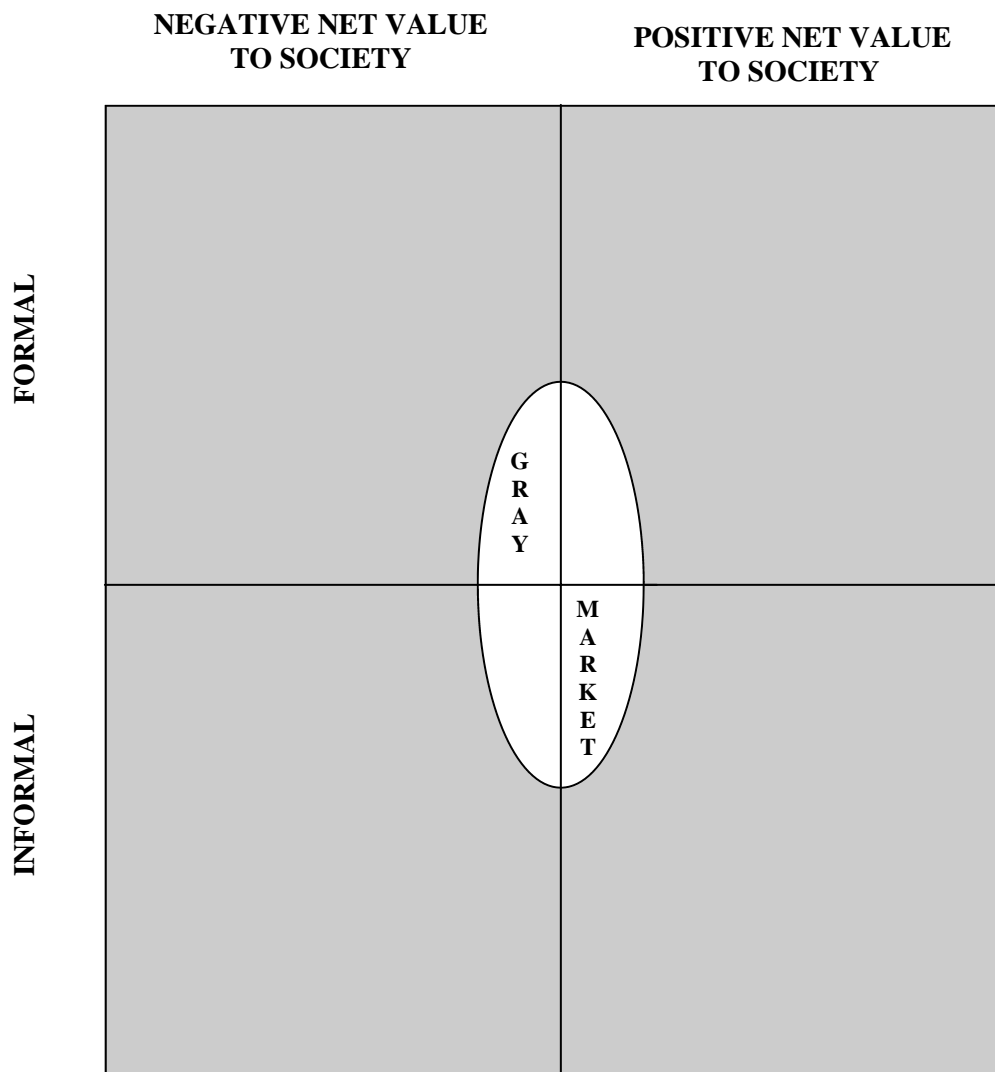
Our classification schema differs from prior works in that we distinguish the UE from the OE by focusing on the formality of the exchange behavior in conjunction with the positive and negative consequences for society. We also emphasize the dynamics of exchange relationships from a complex exchange

perspective as suggested by Bagozzi (1975), and identify descriptors of and motivation for types of exchange (see Figure 1). We believe that the combination of formal and informal exchange behaviors and positive and negative consequences establishes a foundation for public policy based on outcomes for society. In effect, either formal or informal behaviors may be deemed beneficial or detrimental to society, thus creating the classification schema presented in Figure 2.

