

Alter Chen, Martha

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## Rethinking the informal economy: linkages with the formal economy and the formal regulatory environment

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Research Paper No. 2005/10

## **Rethinking the Informal Economy**

Linkages with the Formal Economy  
and the Formal Regulatory Environment

Martha Alter Chen\*

April 2005

### **Abstract**

This paper explores the relationship of the informal economy to the formal economy and to the formal regulatory environment. It begins with a comparison of the earlier concept of the 'informal sector' with the new expanded concept of the 'informal economy' which includes microentrepreneurs, own account operators, informal wage workers, and industrial outworkers. The central arguments of the paper are that (a) most informal enterprises and workers are intrinsically linked to formal firms; (b) different segments of the informal economy are over-regulated, de-regulated, or under-regulated; and (c) there are benefits and costs to both formality and informality. The paper concludes that the appropriate role for government is (i) to ensure that the formal regulatory environment is not biased in favour of formal firms and workers over informal enterprises and workers (or vice versa) and (ii) to regulate the commercial and employment relationships between formal firms, informal enterprises, and informal wage workers.

Keywords: informal sector, legality, gender, regulation, policy

JEL classification: D23, E26, J2

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\* Harvard University, WIEGO.

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UNU World Institute for Development Economics Research (UNU-WIDER)  
Katajanokanlaituri 6 B, 00160 Helsinki, Finland

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## **Introduction**

### **The informal economy**

Since it was ‘discovered’ in Africa in the early 1970s, the informal economy has continued to prove useful as a concept to many policymakers, activists, and researchers because the reality it seeks to capture – the large share of economic units and workers that remain outside the world of regulated economic activities and protected employment relationships – is so large and significant. Although interest in the informal economy has waxed and waned over the past three decades, today there is renewed interest in the informal economy worldwide. This re-convergence of interest stems from two basic facts. First, despite early predictions of its eventual demise, the informal economy has not only grown worldwide but also emerged in new guises and unexpected places. Second, despite continuing debates about its defining features, the informal economy is increasingly recognized as a key to promoting growth and/or reducing poverty.

### **The informal workforce**

The most visible occupational groups in the informal economy are those who work on the streets or in the open air. City streets and village lanes in most developing countries – and in many developed countries – are lined with barbers, cobblers, garbage collectors as well as vendors of vegetables, fruit, meat, fish, snack-foods or a myriad of non-perishable items. In many countries, head-loaders, cart pullers, bicycle peddlers, rickshaw pullers, bullock or horse cart drivers jostle to make their way down narrow village lanes or through the maze of cars, trucks, vans and buses on city streets. In rural areas, the vast majority of people earn their livelihoods working on farms, raising livestock, making handicrafts or collecting and processing minor forest products.

Somewhat less visible are the informal workers who work in small factories or workshops that repair bicycles and motorcycles; recycle scrap metal; make furniture and metal parts; tan leather and stitch shoes; weave, dye and print cloth; polish diamonds and other gems; make and embroider garments; sort and sell cloth, paper and metal waste; and more. The least visible informal workers, the majority of them women, sell or produce goods from their homes: stitching garments, weaving cloth, embroidering textile goods, making crafts, making shoes, processing food or assembling electronic and automobile parts.

The largest occupational categories within the informal economy, in most developing countries, include casual day labourers in agriculture and construction, small farmers, street vendors, domestic workers, workers in small unregistered factories or workshops, and industrial outworkers who work from their homes (also called homeworkers). Other categories of informal employment that are common in both developed and developing countries include casual workers in restaurants and hotels; sub-contracted janitors, security guards and gardeners; and temporary office helpers or off-site data processors.

Conditions of work and the level of earnings differ markedly among those who scavenge on the streets for scrap metal or paper, those who produce goods on a sub-contract from their homes, those who sell goods on the streets, those who work as temporary data processors, and those who run their own microenterprises with hired workers. Even among home-based workers, there is a difference between those who work on their own account and those who work on a piece-rate basis for a contractor or a firm. In every country, the

informal economy is highly segmented by economic sector, place of work, and employment status and, in addition, by social group and gender.

Despite its diversity, the informal economy can be usefully categorized by employment status into two broad groups: the *self-employed* who run small unregistered enterprises; and *wage workers* who work in insecure and unprotected jobs (although some informal workers – notably homeworkers – do not fit neatly into one or other of these categories).<sup>1</sup> Also, most of those who work in the informal economy share one thing in common: the lack of legal recognition, regulation, and protection.

This paper seeks to provide an overview of recent rethinking about the informal economy – and its links to the formal economy and to the formal regulatory environment. Section 1 presents a brief history of the original concept of the ‘informal sector’, including the early debates about the concept. Section 2 introduces the new expanded concept of the ‘informal economy’; discusses its size, composition, and segmentation; relates the new expanded concept to the earlier debates; and presents the most recent available data on the size and composition of the informal economy. Sections 3 and 4 discuss the linkages of the informal economy to, respectively, the formal economy and the formal regulatory environment. The final section suggests why and how more equitable linkages between the informal economy and the formal economy should be promoted through an appropriate policy and regulatory environment.

## **1 The informal sector**

### **1.1 Discovery of the informal sector**

It was widely assumed during the 1950s and 1960s that, with the right mix of economic policies and resources, poor traditional economies could be transformed into dynamic modern economies. In the process, the traditional sector comprised of petty traders, small producers and a range of casual jobs would be absorbed into the modern capitalist – or formal – economy and thereby disappear.<sup>2</sup> This perspective was reinforced by the successful rebuilding of Europe and Japan after the Second World War and the expansion of mass production in Europe and North America. By the early 1970s, however, the optimism about the prospects for economic growth in developing countries began to give way to concerns about persistent widespread unemployment. Reflecting this concern, the International Labour Organization (ILO) mounted a series of large, multi-disciplinary ‘employment missions’ to various developing countries. The first of these was to Kenya in 1972.

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1 In this paper, unless otherwise stipulated, I use the term ‘informal worker’ in a broad sense to include both the self-employed and wage employed in the informal economy.

2 The formal or modern sector is comprised of regulated enterprises (operating out of factories and/or offices) and of regular, stable and protected employment. Fifty years ago, most economists assumed that economic growth would lead to increased labour demand and eventual transformation of all economic activity into the modern or formal sector: classical economists assumed that surplus labour would be absorbed (Lewis 1954); neoclassical economists assumed a shift to skilled labour and capital-intensive activities (see World Bank 1995 for a recent version of the neoclassical theory); and industrial economists assumed a shift in the location of production from households to small units to big firms (Gereffi 1980).

The Kenya employment mission, through its fieldwork and in its official report, recognized that the traditional sector had not just persisted but had expanded to include profitable and efficient enterprises as well as marginal activities (ILO 1972). To highlight this fact, the mission chose to use the term ‘informal sector’ rather than ‘traditional sector’ for the range of small-scale and unregistered economic activities. This term had been coined the previous year by a British economist, Keith Hart, in his 1971 study of economic activities in urban Ghana (Hart 1973).

## **1.2 Debates about the informal sector**

Although both Hart and the Kenya mission team were very positive about the informal sector – noting its efficiency, creativity and resilience – the concept received a mixed review in development circles. Many observers subscribed to the notion that the informal sector was marginal or peripheral and not linked to the formal sector or to modern capitalist development. Some of them continued to believe that the informal sector in Ghana, Kenya and other developing countries would disappear once these countries achieved sufficient levels of economic growth or modern industrial development. Other observers argued that industrial development might take a different pattern in developing countries – including the expansion of informal economic activities – than it had in developed countries.

Over the years, these debates crystallized into three dominant schools of thought regarding what gives rise to the informal sector, its defining characteristics and its links to the formal sector or the formal regulatory environment: the dualist, structuralist and legalist schools of thought (see Box 1). While the dualist school is now considered rather outdated, both the structuralist and legalist perspectives are still evoked to explain different components of the informal economy. In particular, the legalist perspective is used to explain the behaviour of the entrepreneurial class among the informal workforce who seek to avoid the costs associated with formalizing their enterprises; and the structuralist perspective is used to explain the subordinate relationship of labour and small producers to big businesses and, more specifically, of sub-contracted firms and workers to the lead firms who sub-contract work to them.

