How Black Markets Work

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A black market is a transaction where goods or services are exchanged illegally. What makes the market "black" can either be the illegal nature of the goods and services themselves, the illegal nature of the transaction or both.

For example, while the buying and selling of food is not illegal, the transaction enters the black market when the good sold is illegal, such as foie gras in California. And while it's perfectly legal to sell hamburgers, when an all-cash restaurant does not remit to the state government the mandatory sales taxes on its transactions, it too has entered the black market.

Why Black Markets Exist

Black markets, also called shadow markets, come about when people want to exchange goods or services that are prohibited by governments. Black markets skew economic data, as transactions are unrecorded. Black markets also arise when people don't want to pay taxes on the transaction for legal or illegal goods or services. Some black markets exist simply because people don't realize there are laws they aren't following, such as bartering and not reporting the taxable value of the transaction, or hiring a regular housekeeper or babysitter but failing to pay employment taxes.

The licensing restrictions that governments impose on numerous occupations cause some workers to enter the black market because they don't want or can't afford to invest the time and money to obtain the required licenses. For example, in New York City, one must purchase a license called a medallion in order to legally operate a taxi business. These medallions cost hundreds of thousands of dollars, making them
prohibitively expensive for most entrepreneurs. As a result, some people may choose to operate black-market taxis without a license – at least, until they are caught. Ride-sharing services like Uber or Lyft have further splintered the market for these types of businesses.

Sometimes participants in black markets don't want to act illegally, but because they lack the ability to work legally and need to make money, they don't report their jobs or income to the government. Such situations arise when illegal immigrants obtain jobs, when students traveling abroad obtain employment without acquiring a work visa or when children work in violation of minimum age requirements.

Black markets can also appear when government-imposed price ceilings create shortages. For example, if the government caps the price at which a grocery store may sell bottled water after a natural disaster, the store will quickly run out of water. Vendors will then likely appear selling water at the higher prices people are actually willing to pay. This secondary market is a black market.

Governments can also cause black markets through overregulation. An extreme example can be found in Cuba, where the rationing and ineffective central planning of communism made it difficult to purchase the desired quantities of even basic products such as cooking oil. Black markets are rampant because citizens want to buy things that are difficult to come by through legal channels. They're also common because it's so hard to find a job.

High unemployment can give rise to black markets. When workers can't find jobs in the above-ground economy, they may turn to jobs in the underground economy. These jobs could be as innocuous as fixing a neighbor's toilet (but being paid in cash and not reporting the income to the tax authorities) or as serious as selling cocaine (where not only the sale of the product itself but also the non-reporting of taxable income is illegal).
What Can You Buy in the Black Market?

Consumers can buy and sell numerous types of goods and services in the black market. Anything that is subject to the conditions described in the previous section can show up in the underground economy. In the United States, we tend to think of illegal drugs, prostitution, designer knockoffs and ticket scalping when we think of black markets.

More serious and lesser-known black markets operating worldwide include those in human organs, endangered species, babies, weapons and slave labor (human trafficking).

Black markets also exist where people might never expect to find them. Online, it's possible to buy an eBay account (to falsely obtain a favorable seller rating) and to buy Instagram followers (to inflate one's perceived popularity).

The Case for Black Markets

Some people are in favor of black markets. These markets can supply goods that, while illegal (such as marijuana), arguably improve quality of life (for example, when used to alleviate pain for patients who haven't found relief from legal pharmaceuticals).

Black markets can provide legal necessities that are in short supply, as in the case of everyday Cuba or a city hit by a hurricane. Also, the shadow economy makes it possible for people to earn a living who would otherwise be destitute or seek welfare – people who would be perfectly employable under less government regulation or in an economy with a higher employment rate.

Overall, the case for black markets is highly subjective and depends on one's moral beliefs. If you think that drug use is a victimless crime, you might not have a problem with the black market for illegal drugs. If you
think tax rates are too high, you might be happy to hire workers under the table.

The Case Against Black Markets

Black markets have a number of downsides, some of which are subjective, but many of which almost everyone would agree are serious problems.

Some black market goods are stolen from legitimate markets, taking business away from law-abiding entrepreneurs. While some consumers might not mind buying a stolen designer handbag at a discount because they think the retailer's price is too high, others would be appalled if they knew that while they thought they were simply getting a bargain, they were really supporting an organized crime ring. There is often a dark side to organized crime that goes beyond theft and the resale of stolen goods. This and other black market activities are sometimes used to fund terrorism since the profits can't easily be traced.

Violence is another problem inherent in black markets. Because these markets are unregulated, participants can't rely on legitimate police protection in the event of theft or other crimes. If a drug dealer's stash of cocaine is stolen by a rival dealer, he can't ask the police to help him get his merchandise back. The dealer might send one of his employees to shoot the thief and reclaim the stolen goods, further compounding the effects of the original crime.

Another argument against black markets is that because their participants don't pay taxes, a heavier tax burden falls on law-abiding citizens.

The Bottom Line

Black markets will continue to exist as long as we have regulations and taxes. Laws that prevent people from buying and selling the goods and services they desire and taxes that prevent people from keeping what they
feel is their fair share of **earned income** will always cause people to hide their activities from law enforcement agencies, tax authorities and other regulators.