Before proceeding with our framework, we offer a note regarding the development of standards from which to judge the value of societal benefits or detriments. We recognize that a proper assessment of exchange in the UE implicitly requires an evaluation of exchange behaviors and their outcomes from a legal-moral-ethical perspective. As previously stated, however, our primary intent in this paper is to suggest that negative as well as positive societal benefits may accrue from UE exchange. Therefore, we limit the scope of the current paper by treating positive and negative exchange outcomes in a deliberately general manner. Clearly, research that further develops a societal value assessment framework is needed.

We begin by classifying the overall economy using two variables that allow for a simple 2 x 2 framework. First, we assume that nearly all exchange transactions within an economy may be classified as either formal or informal. In this setting, we suggest that informal transactions are those that occur in a channel unregulated by a governing authority. Second, we posit that all exchange transactions may be classified as providing either a positive or negative *net* outcome to society. We recognize that many transactions may result in a bundled set of outcomes that may provide both positive and negative outcomes to various stakeholders and segments of society. In general, however, we evaluate positive and negative outcomes in terms of *net value* added to or depleted from society. The four conditions that result from

FIGURE 2
Taxonomy of the Overall Economy



this broad classification are considered below along with a brief discussion of gray markets. In our view, gray markets cut across the broad classifications, blurring the distinction between the OE and the UE.

Formal Exchange - Positive Outcome. The formal exchange-positive outcome sector of the economy represents the traditional notion of the OE. Exchanges in this sector are formalized through regulated business practices and provide *net* positive benefits to society. Consider the various transactions surrounding the introduction of a new Wal-Mart retail store in a local economy. We would expect that Wal-Mart as a reputable firm will operate in accordance with both local regulation (e.g., sales tax) and federal regulation (e.g., wage and hour laws). Some level of positive benefits would also be expected for the local economy including the creation of new jobs and the opportunity to purchase consumer goods at competitive prices.

Formal Exchange - Negative Outcome. The formal exchange-negative outcome sector of the economy is also considered part of the OE. In this sector, the transactions envisioned occur in formal channels, but result in net negative consequences for society. Examples of factors leading to negative outcomes might include excessive competitive pressures, regulatory loopholes, and cost saving measures. Consider the decisions faced by many U.S. manufacturing firms. To compete under conditions of increased global competition, many firms move their domestic plants to overseas locations to receive the benefits of reduced labor costs. While such a move may improve the profitability for the firms, the move may do so at the short-run expense of the local worker and the local economy. The exchange activity of Wal-Mart may also be considered in this sector of our proposed framework. While their retail transactions in small communities may offer benefits in the form of lower prices for its customers, other local businesses may be adversely impacted and forced to shut down.

Local residents, too, may feel that an incoming Wal-Mart store weakens the fabric of their local and independent retail store community.

Informal Exchange - Negative Outcome. Economic activity within the informal exchange-negative outcome sector is generally considered the “dark side” of underground exchange. In this sector, exchange parties engage in informal (and sometimes illegal) behaviors that have negative net consequences for the OE and/or society. To illustrate exchange within this sector, consider the illegal trade of illicit drugs in the United States. Despite laws expressly prohibiting the sale and purchase of such drugs, criminal exchange activities are prevalent. As such, the methods and practices under which such goods are transferred are not approved or mandated by a legitimate governing authority (Becker, Murphy and Grossman 2006). Instead, exchange behavior in this sector is often based on localized norms and terms developed by unlawful groups. In terms of negative outcomes to society, the consumption of illicit drugs make users (i.e., consumers), at minimum, less productive. Furthermore, the proceeds from the sale of such drugs may be likely to stimulate additional underground activity such as money laundering (Levi 2002). Consider also the serious health concerns raised by illegal beauty treatments offered by unlicensed practitioners (Signer 2006). Lured by lower prices and the convenience of not needing to make an appointment weeks in advance, patients willingly use illegal permanent wrinkle fillers *despite* the fact that this type of beauty treatment is associated with life-threatening side effects.

Informal Exchange - Positive Outcome. The informal exchange-positive outcome sector provides the most counter-intuitive view of the UE. As demonstrated in the work of Szykman and Hill (1993), some informal exchange markets are likely to develop when formalized, sanctioned markets do not satisfy existing consumption needs. Furthermore, informal

economies may develop in response to market inefficiencies that fail to provide the appropriate exchange of goods and labor. For example, estimates reveal that upwards of 85 percent of new jobs in Latin America have been created via black market entrepreneurship (Roche 2001). In another report, because Pakistan's UE accounts for nearly half of its official GDP, the country's economy has shown great economic instability when underground exchange has been disrupted (Balfour 2001). McMillan's (2006) investigation of underground markets for the poor acknowledges that the UE allows billions of people to live on less than one U.S. dollar a day. Finally, underground markets have also been used as a safe haven for people trying to escape the attention of the mafia demanding "protection money" to allow them to run legitimate businesses (McMillan 2006).