During the 1980s, the focus of the informal sector debate expanded to include changes that were occurring in advanced capitalist economies. In both North America and Europe, production was increasingly being reorganized into small-scale, decentralized and more flexible economic units. Mass production was giving way to ‘flexible specialization’ or, in some contexts, reverting to sweatshop production (Piore and Sabel 1984). These new patterns of capitalist development were (and are still) associated with the informalization of employment relations – standard jobs being turned into non-standard<sup>3</sup> or atypical jobs

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3 Non-standard work is the general term used in OECD countries for forms of work that are not full-time wage employment for one employer on a known schedule or contract, including self-employment, part-time work, temporary work and various forms of casual day labour or contract work. The majority of these workers receive few (if any) employment-based benefits or protection. Informal employment is the general term used in developing countries for forms of work that are not protected by labour or social protection legislation, including the self-employed, various types of casual day labourers, homeworkers as well as ‘employees’ (full-time or part-time) of informal enterprises. In this paper, I use the term ‘informal employment’ to include those forms of non-standard work in both OECD and developing countries that are not covered by employment-based benefits or protections.

with hourly wages but few benefits, or into piece-rate jobs with no benefits – and with the sub-contracting of the production of goods and services to small-scale informal units and industrial outworkers/homeworkers. In the process, the informal economy becomes a permanent, albeit subordinate and dependent, feature of capitalist development (Portes *et al.* 1989).

#### Box 1

##### Three dominant schools of thought on the informal sector

The *dualist* school, popularized by the ILO in the 1970s, subscribes to the notion that the informal sector is comprised of marginal activities – distinct from and not related to the formal sector – that provide income for the poor and a safety net in times of crisis (Hart 1973; ILO 1972; Sethuraman 1976; Tokman 1978). According to this school, the persistence of informal activities is due largely to the fact that not enough modern job opportunities have been created to absorb surplus labour, due to a slow rate of economic growth and/or to a faster rate of population growth.

The *structuralist* school, popularized by Caroline Moser and Alejandro Portes (among others) in the late 1970s and 1980s, subscribes to the notion that the informal sector should be seen as subordinated economic units (micro firms) and workers that serve to reduce input and labour costs and, thereby, increase the competitiveness of large capitalist firms. In the structuralist model, in marked contrast to the dualist model, different modes and forms of production are seen not only to co-exist but also to be inextricably connected and interdependent (Moser 1978; Castells and Portes 1989). According to this school, the nature of capitalist development (rather than a lack of growth) accounts for the persistence and growth of informal production relationships.

The *legalist* school, popularized by Hernando de Soto in the 1980s and 1990s, subscribes to the notion that the informal sector is comprised of microentrepreneurs who choose to operate informally in order to avoid the costs, time and effort of formal registration (de Soto 1989). According to de Soto *et al.*, microentrepreneurs will continue to produce informally so long as government procedures are cumbersome and costly. In this view, unreasonable government rules and regulations are stifling private enterprise.

Meanwhile, in the 1980s, the economic crisis in Latin America served to highlight another feature of the informal sector: namely, that employment in the informal sector tends to grow during periods of economic crisis (Tokman 1992). In the Asian economic crisis a decade or more later, millions of people who lost formal jobs in the former East Asian ‘Tiger’ countries tried to find jobs or create work in the informal economy (Lee 1998). Meanwhile, structural adjustment in Africa and economic transition in the former Soviet Union and in Central and Eastern Europe were also associated with an expansion of employment in the informal economy. Informal employment tends to expand during periods of economic adjustment or transition because:

- when private firms or public enterprises are downsized or closed, retrenched workers who do not find alternative formal jobs have to turn to the informal economy for work because they cannot afford to be unemployed; and
- in response to inflation or cutbacks in public services, households often need to supplement incomes from formal jobs with informal earnings.

During the 1990s, globalization of the economy contributed to the informalization of the workforce in many industries and countries (Standing 1999). Whereas globalization generates new jobs and new markets, available evidence suggests that not all the jobs are ‘good’ jobs and that the most disadvantaged producers have not been able to seize new

market opportunities. This is because global competition tends to erode employment relations by encouraging formal firms to hire workers at low wages with few benefits or to sub-contract (or out-source) the production of goods and services (Rodrik 1997). Global integration also tends to reduce the competitiveness of many informal firms or own account producers vis-à-vis imported goods (in domestic markets) and vis-à-vis larger, more formal firms (in export markets) (Chen *et al.* 2004).

### 1.3 Renewed interest in the informal economy

Given the fact that the informal economy has grown and appears to be a permanent feature of capitalist development, there has been renewed interest in the informal economy over the past decade. Interested observers in the *research* community include:

- *neoclassical development economists*: who see small-scale enterprises as using the ‘right’ combination of labour and capital for developing countries
- *agricultural development economists*: who see agricultural growth as the engine of development in developing countries, in part because it creates demand for rural small-scale enterprises
- *informal sector scholars*: who study the divisions and linkages between large/formal and small/informal firms in developing countries
- *industrial relations scholars*: who study the changing patterns of production and labour relations in formal manufacturing in developed countries (e.g., flexible specialization literature) (Tendler 1987).

Interested observers in the *practitioner* community include:

- *microfinance and microenterprise practitioners*: who recognize the economic growth and/or poverty reduction potential of microenterprises
- *sustainable livelihoods specialists*: who are concerned about the erosion of the natural resource base for livelihoods of the poor
- *labour advocates*: who are concerned about the erosion of employment relations and working conditions of the global workforce
- *fair trade proponents*: who are concerned about the competitiveness of small producers and the protection of workers under specific trade agreements and trade liberalization more broadly.

### 1.4 Continuing debates

With the renewed interest in the informal economy, the debates about the informal economy have resurfaced. As in the past, different parties to the current debate tend to focus on different segments of the informal economy – on microentrepreneurs, own account operators, wage workers, or industrial outworkers – and, therefore, to subscribe to quite different perspectives regarding the causes and nature of the informal economy. As a result, the debate tends to get polarized: at one end are those who focus on *informal wage*



*employment* that is *not protected* and is, therefore, associated with low wage-levels and poor working conditions (compared to formal workers); and, at the other end are those who focus on *informal enterprises*, that are *not regulated* and are, therefore, associated with tax evasion and other unfair competitive advantages (compared to formal firms).<sup>4</sup> Other observers point out that many of the self-employed – notably, *own account operators* – face low earnings and poor working conditions and argue that own account operators should, therefore, be considered to belong to the working class, not the entrepreneurial class.<sup>5</sup>

Underlying these differences in perspective is also the fact that those who are interested in the informal economy come from quite different ‘hues’ of the political spectrum. It is important to recognise that those who are interested in the informal economy include:

- *neoliberals*: who seek to promote economic growth through microenterprises
- *liberals*: who seek to reduce poverty and improve social welfare through support to the working poor in the informal economy
- *conservatives*: who see private entrepreneurs in opposition to ‘big government’ and call for restraint in government regulations
- *radicals*: who see informal producers and workers as subordinated to ‘big business’ and seek to promote the economic empowerment of informal producers and workers (Peattie 1987; Rakowski 1994).

