

**INDIVIDUAL LABOUR SUPPLY IN THE UNDERGROUND MARKET :
A MICRO-ECONOMETRIC APPROACH**

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Unreported labour has strived unabated across countries and centuries. Its innate ability to survive in various circumstances makes it particularly difficult to identify its real causes. Consequently we propose three research avenues. Our objective is twofold. First, from the theoretical point of view, our approach consists in the development of unreported labour supply models that take into account the official market. Second, from the empirical point of view the econometric estimation of these models aims at levying certain theoretical ambiguities as well as testing the validity of a number of standard theoretical assumptions.

The first research avenue focuses on the factors which help determine both the participation and the intensity of unreported activities. Our approach is relatively novel since it allows for fixed entry costs in the underground market while taking into account the official employment status. Our results provide support to the existence of important fixed costs in the underground market. While lower than those in the official market, they still represent as much as one third of the potential income of non-participants.

The second research avenue is related to taxation and fraud prevention policies. Our structural model takes into account both the subjective audit probabilities as well as the penalty rates. To our knowledge, the econometric approach we use is the first to account rigorously for the potential endogeneity of these variables that may arise because of cognitive dissonance. Our results show that women are less likely to participate in the underground market, which is consistent with a higher degree of risk aversion. They also show that neighbourhood effects are an important determinant of participation in the underground market and that there is little gender wage discrimination in the market. The structural parameters of the model indicate that the assumption of perfect substitutability between hours of work in both the official and the underground market is rejected. Just as the assumption of additive separability of the utility function. Lastly, our results show that the repression policies lack some credibility.

The third research avenue is related to social norms. Our approach is the first to investigate the role of psychological and social factors on the choice between official and underground activity in a structural manner. The undeclared labour supply is thus assumed to result from complex interactions between an individual's decisions and her perceptions about their impact on others. According to our results, the young are very sensitive to the threat of social ostracism. On the other hand, women seem to pay little attention to moral considerations. Consequently, the lower incidence of fraud among women seem not to result from higher ethical values, but from the fear of financial sanctions. Lastly, our results show that the hours worked, even assuming away uncertainty in the underground market, are imperfect substitutes.

Keywords: Underground Economy, Taxation, Social Transfers, Decision Making under Uncertainty, Full-Information Maximum Likelihood, Fixed Costs, Social Norms.

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