Gray Market Exchange. As shown in Figure 2, we view gray market behaviors as cutting across formal and informal exchange, blurring the distinction between the OE and the UE. Having not been officially sanctioned, the formality of the gray market is less clear according to our classification (cf. Duhan and Sheffet 1988). The controversy between Napster and the recording industry in 1999 provides an example. With the introduction of Napster as an unauthorized and unregulated distributed channel, many individuals gained free access to music although at the expense of the OE (in particular, the music recording industry). While the initial generation of Napster was shut down by U. S. courts in 2001, the introduction of file sharing led the music industry to change its distribution and pricing in response to the negative impact its previous legal constraints had on consumer access to free music (Wade 2004).

IMPLICATIONS AND DIRECTIONS FOR FUTURE RESEARCH

In the preceding section, we proposed a framework that considers both formal and

informal transactions along with their positive and negative consequences. Our intention was to expose the underground economy exchange as a fertile ground for future research. We now present the implications for theory and public policy, including directions for future research.

Theoretical Implications

When Bagozzi (1975) introduced the concept of complex exchange relationships, he illustrated how the consequences of positive or negative exchange might ripple throughout society, but provided little direction for understanding the UE. This paper extends the work of Bagozzi as well as others who have looked at marketing as exchange (cf. Houston and Gassenheimer 1987). We first define the UE within a marketing exchange framework and identify descriptors and motivations underlying the UE. We also propose a classification schema that distinguishes between the UE and OE through the formality of exchange behavior and positive and negative consequences for society. Following the directive of Bagozzi (1975), we highlight the dynamics of exchange relationships from a complex exchange perspective. We argue that combining formal and informal exchange behaviors and positive and negative consequences within the same framework establishes a foundation for public policy based on the good of or harm to society. By taking a complex exchange perspective of the UE, we not only recognize exchange in its simplest, two-party form, but also acknowledge the power of regulated and unregulated behaviors (i.e., formal and informal) on the ability of the overall economy (both the UE and the OE) to fully support its citizens.

While this paper takes an important step toward a definition of the UE from the perspective of marketing, we recognize that our efforts serve only as a first step toward the development of a complete framework of the overall economy. Continued investigation into the workings of underground exchange behavior is clearly

necessary to establish a solid research footing. In particular, we believe that the body of exploratory field research must be advanced in order to properly expose the seemingly infinite forms of exchange.

Public Policy Implications

Although we suggest that consumers enter into underground economy exchange in order to seek out positive benefits unavailable in more formal channels, the current paper does not seek to determine the set of conditions that drive such behavior. An understanding of the antecedents of UE exchange might provide insight for the normative issue of either prevention or promotion of UE channels of exchange. For example, unregulated new technologies that support Internet-based exchanges (e.g., Napster, KaZaa) may lead to increased gray market behavior. In the case of music piracy, one of the main obstacles faced by the music industry involves changing the attitude that nothing is wrong with file sharing (Wade 2004). In our view, the conclusions of such future research could lead to valuable strategies for public policy makers.

Another promising aspect of the present study is the notion that economically efficient UE activities may be identified and legalized to complement the overall economy. Consider the undocumented alien workers who flood the U.S. labor market and are willing to accept low wages (Djajic 1997). Recent estimates suggest that there are as many as 11 million undocumented alien workers in the U.S. (Jacoby 2006). Obviously, access to this labor population may increase a single firm's profitability and could, therefore, benefit U. S. consumers by way of lower prices. While we do not endorse illegal and exploitative labor practices, it seems plausible that a compromise position may be reached that recognizes and legitimizes the behavior with benefits for all parties. An example is the recent proposal by the U.S. administration for a temporary worker program in which the practice of using migrant

workers is legalized and firms are better able to optimize their labor expenditures (Whitehouse Press Release 2004). This could be compared, in spirit, to the accepted practice of hiring temporary employees to fill jobs during periods of increased seasonal demand that might otherwise go unmet due to high levels of employment in the U.S. workforce (Swarns 2006). Legitimizing the labor force could also help screen out individuals who potentially threaten the nation's security.