An alternative school of thought, summarized in Section 2, suggests the need for an *integrated* approach that looks at which elements of the dualist, legalist and structuralist schools of thought – and which ideological perspectives – are most appropriate to which segments of informal employment and in what contexts. Clearly, some poor households and individuals engage in survival activities that have – or seem to have – very few links to the formal economy and the formal regulatory environment (*a la* dualism); some microentrepreneurs choose to avoid taxes and regulations (*a la* legalism); while other units and workers are subordinated to larger firms (*a la* structuralism). And, clearly, most informal enterprises (and, it should be added, informal wage workers) contribute to economic growth (*a la* neoliberalism); the working poor in the informal economy need basic infrastructure and social services (*a la* liberalism); some microentrepreneurs and own account operators face excessive government regulations (*a la* conservatism); while other microentrepreneurs and own account operators (as well as informal wage workers) are subordinated to capitalist interests (*a la* radicalism). The point is to determine which segment of the informal economy one is talking about and to develop an appropriate

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4 One current observer has posited a theory for the informal economy as a whole – namely, that people ‘voluntarily’ choose to work informally – based primarily on a study of microenterprises run by young men in Mexico (Maloney 2003).

5 In the Conclusions to the General Discussion on ‘Decent Work and the Informal Economy’ at the International Labour Conference 2002, members of the Workers’ Group introduced the following clause (# 4) on own account workers: ‘Workers in the informal economy include both wage workers and own-account workers. Most own-account workers are as insecure and vulnerable as wage workers and move from one situation to the other. Because they lack protection, rights and representation, these workers often remain trapped in poverty’ (ILC 2002).

response to that segment – rather than seeking a single causal explanation or policy response to the informal economy as a whole.

## 2 The informal economy

The recent re-convergence of interest in the informal sector has been accompanied by significant re-thinking of the concept, at least in some circles. The rethinking about the informal sector, summarized below, includes a new term and expanded definition; recognition of the segmented nature of the informal economy; and a revised set of assumptions about the defining features of the informal economy. This section concludes with a summary of available statistics on women and men in the informal economy broadly defined.

### 2.1 New term and expanded definition

In recent years, a group of informed activists and researchers, including members of the global research policy network Women in Informal Employment: Globalizing and Organizing (WIEGO), have worked with the International Labour Organization (ILO) to broaden the concept and definition of the ‘informal sector’ to incorporate certain types of informal employment that were not included in the earlier concept and definition (including the official international statistical definition).<sup>6</sup> They seek to include the whole of informality, as it is manifested in industrialized, transition and developing economies and the real world dynamics in labour markets today, particularly the employment arrangements of the working poor. These observers want to extend the focus from *enterprises* that are not legally regulated to *employment relationships* that are not legally regulated or protected. In brief, their new definition of the ‘informal economy’ focuses on the nature of employment in addition to the characteristics of enterprises.

Under this new definition, the informal economy is seen as comprised of all forms of ‘informal employment’ – that is, employment without formal contracts (i.e., covered by labour legislation), worker benefits or social protection – both inside and outside informal enterprises, including:

- *Self-employment in informal enterprises*: workers in small unregistered or unincorporated enterprises, including:
  - employers;
  - own account operators;
  - unpaid family workers.
- *Wage employment in informal jobs*: workers without formal contracts, worker benefits or social protection for formal or informal firms, for households or with no fixed employer, including:

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<sup>6</sup> In 1993, the International Conference of Labour Statisticians adopted the current official international definition of the ‘informal sector’ that includes all those who work in informal enterprises. In 2003, the International Conference of Labour Statisticians adopted guidelines to expand the definition to include informal employment outside of informal enterprises.

- employees of informal enterprises;
- other informal wage workers such as:
  - casual or day labourers;
  - domestic workers;
  - unregistered or undeclared workers;
  - temporary or part-time workers;<sup>7</sup>
- industrial outworkers (also called homeworkers).

## 2.2 Key features of the informal economy

What follows is a discussion of key features of the informal economy broadly defined, including: (a) its significance and permanence, (b) the continuum of employment relations within it and (c) its segmented structure. The discussion ends on the issue of its legality or illegality as there is a widespread misconception that the informal economy is somehow illegal or is the equivalent of the underground, or even criminal, economy.

*Significance and permanence:* The recent re-convergence of interest in the informal economy stems from the recognition that the informal economy is growing and is not a short-term but a permanent phenomenon. Also, it is not just a traditional or residual phenomenon but a feature of modern capitalist development, associated with both growth and global integration. For this reason, the informal economy needs to be seen not as a marginal or peripheral sector but as a basic component – the base, if you will – of the total economy.

*Continuum of economic relations:* Earlier, observers who subscribed to the *dualist* theory considered the informal and formal sectors to be two distinct economic sectors without direct links to one another. The reality is, as always, far more complex. To begin with, production, distribution and employment relations tend to fall at some point on a continuum between pure ‘formal’ relations (i.e., regulated and protected) at one pole and pure ‘informal’ relations (i.e., unregulated and unprotected) at the other, with many categories in between. Depending on their circumstances, workers and units are known to move with varying ease and speed along the continuum and/or to operate simultaneously at different points on the continuum. Consider, for example, the self-employed garment maker who has to supplement what she makes on her own by stitching clothes under a sub-contract, or shift to working on a sub-contract for a garment firm when her customers decide they prefer to buy ready-made garments rather than tailor-made ones. Or consider the public sector employee who has an informal job on the side.

Moreover, the formal and the informal ends of the economic continuum are often dynamically linked. For instance, many informal enterprises have production or distribution relations with formal enterprises, supplying inputs, finished goods or services either through direct transactions or sub-contracting arrangements. Also, many formal enterprises hire wage workers under informal employment relations. For example, many

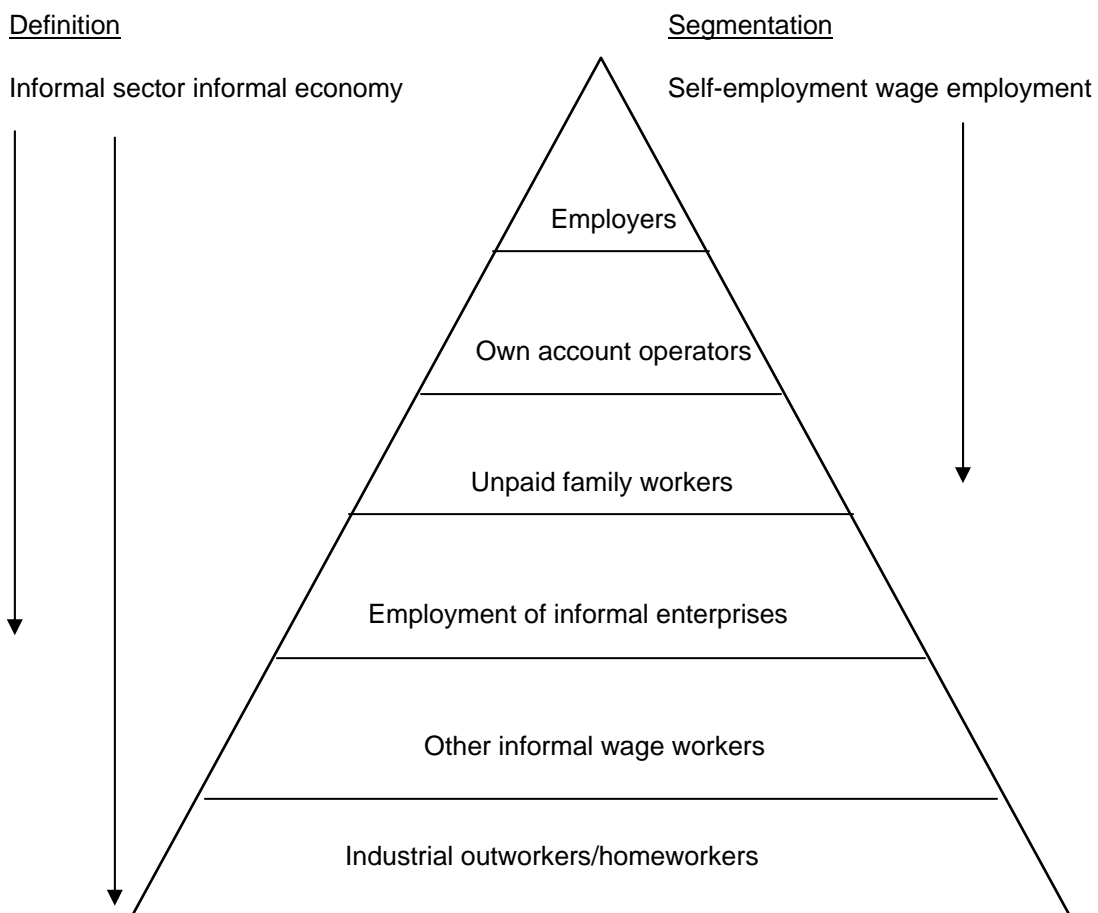
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<sup>7</sup> Those temporary and part-time workers who are covered by labour legislation and statutory social protection benefits are not included in the informal economy.

part-time workers, temporary workers and homeworkers work for formal enterprises through contracting or sub-contracting arrangements.

