# The underground economy, a shortsighted strategy

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## The underground economy may be tempting to avoid some cost burdens, but is it acceptable for a company to take part in it?

The underground economy entails some shady business practices. The number of evasion techniques is seemingly endless, ranging from covering up certain business activities in order to lower the tax burden, to going overboard on tax-deductible expenses, or even failing to enroll all of the company's staff in order to pay less in social security.

IESE Prof. Antonio Argandoña, holder of "la Caixa" Chair of Corporate Social Responsibility and Corporate Governance, examines the ethics of the underground economy. He breaks the practices down into three main categories: those involving the failure to comply with tax obligations; those related to social security; and those involving rules and regulations — for example, those pertaining to occupational safety and hygiene.

The practices of the underground economy arise from a need to adjust to a difficult situation, such as aggressive competition or a major recession. Other times, they are designed to avoid certain costs or regulations. Either way, the objective is always the same: to lower the company's cost burden.

Companies may justify such conduct as a way of expressing their opposition to burdensome taxation or bureaucracy. Instead of interfering excessively in business operations, public authorities should learn to manage their own expenses more effectively, companies may argue.

Another justification is that businesses need to lower their operating costs. In addition, they

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say that they are under intense pressure from certain customers or suppliers, who request invoices without VAT included, for example.

Regardless of these many arguments, when a company resorts to these measures as the foundation of its long-term strategy, it is erring not only on an ethical level, but also in terms of sound business and management practice, says the author.

When sales fall and companies need to cut costs quickly, paying less tax and social security, as well as lowering the financial impact of certain regulations, may seem like attractive options. When the company's solvency is on the line, urgency and efficiency take precedence, and ethical arguments generally go by the wayside.

At first glance, unreported hires may seem tempting: lower social security costs, fewer financial, administrative and legal burdens associated with employee terminations, and more relaxed working conditions in general.

But beware of the other costs involved: getting caught and fined, reduced employee commitment, and fewer skilled personnel.

## Fleeting advantages

The fact that many governments maintain vague stances concerning the underground economy only serves to muddy the waters further.

You would think that governments would want to clamp down on unreported hires because of the tax income they are missing out on. However, on the flip side, it means that the government does not have to pay unemployment benefits to these undeclared workers.

Also, looking the other way while companies employ lower waged workers may help to boost the country's international competitiveness and economic development overall.

Society, too, tends to be fairly tolerant of these practices, especially when the survival of a business sector is in danger, or they perceive cost advantages for themselves.

But Argandoña is insistent, saying that rather than merely being realistic, the underground economy is "the recognition, express or tacit, of an economic, political, social, human and ethical failure."

Had the necessary measures been taken in the first place, then maybe companies would not find themselves in such awkward positions where compromise appears the most tempting

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option.

A country will only have to resort to the underground economy if it has failed to develop a prior set of institutions and policies that will help businesses and families adapt when hard times hit.

The underground economy is also an indictment of the ethical shortcomings of society as a whole, adds the author.

Argandoña calls the underground economy "an ill-advised, shortsighted strategy." It hinders innovation strategies and artificially maintains competitive advantages through an unsustainable tax or labor scheme. It also passes its costs on to other groups, such as workers with less social protection, or local communities with less financial power.

Combating the underground economy is no easy task, but it is nevertheless worthwhile, not only for ethical reasons, but also to maintain a good economy and good citizenship.

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