In the case of regulating unmonitored, seemingly lawful transactions such as garage sales or eBay auctions, public policy makers could provide easy access to rules, guidelines, and consequences governing buyer and seller transactions; thus, allowing buyers and sellers to be better educated on the consequences of their activity (e.g., tax evasion, trading illegal goods, and counterfeit goods). For auction sites, such as eBay, one option might be to require each respective site to clearly state guidelines and require electronic documentation so that appropriate tax authorities could monitor buyer and seller activity. Thus, the users of these sites would reap the benefits of efficient transactions without violating the law.

An obvious consequence of UE activity is unreported taxable revenue, which drains funds earmarked for society and public programs. Furthermore, the proliferation of tax evading behaviors may undermine citizens' respect for a formalized government and its laws (Alm 1985). One long-standing proposal in the U.S. to attenuate these consequences is to simplify the tax code (e.g., a flat tax) in an attempt to increase tax compliance. In support of this view, the Russian government's recent adoption of a 13 percent flat tax in response to disproportionate levels of UE activity has been met with initial success, such as increasing tax revenue by 26 percent (Ivanova, Keen and Klemm 2005). This suggests that optimal taxation levels may contribute to the level of

compliance and lead to a reduction in UE behaviors.

CONCLUSION

The intended contribution of this paper has been to broaden the understanding of the overall economy by first seeking to distinguish between the OE and the UE and, second, defining the UE in terms of exchange behaviors and consequences. We have explored the possibilities of both negative and positive consequences that may result from UE transactions. As such, this paper highlights the notion that UE exchange may promote positive as well as negative benefits for the OE and society as a whole.

In the marketing discipline, our central concern is the study of exchange behavior. Unfortunately, with exceptions noted in this paper, our field has not paid the deserved attention to many of the aspects of exchange that occur within the informal realm of the economy. With the growth of e-commerce exchange, the separation between formal and informal exchange has become blurred. For example, eBay had over 120 million regular users in 2006, up from 40 million in 2003 (The Bid Floor.Com 2007). While eBay serves as a legitimate exchange medium, not all sellers follow tax laws by recording their transactions and paying taxes (McTague 2005). And despite its growing success as an exchange medium, eBay refuses ownership of or concern for this problem, contending in fact that a seller's tax accountability lies outside its responsibility (McTague 2005). Thus, a fundamental understanding of the behaviors and conditions surrounding transactions in all types of economies provides a necessary step toward better understanding exchange theory and the value exchange theory holds for society.

REFERENCES

- Alderson, Wroe (1965), *Dynamic Marketing Behavior*, Homewood, IL, Richard D. Irwin, Inc.
- Alm, James (1985), "The Welfare Cost of the Underground Economy," *Economic Inquiry*, Vol. 24, April, pp. 243-264.
- Antia, Kersi D., Mark E. Bergen and Shantanu Dutta (2004), "Competing with Gray Markets: the Sale of Branded Products through Unauthorized Channels Is a Growing Problem for Suppliers. A Three-Pronged Approach Can Help Them Fight Back," *MIT Sloan Management Review*, Vol. 46, Fall, pp. 63-71.
- Antia, Kersi D., Mark E. Bergen, Shantanu Dutta and Robert J. Fisher (2006), "How Does Enforcement Deter Gray Market Incidence?" *Journal of Marketing*, Vol. 70, January, pp. 92-106.
- Bagozzi, Richard P. (1974), "Marketing as an Organized Behavioral System of Exchange," *Journal of Marketing*, Vol. 38, October, pp. 77-81.
- Bagozzi, Richard P. (1975), "Marketing as Exchange," *Journal of Marketing*, Vol. 39, October, pp. 32-39.
- Balfour, Frederick (2001), "Dark Days for a Black Market," *Business Week*, October 15, pp. 60-61.
- Becker, Gary S., Kevin M. Murphy and Michael Grossman (2006), "The Market for Illegal Goods: The Case of Drugs," *Journal of Political Economy*, Vol. 114, 1, pp. 38-60.
- Berman, Barry (2004), "Strategies to Combat the Sale of Gray Market Goods," *Business Horizons*, Vol. 47, July-August, pp. 51-60.
- Bhattacharyya, Dilip K. (1999), "On the Economic Rationale of Estimating the Hidden Economy," *The Economic Journal*, Vol. 109, June, pp. 348-359.
- Buzzeo, Ronald W. (2005), "Drug Counterfeiting: A Rising Public Health Concern," *Drug Topics*, Vol. 149, 8, April, pp. 18-19.
- Cebula, Richard J. (1997), "An Empirical Analysis of the Impact of Government Tax and Auditing Policies on the Size of the Underground Economy: The Case of the United States, 1973-94," *American Journal of Economics and Sociology*, Vol. 56, April, pp. 173-186.