*Segmentation:* The informal economy consists of a wide range of informal enterprises and informal jobs. Yet there are meaningful ways to classify it. Figure 1 provides a graphic depiction of the universe of informal employment that also shows: on the left, how the earlier definition of the ‘informal sector’ is a component part of the recently-expanded definition of the ‘informal economy’; and on the right, the two broad components of the informal economy – self-employment and wage employment – and the various sub-components of each.

Figure 1  
Definition and segmentation of the informal economy



At the top of the figure is the most visible or best known segment – employers/microentrepreneurs; at the base is the least visible and least understood segment – homeworkers.<sup>8</sup> From available field studies and official data, two stylized global facts emerge about the segmented informal economy. The first global fact is that, around the world, there are significant gaps in wages or earnings within the informal economy: on

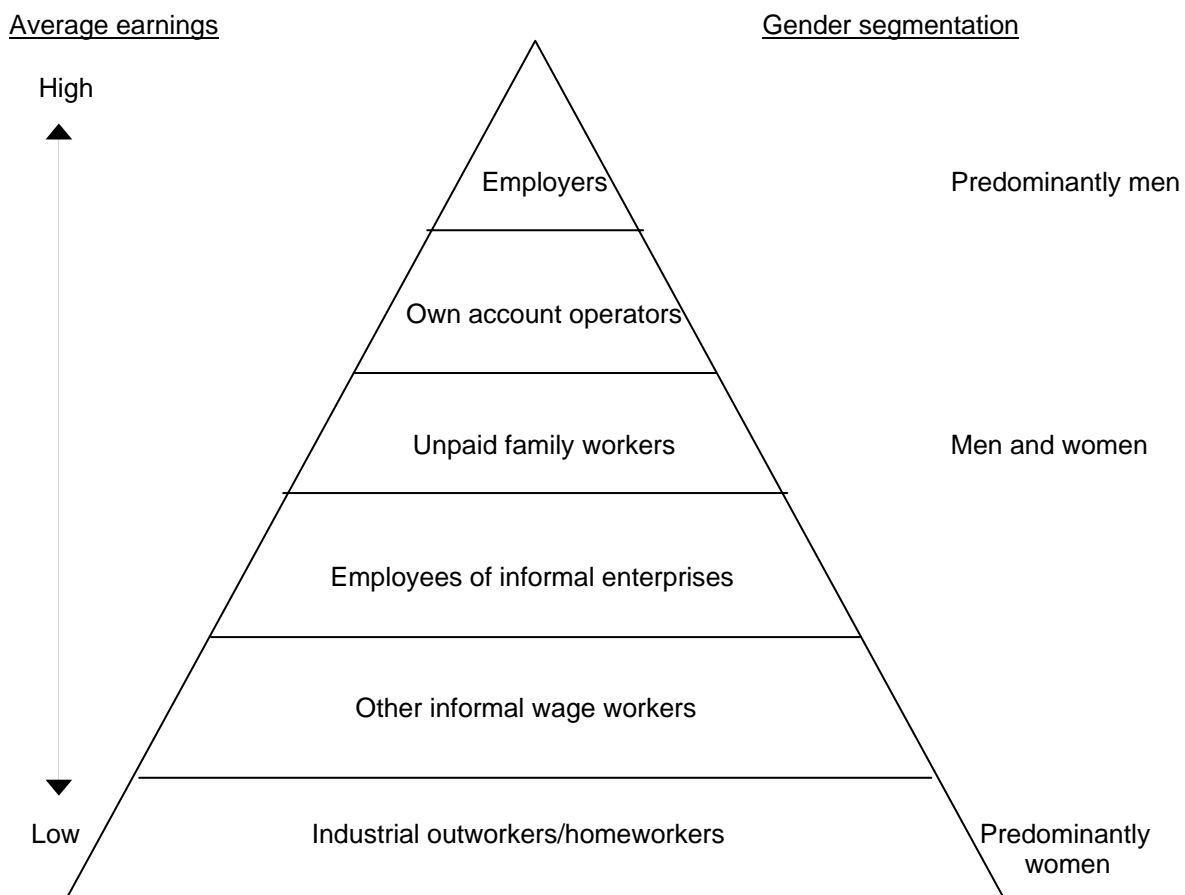
<sup>8</sup> The ‘iceberg’ shape in Figures 1 and 2 is supposed to depict graphically the ‘visibility’ of the various segments of the informal economy: with employers or microentrepreneurs at the tip as the most visible segment and the industrial outworkers at the bottom as the least visible segment. The ‘iceberg’ shape does not represent the relative size of the different segments.

average, employers have the highest earnings; homeworkers have the lowest; and own account workers and wage workers earn somewhere in between, depending on the economic sector and country. The net result is a significant gender gap in earnings within the informal economy, with women earning less on average than men.<sup>9</sup>

The second is that, around the world, men tend to be over-represented in the top segment and women tend to be over-represented in the bottom segment. While the shares of men and women in the intermediate segments tend to vary across sectors and countries, women tend to be over-represented as unpaid family workers.

These twin global facts are depicted graphically in Figure 2. To the left, the figure depicts the average earnings associated with the different employment status categories within the informal economy: average earnings tend to decline as one moves down the figure. To the right, the figure depicts the gender segmentation of employment: women are over-represented in the lowest segment of the structure and under-represented in the top segment of the informal economy.

Figure 2  
Gender segmentation of the informal economy



9 For a detailed analysis of available statistics on the gender segmentation of the informal economy and the linkages between working in the informal economy, being a woman or man, and being poor, see Chen *et al.* 2004.

An additional fact, not captured in Figure 2, is that there is further segmentation of employment within these broad status categories. Women tend to be employed in different types of activities, associated with different levels of earning, than men – with the result that they tend to earn less even within specific segments of the informal economy. Some of this difference can be explained by the fact that men tend to have *better tools* of the trade, operate from *better work sites/spaces* and have *greater access to productive assets and financial capital*. In addition, or as a result, men often produce or sell a *higher volume* or a *different range* of goods and services. For instance, among street vendors in some countries, men are more likely to sell non-perishable goods while women are more likely to sell perishable goods (such as fruits and vegetables). In addition, men are more likely to sell from push-carts or bicycles while women are more likely to sell from baskets on their heads or on the ground, or simply from a cloth spread on the ground. This is also because men are more likely to be heads of family businesses, while women are more likely to be unpaid contributing family members.

### *Legality or semi-legality*

Previously, there was a widespread assumption that the informal sector was comprised of unregistered and unregulated enterprises whose owner operators chose to avoid registration and, thereby, taxation. While it is important to understand informal employment in relation to the legal framework in any given country, this is far from being the whole story.

- There is a distinction between illegal *processes or arrangements* and illegal *goods and services*. While production or employment arrangements in the informal economy are often semi-legal or illegal, most informal workers and enterprises produce and/or distribute legal goods and services. Admittedly, one part of the informal economy – the criminal economy – not only operates illegally but also deals in illegal goods and services. But it is only a small part of a larger whole that is, for the most part, not illegal or criminal.
- Many owner operators of informal enterprises operate semi-legally or illegally because the regulatory environment is too punitive, too cumbersome or simply non-existent. Also, many activities in the informal economy do not generate enough output, employment or income to fall into existing tax brackets.
- Most owner operators would be willing to pay the costs of registration and pay taxes if they were to receive the incentives and benefits of formality (enjoyed by registered businesses).
- It is very important to note that, in the case of informal wage work, it is not the workers but their employers, whether in formal or informal firms, who are avoiding registration and taxation.

