Abstract

The level of human capital affects not only effective labor but also the productivity. Because the coordination and interaction between individuals cause spillover effects on production, higher level of human capital leads to higher productivity growth. The extent of this effect on productivity growth also depends on the characteristics of the markets. Entrepreneurs may conduct their businesses underground to evade tax audit or to reduce the burden of bureaucracy. In order to avoid potential audit from the government, they conduct businesses in ways with less interaction in the unofficial sector. The extent of the spillover effect of human capital is thus smaller in the unofficial sector. Therefore, the unofficial sector is detrimental to productivity growth. This paper also uses cross-country data to investigate the relationship between productivity growth and the size of unofficial sector. The results suggest that the data are consistent with the argument that unofficial economy is detrimental to productivity growth.

Keywords: Unofficial economy; Productivity growth, Burden of regulation

JEL classification: H26; H32; O47

---

1 Department of Economics, National Tsing Hua University, Hsin-Chu 300, Taiwan. Tel.: 886-3-5715131 ext: 4637; fax: 886-3-5722476
E-mail address: wus@mx.nthu.edu.tw.