- Champion, David (1998), "The Bright Side of Gray Markets," *Harvard Business Review*, Vol. 76, September-October, pp. 19-20.
- Clinard, Marshall B. (1952), *The Black Market: A Study of White Collar Crime*, New York, Rinehart & Company.
- Djajic, Slobodan (1997), "Illegal Immigration and Resource Allocation," *International Economic Review*, Vol. 38, February, pp. 97-117.
- Duhan, Dale F. and Mary Jane Sheffet (1988), "Gray Markets and the Legal Status of Parallel Importation," *Journal of Marketing*, Vol. 52, July, pp. 75-83.
- Eagle, Lynne, Philip J. Kitchen, Lawrence Rose and Brendan Moyle (2003), "Brand Equity and Brand Vulnerability: The Impact of Gray Marketing/Parallel Importing on Brand Equity and Values," *European Journal of Marketing*, Vol. 37, 10, pp. 1332-1253.
- Feige, Edgar L. (1989), *The Underground Economies: Tax Evasion and Information Distortion*, Cambridge, MA, Cambridge University Press.
- Frey, Bruno S. and Friedrich Schneider (2000), "Informal and Underground Economy," *International Encyclopedia of Social and Behavioral Science*, Amsterdam, Elsevier Science Publishing Company.
- Giles, David E.A. (1999), "Measuring the Hidden Economy: Implications for Econometric Modeling," *The Economic Journal*, Vol. 109, June, pp. 370-380.
- Hanson, Kund L. (1981), "'Black' Exchange and Its System of Social Control," in *Networks, Exchange, and Coercion*, David Willer and Bo Anderson, eds., pp. 70- 83, New York, Elsevier.
- Hill, Ronald Paul (1992), "Criminal Receiving: The 'Fence' as Marketer," *Journal of Public Policy and Marketing*, Vol. 11, Fall, pp. 126-134.
- Hirschman, Elizabeth C. (1987), "People as Products: Analysis of a Complex Marketing Exchange," *Journal of Marketing*, Vol. 51, January, pp. 98-108.
- Houston, Franklin S. and Jule B. Gassenheimer (1987), "Marketing and Exchange," *Journal of Marketing*, Vol. 51, October, pp. 3-18.
- Inc. (2001), "Declaration of Independents," September 1.
- Ivanova, Anna, Michale Keen, and Alexander Klemm (2005), "The Russian 'Flat Tax' Reform," *Economic Policy*, Vol. 20, 43, pp. 399-444.
- Jacoby, Tamar (2006), "Bitter Sweet Spot," *The Wall Street Journal*, March 15.
- Levi, Michael (2002), "Money Laundering and Its Regulation," *Annals of the American Academy of Political and Social Science*, Vol. 582, July, pp. 181-194.
- Maskulka, James M. and Charles S. Gulas (1987), "The Long-Term Dangers of Gray-Market Sales," *Business*, Vol. 37, January-February-March, pp. 25-31.
- McCrohan, Kevin F. and James D. Smith (1986), "A Consumer Expenditure Approach to Estimating the Size of the Underground Economy," *Journal of Marketing*, Vol. 50, April, pp. 48-60.
- McCrohan, Kevin F. and James D. Smith (1987), "Consumer Participation in the Informal Economy," *Academy of Marketing Science*, Vol. 15, Winter, pp. 62-68.
- McLaren, John (1998), "Black Markets and Optimal Evadable Taxation," *The Economic Journal*, Vol. 108, May, pp. 665-679.
- McMillan, John (2006), "Below the Radar: Underground Markets for the Poor," *Harvard International Review*, Vol. 27, Winter, pp. 46-50.
- McTague, Jim (2005), "Going Underground," *Barron's*, January 3.
- ____ (2005), "The Underground Economy: Illegal Immigrants and Others Working off the Books Cost the U.S. Hundreds of Billions of Dollars in Unpaid Taxes," *The Wall Street Journal College Edition*, April, [available at [http:// wsjclassromediton.com/archive/05apr/econ_underground.htm](http://wsjclassromediton.com/archive/05apr/econ_underground.htm)].
- Pozo, Susan and Mark Wheeler (1999), "Expectations and the Black Market Premium," *Review of International Economics*, Vol. 7, pp. 245-253.
- Pozo, Susan (2006), "Below the Surface: Underground Economic Activity," *Harvard International Review*, Vol. 27, Winter, pp. 27-31.