More fundamentally, most informal workers associate operating outside the legal regulatory framework with costs rather than benefits. Most self-employed and wage workers in the informal sector are deprived of secure work, worker's benefits, social protection and representation or voice. The self-employed have to take care of themselves and their enterprises as well as their employees (if they hire others) or unpaid contributing family members (if they run a family business). Moreover, they often face competitive disadvantage vis-à-vis larger formal firms in capital and product markets. Informal wage workers also have to take care of themselves as they receive few (if any) employer-

sponsored benefits. In addition, both groups receive little (if any) legal protection through their work or from their governments. As a result of these and other factors, a higher percentage of people working in the informal economy, compared to those working in the formal economy, are poor.

In summary, some key differences between earlier and current thinking on the informal economy are presented in Table 1.

Table 1  
Old and new views of the informal economy

The old view	The new view
The informal sector is the traditional economy that will wither away and die with modern, industrial growth.	The informal economy is 'here to stay' and expanding with modern, industrial growth.
It is only marginally productive.	It is a major provider of employment, goods and services for lower-income groups.  It contributes a significant share of GDP.
It exists separately from the formal economy.	It is linked to the formal economy – it produces for, trades with, distributes for and provides services to the formal economy.
It represents a reserve pool of surplus labour.	Much of the recent rise in informal employment is due to the decline in formal employment or to the informalization of previously formal employment relationships.
It is comprised mostly of street traders and very small-scale producers.	It is made up of a wide range of informal occupations – both 'resilient old forms' such as casual day labour in construction and agriculture as well as 'emerging new ones' such as temporary and part-time jobs plus homework for high tech industries.
Most of those in the sector are entrepreneurs who run illegal and unregistered enterprises in order to avoid regulation and taxation.	It is made up of non-standard wage workers as well as entrepreneurs and self-employed persons producing legal goods and services, albeit through irregular or unregulated means. Most entrepreneurs and the self-employed are amenable to, and would welcome, efforts to reduce barriers to registration and related transaction costs and to increase benefits from regulation; and most non-standard wage workers would welcome more stable jobs and workers' rights.
Work in the informal economy is comprised mostly of survival activities and thus is not a subject for economic policy.	Informal enterprises include not only survival activities but also stable enterprises and dynamic growing businesses, and informal employment includes not only self-employment but also wage employment. All forms of informal employment are affected by most (if not all) economic policies.

### 2.3 Women and men in the informal economy

Compiling statistics on the size, composition and contribution of the informal economy is hampered by the lack of sufficient data. While many countries have by now undertaken a survey on employment in the informal sector, very few countries undertake these on a regular basis. Furthermore, only two or three countries have collected the data that provide for measures of informal employment outside informal enterprises. In addition, the available data are not comprehensive. Many countries exclude agriculture from their measurement of the informal sector, and some measure only the urban informal sector. There are also a number of problems that limit the international comparability of data. However, in the absence of reliable data collected directly, various indirect methods to estimate the size and composition of the informal economy can be used. What follows is a summary of main findings from the most recent and most comprehensive set of estimates of the informal economy, including its gender dimensions, using indirect methods where necessary.<sup>10</sup>

#### *Developing countries*

Size of the informal economy – informal employment comprises one-half to three-quarters of non-agricultural employment in developing countries: specifically, 48 per cent in North Africa; 51 per cent in Latin America; 65 per cent in Asia; and 72 per cent in sub-Saharan Africa. If South Africa is excluded, the share of informal employment in non-agricultural employment rises to 78 per cent in sub-Saharan Africa; and if comparable data were available for other countries in South Asia in addition to India, the regional average for Asia would likely be much higher.

Some countries include informal employment in agriculture in their estimates. This significantly increases the proportion of informal employment: from 83 per cent of *non-agricultural* employment to 93 per cent of *total* employment in India; from 55 to 62 per cent in Mexico; and from 28 to 34 per cent in South Africa.

Informal employment is generally a larger source of employment for women than for men in the developing world. Other than in North Africa, where 43 per cent of women workers are in informal employment, 60 per cent or more of women workers in the developing world are in informal employment (outside agriculture). In sub-Saharan Africa, 84 per cent of women non-agricultural workers are informally employed compared to 63 per cent of men; and in Latin America the figures are 58 per cent of women in comparison to 48 per cent of men. In Asia, the proportion is 65 per cent for both women and men.

Composition of the informal economy – as noted earlier, in the discussion of its segmented structure, informal employment is comprised of both self-employment in informal enterprises (i.e., small and/or unregistered) and wage employment in informal jobs (i.e., without secure contracts, worker benefits or social protection). In all developing regions, self-employment comprises a greater share of informal employment (outside of agriculture) than wage employment: specifically, self-employment represents 70 per cent

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<sup>10</sup> This section draws from a statistical booklet that Joann Vanek and I prepared in 2002 for the ILO that includes data compiled by Jacques Charmes for anywhere from 25-70 countries, depending on the specific estimate, as well as case studies for India, Mexico, South Africa and OECD countries written by, respectively, Jeemol Unni, Rodrigo Negrete, Debbie Budlender and Francoise Carre (ILO 2002b). Data available since 2002 were supplied by Jacques Charmes.



of informal employment in sub-Saharan Africa, 62 per cent in North Africa, 60 per cent in Latin America and 59 per cent in Asia. If South Africa is excluded, since black-owned businesses were prohibited during the apartheid era and have only recently begun to be recognized and reported, the share of self-employment in informal employment increases to 81 per cent in sub-Saharan Africa.

Informal wage employment is also significant in the developing world, comprising 30 to 40 per cent of informal employment (outside of agriculture). Informal wage employment is comprised of employees of informal enterprises as well as various types of informal wage workers who work for formal enterprises, households or no fixed employer (see definition above).

In most countries for which data are available, women in informal employment are more likely to be in self-employment than in wage employment (see Table 2). In North Africa, Asia, three of the five sub-Saharan African countries and half of the Latin America countries, more women in informal employment (outside agriculture) are in self-employment than in wage employment. By contrast, informal wage employment is more important for women in Kenya, South Africa and four countries in South America – Brazil, Chile, Columbia and Costa Rica. In these countries more than half of women in informal employment are wage workers. Moreover, in all but one of these countries – South Africa – women are more likely to be informal wage workers than men.

#### *Developed countries*

In developed countries, the terms ‘informal sector’ and ‘informal economy’ are not used in the collection and classification of labour statistics. The most commonly-used term is ‘non-standard work’, which refers to all work that is not regular, stable and protected. In the late 1990s, three categories of non-standard or atypical work – self-employment, part-time work and temporary work – comprised 30 per cent of overall employment in 15 European countries and 25 per cent of total employment in the United States. Although not all self-employed, part-time workers and temporary workers are informally employed, the majority receive few (if any) employment-based benefits or protection. In the United States, for instance, less than 20 per cent of regular part-time workers have employer-sponsored health insurance or pensions.

Self-employment comprised 12 per cent of total non-agricultural employment in developed countries. Part-time work represented about 14 per cent of total employment for the Organization for Economic Co-operation and Development (OECD) countries as a whole and more than 20 per cent of total employment in eight of these countries. In the countries of the European Union (EU), temporary work comprised 11 per cent of total employment.

Although women’s labour force participation rates are lower than men’s, women comprise a significant share of non-standard employment. Women represented 60 per cent or more of part-time workers in all OECD countries reporting data. Their share of part-time work for specific countries was as high as 98 per cent in Sweden, 80 per cent in the United Kingdom and 68 per cent in both Japan and the United States. In many countries of the EU the majority of workers in temporary employment are women. In nine of the (then) 15 EU countries, women accounted for about half or more of temporary employment. And in OECD countries, women comprised one-third of self-employed workers in 1997 and this share of women appears to be growing.

Table 2  
Wage and self-employment in non-agricultural informal employment, by sex (1994/2000)

Country/region	Self-employment as a percentage of non-agricultural informal employment			Wage employment as a percentage of non-agricultural informal employment		
	Total	Women	Men	Total	Women	Men
<b>North Africa</b>	<b>62</b>	<b>72</b>	<b>60</b>	<b>38</b>	<b>28</b>	<b>40</b>
Algeria	67	81	64	33	19	36
Egypt	50	67	47	50	33	53
Morocco	81	89	78	19	11	22
Tunisia	52	51	52	48	49	48
<b>Sub-Saharan Africa</b>	<b>70</b>	<b>71</b>	<b>70</b>	<b>30</b>	<b>29</b>	<b>30</b>
Benin	95	98	91	5	2	9
Chad	93	99	86	7	1	14
Guinea	95	98	94	5	2	6
Kenya	42	33	56	58	67	44
South Africa	25	27	23	75	73	77
<b>Latin America</b>	<b>60</b>	<b>58</b>	<b>61</b>	<b>40</b>	<b>42</b>	<b>39</b>
Bolivia	81	91	71	19	9	29
Brazil	41	32	50	59	68	50
Chile	52	39	64	48	61	36
Colombia	38	36	40	62	64	60
Costa Rica	55	49	59	45	51	41
Dominican Rep.	74	63	80	26	37	20
El Salvador	65	71	57	35	29	43
Guatemala	60	65	55	40	35	45
Honduras	72	77	65	28	23	35
Mexico	54	53	54	46	47	46
Venezuela	69	66	70	31	34	30
<b>Asia</b>	<b>59</b>	<b>63</b>	<b>55</b>	<b>41</b>	<b>37</b>	<b>45</b>
India	52	57	51	48	43	49
Indonesia	63	70	59	37	30	41
Philippines	48	63	36	52	37	64
Syria	65	57	67	35	43	33
Thailand	66	68	64	34	32	36

Source: ILO (2002b), based on data prepared by Jacques Charmes from official national statistics.

### 3 Links with the formal economy

A key issue in both the early and current debates on the informal sector/economy is whether and how the informal sector/economy is linked to the formal sector/economy. However, these debates have tended to blur the distinction between the formal economy and the formal regulatory environment and the relationship of the informal economy to each. But it is important to distinguish between the:

- *formal economy*: comprised of regulated economic units and protected workers
- *formal regulatory environment*: comprised of government policies, laws, and regulations

In this section of the paper, I discuss the linkages between informal enterprises and workers to the formal economy: that is, to formal firms. In the following section of the paper, I discuss the linkages between informal enterprises and workers to the formal regulatory environment. In real life, of course, it is often hard to know what is driving what: as large formal registered enterprises are often involved in ‘setting’ formal policies and regulations; and formal policies and regulations are often biased towards formal registered firms to the disadvantage of both informal enterprises and informal wage workers.

### **3.1 Competing theories**

As noted earlier, there are three broad schools of thought regarding the informal economy: dualism, structuralism and legalism. Each of these broad schools has a different perspective on how the informal economy is linked to the formal economy, even if they do not explicitly distinguish between the formal economy and the formal regulatory environment.

#### *Dualists*

In regard to informal enterprises or economic activities, dualists subscribe to the notion that informal units and activities have few (if any) linkages to the formal economy but, rather, operate as a distinct separate sector of the economy. In regard to informal labour markets, dualists subscribe to the notion that informal workers comprise the less-advantaged sector of a dualistic or segmented labour market. According to orthodox labour economists, wage rigidities – that is, above-market wages in the formal sector introduced through legislation or negotiation – segment the labour market (Harris and Todaro 1970).

#### *Structuralists*

Unlike the dualists, structuralists see the informal and formal economies as intrinsically linked. In the interest of increasing their competitiveness, capitalist firms in the formal economy are seen to reduce their input costs, including labour costs, by promoting informal production and employment relationships with subordinated economic units and workers. According to structuralists, both informal enterprises and informal wage workers are subordinated to the interests of capitalist development, providing cheap goods and services.

#### *Legalists*

The legalists focus on informal enterprises and the formal regulatory environment to the relative neglect of informal wage workers and the formal economy per se. While they do not focus on the relationship between informal enterprises and formal firms, the legalists acknowledge that capitalist interests – what de Soto calls ‘mercantilist’ interests – collude with government to ‘set’ the bureaucratic ‘rules of the game’ (de Soto 1989).

### **3.2 Competing realities**

Given the heterogeneity of the informal economy, there is some truth to each of the theories summarized above. However, also given its heterogeneity, the reality of informal work is more complex than the standard theories outlined above suggest. What follows is a summary of various ways in which informal enterprises and workers are linked to formal firms.

### *Informal enterprises and formal firms*

Few informal enterprises, except perhaps some survival activities, operate in total isolation from formal firms. Most source raw materials from and/or supply finished goods to formal firms either directly or through intermediate (often informal) firms. Sourcing and supplying of goods or services can take place through *individual transactions* but are more likely to take place through a *sub-sector network* of commercial relationships or a *value chain* of sub-contracted relationships.

To understand the linkages between informal enterprises and formal firms it is important to consider the nature of the production system through which they are linked. This is because the nature of the linkage – specifically, the allocation of authority and risk between the informal and formal firm – would vary according to the nature of the production system. For instance, a garment maker might produce for the open market (with some authority and all of the risk) or for a supply firm linked to a multinational company (with little authority but much of the risk in the form of non-wage costs, rejected goods, and delayed payments). Types of production systems include:

- *individual transactions*: some informal enterprises or own account operators exchange goods and services with formal firms in what might be characterised as open or pure market exchange (in the sense of independent units transacting with each other). In such cases, the dominant firm in terms of market knowledge and power – usually the formal firm – controls the exchange or transaction.
- *sub-sectors*: many informal enterprises or own account operators produce and exchange goods and services with formal firms in what are called sub-sectors, that is, networks of independent units involved in the production and distribution of a particular product or commodity. In such networks, individual units are involved in a series of transactions with suppliers and customers. The terms and conditions of these transactions are governed largely by the dominant firm in specific transactions (as above) but also by the ‘rules of the game’ for the sub-sector as a whole, which typically are determined by dominant firms in the network.
- *value chains*: some informal enterprises and own account operators and, by definition, all homeworkers produce goods within a value chain. The terms and conditions of production in value chains are determined largely by the lead firm: in domestic chains, a large national firm and, in global value chains, a large transnational company. However, the major suppliers to whom the lead firm sub-contracts work – also often formal firms – also help determine the terms and conditions of work that they sub-contract to informal firms and workers down the chain.

In sum, informal enterprises are quite likely to have linkages with formal firms. But the commercial relationship between informal enterprises and formal firms is not likely to be regulated, although this differs context to context. Hence, there is a need to distinguish (a) the linkages between informal firms and formal firms and (b) the linkages between informal firms and the formal regulatory environment.

### *Informal workers and formal firms*

Informal Employment Relations – historically, around the world, the ‘employment relationship’ has represented the cornerstone – the central legal concept – around which labour law and collective bargaining agreements have sought to recognize and protect the rights of workers. Whatever its precise definition in different national contexts, it has represented ‘a universal notion which creates a link between a person, called the employee (frequently referred to as ‘the worker’) with another person, called the employer to whom she or he provides labour or services under certain conditions in return for remuneration’ (ILO 2003).