- Pyle, David J. (1989), *Tax Evasion and the Black Economy*, New York, NY, St. Martin's Press, Inc.
- Roche, Timothy (2001), "Underground Riches: Unleash the Energy of Black-Market Entrepreneurs, Says a Best-Selling Author," *Time*, May 7, [available at <http://www.time.com/time/global/may/profit.html>].
- Robles, Fernando and Adel El-Ansary (1989), "Informal Sector and Economic Development: A Marketing Perspective," in *Marketing and Development: Toward Broader Dimensions*, Erdoğan Kumcu and A. Fuat Firat, eds., Greenwich, CT, JAI Press, pp. 199-228.
- Rutkowski, Conrad P. (1995), "Review of Invisible, Outlawed and Untaxed: America's Underground Economy," *Public Administration Review*, Vol. 55, July-August, pp. 390-391.
- Schneider, Friedrich and Dominik H. Enste (2002), *The Shadow Economy: An International Survey*, Cambridge, MA, Cambridge University Press.
- Schneider, Friedrich (2006), "Shadow Economies of 145 Countries All Over The World: What Do We Really Know?," *Economic Policy Planning Unit*, Working Paper No 4, [available at http://www.eppu.ba/pdf/working_paper_04.pdf].
- Seligman, Dan (2002), "Illegals with Legal Rights," *Forbes*, January 7.
- Sherry Jr, John F. (1990), "Dealers and Dealing in a Periodic Market: Informal Retailing in Ethnographic Perspective," *Journal of Retailing*, Vol. 66, Summer, pp. 174-201.
- Signer, Natasha (2006), "Beauty on the Black Market," *The New York Times*, February 16.
- Stahl II, Dale O. and Michael Alexeev (1985), "The Influence of Black Markets on a Queue-Rationed Centrally Planned Economy," *Journal of Economic Theory*, Vol. 35, pp. 34-250.
- Slemrod, Joel B. (1985), "An Empirical Test for Tax Evasion," *Review of Economics and Statistics*, Vol. 67, 2, pp. 232-67.
- Szykman, Lisa R. and Ronald Paul Hill (1993), "A Consumer-Behavior Investigation of a Prison Economy," *Research in Consumer Behavior*, Vol. 6, pp. 231-260.
- Swarns, Rachel L. (2006), "National Briefing Washington: Commerce Secretary Urges Guest Worker Program," *The New York Times*, July 13.
- Tanzi, Vito (1982), *The Underground Economy in the United States and Abroad*, Lexington, MA: Lexington Books.
- ____ (1999), "Uses and Abuses of Estimates of the Underground Economy," *The Economic Journal*, Vol. 109, June, pp. 338-347.
- The BidFloor.Com (2007), "eBay Statistics," [available at http://www.thebidfloor.com/ebay_Statistics.htm].
- Thomas, James J. (1990), "Measuring the Underground Economy," *American Behavioral Scientist*, Vol. 33, May/June, pp. 621-637.
- ____ (1992), *Informal Economic Activity*, Ann Arbor, MI, The University of Michigan Press.
- Thomas, Jane Boyd and Cara Lee Okleshen Peters (2006), "The Underground Mall: An Investigation of Factors Influencing Gray Market Consumption," *International Journal of Retail and Distribution Management*, Vol. 34, 2, pp. 106.
- Wade, Jared (2004), "The Music Industry's War on Piracy," *Risk Management Magazine*, February.
- Whitehouse Press Release (2004), "President Bush Proposed New Temporary Worker Program," January 07, [available at <http://www.whitehouse.gov/news/releases/2004/01/20040107-3.html>]
- Williams, Colin C. (2005), "Unraveling the Meanings of Underground Work," *Review of Social Economy*, Vol. LXIII, March, pp. 1-18.
- Williamson, Oliver E. (1985), *The Economic Institutions of Capitalism*, New York, the Free Press.