The concept of employment relationship has always excluded those workers who are self-employed. Increasingly, some categories of wage workers have found themselves to be, in effect, without legal recognition or protection because their employment relationship is either:

- *disguised*: the employment relationship is deliberately disguised by giving it the appearance of a relationship of a different legal nature. For example, the lead firm in a sub-contracting chain may claim that it has a ‘sales-purchase’ – or commercial – relationship with those who produce goods for it, rather than a sub-contracted employment relationship. In Ahmedabad City, India, many bidi traders now claim that they sell tobacco and other raw materials to those who produce bidis (hand-rolled cigarettes) and buy the finished bidis from them. This is because the bidi-rollers are trying to leverage employer contributions to a retirement fund from the bidi traders.
- *ambiguous*: the employment relationship is objectively ambiguous so there is doubt about whether or not an employment relationship really exists. This is the case, for instance, with street vendors who depend on a single supplier for goods or sell goods on a commission for a distributor.
- *not clearly defined*: the employment relationship clearly exists but it is not clear who the employer is, what rights the worker has, and who is responsible for securing these rights. For example, in value chain production, it is not clear who the real employer is: the lead firm, the supply firm, or the sub-contractor? Similarly, in the case of temporary work, it is not clear who the real employer is: the agency that supplies temporary workers or the firms that hire them on a temporary basis?

Under each of these employment relationships, workers tend not to be protected under labour law or collective bargaining agreements: in brief, they are informally employed. It is important to note that, in many such cases, the employer seeks to disguise the employment relationship or avoid definition of who is responsible; and that the employer in question may well represent a formal firm, not an informal enterprise.

Variations on Labour Market Segmentation – beginning in the 1980s, as noted earlier, formal firms in developed countries began to favour flexible labour relationships. This form of labour market segmentation took place in the interest of flexible specialized production, not in response to rising wage rates or labour costs (Piore and Sabel 1984). Also increasingly since the 1980s, many formal firms in developed countries have decided to sub-contract production out to unprotected workers in developing or transition countries. Production under this form of labour market segmentation takes place in developing

countries where labour costs are already low and where there is no real threat of rising wages due to legislation or unionized labour. In producing countries, there is often further segmentation between the core semi-permanent workforce and a peripheral temporary workforce that is mobilized during peak seasons and demobilized during slack seasons (what has been called a ‘permanent temporary workforce’).<sup>11</sup>

In summary, many formal firms prefer informal employment relationships, in the interest of flexible specialized production, global competition, or (simply) reduced labour costs. The related point is that formal firms choose these types of informal employment relationships as a means to avoiding their formal obligations as employers. In such cases, it is the formal firm not the informal worker that chooses or ‘volunteers’ to operate informally and enjoys the ‘benefits’ of informality. This reality points to the need to re-examine the notion that informal employment is ‘voluntary’ from the perspective of informal wage workers, not just of the self-employed.<sup>12</sup>

## **4 Links with the formal regulatory environment**

### **4.1 Competing theories**

#### *Dualists*

In regard to informal enterprises, dualists paid relatively little attention to government regulations per se but focused instead on government provision of necessary support services to informal enterprises: notably, credit and business development services. In regard to informal employment relations, the dualists tended to subscribe to the orthodox notion that government intervention in labour markets would result in wage rigidities which would, in turn, lead to more informal employment.

#### *Structuralists*

In marked contrast, the structuralists see a role for government in regulating the unequal relationships between ‘big businesses’ and subordinated informal producers and workers. This would involve the regulation of commercial relations in the case of informal producers and the regulation of employment relations in the case of informal wage workers.

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<sup>11</sup> The permanent temporary workforce is a well-known phenomenon in the tourist industry. In Spain, the Union General de Trabajadores (UGT) union got job security for such workers in the form of a guarantee that they would be re-hired in the same jobs when the season started again (Dan Gallin, personal communication).

<sup>12</sup> The legalist school of thought subscribes to the notion that operating informally is both voluntary and rational, given the high costs of becoming formal. But the legalist school of thought tends to focus on the self-employed – and, more specifically, on the entrepreneurial class among the self-employed – to the relative neglect of informal wage workers and own account workers. Available evidence suggests that microentrepreneurs tend to have far higher earnings on average than their employees (which is to be expected) but also compared to own account operators (see Chen *et al.* 2004).

## *Legalists*

The central proposition of the legalist school of thought is that costly and cumbersome government regulations inhibit the ability of informal entrepreneurs to operate a business and earn a living and that deregulation would lead to increased economic freedom and entrepreneurship among working people, especially in developing countries (de Soto 1989). More recently, the founder of the legalist school – Hernando de Soto – has advocated one form of regulation: namely, the *formalization* of property rights for the informal workforce to help them convert their informally-held assets into real assets (de Soto 2000).

## **4.2 Competing realities**

### *Over-regulation*

As noted earlier, the legalists have focused on excessive regulations that create barriers and costs to working formally. A different perspective focuses on how over-regulation raises barriers to working formally while, at the same time, raises costs to operating informally. Consider the case of government monopoly of forest products in India.

Following the nationalization of the forests in India, gum, salt, and other forest products came under the control of the National and State Forest Departments which means, among other things, that they cannot be traded without a license from the requisite government institution.

- *Gum collectors*: although there is a thriving open market for gum that includes textile and pharmaceutical companies, those who collect gum have to sell the gum to the Forest Development Corporation; to sell in the open market requires a special permit or license. Most gum collectors – except those who can afford to obtain a permit or license – have to sell to the Forest Development Corporation at a price far below the prevailing market price (Crowell 2003).
- *Salt makers*: the cheapest way to transport salt within India is via railway. But, historically, small salt producers have been unable to use rail service to transport their salt. This is because of a long-standing government regulation that stipulates that salt farmers need to own a minimum of 90 acres of land to be eligible to book a train wagon. Given that most small salt farmers lease land from the government or local landlords, most small salt farmers are not eligible to use rail transport. Because they have to use private transport, small salt farmers face high transportation costs and, therefore, remain less competitive than larger salt farmers (Crowell 2003).

### *Deregulation*

As part of economic restructuring and liberalization, there has been a fair amount of *deregulation*, particularly of financial and labour markets. Deregulation of labour markets is associated with the rise of informalization or ‘flexible’ labour markets (discussed above). In regard to labour markets, it should be noted that workers are caught between two contradictory trends: *rapid flexibilization* of the employment relationship (making it easy for employers to contract and expand their workforce as needed) and *slow*

*liberalization* of labour mobility (making it difficult for labour to move easily and quickly across borders) (Chen *et al.* 2004).<sup>13</sup> Labour advocates have argued for *re-regulation* of labour markets to protect informal wage workers from the economic risks and uncertainty associated with flexibility and informalization.

### *Lack of regulation*

The regulatory environment often overlooks whole categories of the informal economy. A *missing* regulatory environment can be as costly to informal operators as an *excessive* regulatory environment. For example, city governments around the world tend to adopt either of two stances towards street trade: trying to eliminate it or turning a ‘blind eye’ to it. Either stance has a punitive effect: eviction, harassment, and the demand for bribes by police, municipal officials and other vested interests. Around the world, few cities have adopted a coherent policy – or set of regulations – towards street trade. Rather, most cities assign the ‘handling’ of street traders to those departments – such as the police – that deal with law and order (Bhowmik 2004; Mitullah 2004).

The different perspectives on regulation outlined above are appropriate in regard to the specific components of the informal economy they refer to: the legalists focus on informal *enterprises* (and informal *commercial* relationships); the labour advocates focus on informal *jobs* (and informal *employment* relationships); and those concerned about street vendors focus on the regulation of *urban space* and *informal trade*. Arguably, for each component of the informal economy, what is needed is *appropriate regulation*, not complete deregulation or the lack of regulation.

## **5 Promoting more equitable linkages**

Given that the informal economy is here to stay and that the informal and formal economies are intrinsically linked, what is needed is an appropriate policy response that promotes more equitable linkages between the informal and formal economies.

This concluding section provides a framework for developing an appropriate policy response that balances the costs and benefits of working formally and informally. While the framework focuses on the role of government, it sees a role for all stakeholders, including an active role for formal firms in promoting socially responsible corporate practices and an active role for organizations of informal workers in policy making.

### **5.1 Alternative policy perspectives**

Historically, policymakers have taken differing policy stances on the informal economy: some observers view informal workers as a nuisance to be eliminated or strictly regulated; others see them as a vulnerable group to be assisted through social policies; still others see them as dynamic entrepreneurs to be freed from cumbersome government regulations.

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<sup>13</sup> Liberalization of labour markets implies (a) wage flexibility, (b) flexibility in contractual arrangements, and (c) limited regulation in terms of the conditions under which labour is exchanged. It should be noted that international labour mobility is often excluded from discussions of labour market flexibility (James Heintz, personal communication).



Another perspective sees the informal workforce as comprised of unprotected producers and workers who need to be covered by labour legislation and social protection. Subscribing to one or another of these perspectives, policymakers have tended to over-react to the informal economy, trying to discourage it altogether, to treat it as a social problem or to promote it as a solution to economic stagnation or employment creation.

But at the core of the policy debate on the informal economy is the oft-repeated and greatly-misunderstood question of whether or not to ‘formalize’ the informal economy. To begin with, it is not clear what is meant by ‘formalization’. To many policymakers, formalization means that informal enterprises should obtain a license, register their accounts, and pay taxes. But to the self-employed these represent the costs of entry into the formal economy. What they would like is to receive the benefits of formality in return for paying these costs, including: enforceable commercial contracts; legal ownership of their place of business and means of production; tax breaks and incentive packages to increase their competitiveness; membership in formal trade associations; and statutory social protection. But what about informal wage workers? To them, formalization means obtaining a formal wage job – or converting their current job into a formal job – with secure contract, worker benefits, and social protection.

If this is what is meant by formalization, it is not clear whether it is feasible to formalize the informal economy. First, most bureaucracies would not be able to handle the volume of license applications and tax forms if all informal businesses decided to formalize. Second, most bureaucracies would claim that they do not have the funds to offer informal businesses the types of incentives and benefits they offer formal businesses. Third, recent trends suggest that employment growth is not keeping pace with the demand for jobs – there simply are not enough jobs to go around. Finally, available evidence suggests that employers are more inclined to convert ‘good’ jobs into ‘bad’ jobs – rather than the other way around.

The policy approach proposed here recommends turning the whole formalization debate on its head by recognizing (a) that it is unlikely that most informal producers and workers will be formalized – although efforts should be made to do so; but that, meanwhile, (b) that there are costs of working informally which need to be addressed. The policy challenge then is to decrease the costs of working informally: or, as the ILO puts it, to reduce the ‘decent work deficits’ of working informally (ILO 2002a).

What follows provides a framework for such a policy approach.

## **5.2 Informed and comprehensive policy perspective**

An *informed* policy approach to the informal economy should be premised on the understanding that the informal economy:

- is here to stay: that it is a permanent feature of capitalist development (not just a residual feature of traditional economies)
- is diverse, including:
  - survival activities and dynamic enterprises;
  - unprotected workers as well as risk-taking entrepreneurs;

- contributes to both economic growth and poverty reduction;
- needs to be the target of both economic and social policies;
- is caused variously by jobless growth, economic crises, global competition, corporate business strategies, changes in investment patterns, lack of unemployment insurance and safety nets, cutbacks in social spending, increased costs of living, retrenchment of formal workers and privatization of public enterprises – not just by decisions taken by informal workers;
- is affected by all policies, both general and targeted; and
- is affected in different ways by policies than formal enterprises and formal workers are.

A *comprehensive* policy approach needs to take into account the different dimensions of the informal economy:

- its component segments and their specific needs and constraints:
  - the self-employed and their enterprises/economic activities;
  - informal wage workers and their employers;
  - disguised wage workers, such as homeworkers, and their employers;
  - women and men within each of these categories;
- the informal workforce as a whole and its common needs and constraints; and
- organizations of informal workers and their lack of recognition and voice.

### 5.3 Policy goals

Reflecting the Decent Work agenda of the ILO, the *overarching* policy goals of an informed and comprehensive policy approach toward the informal economy should be to:

- *promote opportunities*: to increase the assets, skills, productivity and competitiveness of the informal workforce – both self-employed and wage workers (both women and men) – through a mix of service provision (microfinance, training, improved technologies and other business development services) and policy interventions (workforce development, incentive packages);
- *secure rights*: to secure the rights of (a) informal wage workers through extending the scope of existing legislation, promoting collective bargaining agreements and/or enforcing labour standards; and (b) the self-employed through enabling equal access to credit and other resources, extending property rights, and promoting equitable policies for formal and informal enterprise development;
- *protect informal workers*: to provide insurance coverage for illness, maternity, disability, old age and death and for property through extending existing schemes and/or developing alternative schemes; to provide safety nets to ‘cushion’ informal workers during economic crises or business downturns; and to promote occupational health and safety measures for informal workers;

- *build and recognize the ‘voice’ of informal workers*: to promote the organization of informal workers into trade unions, cooperatives, or other membership-based organizations and their representation in relevant policymaking or rule-setting institutions or in collective bargaining agreements.

Special efforts should be made to promote the opportunities, rights, protection and voice of women in the informal economy, who are often among the most disadvantaged in the informal economy. To do so, the special problems and constraints of women workers need to be assessed in policy design, organizations of women workers need to be built, and the participation of women workers in the planning process needs to be promoted.

#### 5.4 Key policy areas

As noted earlier, virtually all policies affect one or other segment of the informal economy. But four areas of policy have particular impact on the informal economy:

- *macroeconomic policies*: tax burdens, incentives, and statutory benefits (e.g. unemployment insurance and pension funds) should be more equitably distributed between micro, small, and big businesses, and between employers and employees (of all kinds);
- *labour policies*: the scope of labour legislation, labour policies, and collective bargaining agreements should be expanded to cover all categories of workers;
- *urban regulations*: appropriate regulations and equitable allocation of urban space should be developed through a consultative process and negotiated settlements between all stakeholders; and
- *social protection measures*: the scope of statutory schemes should be expanded to cover as many categories of workers as possible; and alternative schemes that target informal workers should be encouraged.

#### 5.5 Other policy areas

Other functional areas of policies that have particular relevance for informal enterprises and the informal workforce include:

- *microfinance and enterprise development services* to increase the productivity of their enterprises;
- *infrastructure and services* to improve their housing and living environment and *social policies* to improve their health and education;
- *property rights* to give them security of tenure over their assets and, as needed, the ability to transform their assets into capital assets; and
- *intellectual property rights* to protect their traditional knowledge and their rights to natural resources.

Most sector-specific policies also have effects on the informal economy. Seen from the perspective of the working poor in the informal economy, these include the following key sectors and concerns:

- *agriculture*: food security and sustainable livelihoods;
- *forestry*: sustainable and equitable access to non-timber forest products, wood fuel, pastures and other common property resources;
- *fishery*: sustainable and equitable management of water resources and sustainable and equitable allocation of fishing rights;
- *manufacturing*: balance of efficiency and equity concerns in the choice of sector of production, technology, site of production and employment relations; and
- *construction*: balance of efficiency and equity concerns in the choice of technology and employment relations.

Finally, to ensure that appropriate policies are put in place, the informal workforce needs to be visible to policymakers. Also, to ensure that the policy approach is well-informed it needs to be evidence-based. Yet there are currently limited data on the informal economy. Greater priority needs to be given to the collection of data on informal employment, which is a relatively new topic in labour statistics.

## 5.6 Policy process

Clearly, there is no universal policy prescription for the informal economy. However, the following guiding principles should be seen as essential aspects of a positive policy process:

- It should be *participatory and inclusive* and allow for policies to be developed through consultation with informal workers, and through consensus of relevant government departments, the organizations of informal workers and other appropriate social actors. In order to have a voice, those who work in the informal economy must be organized and their efforts to organize into trade unions and co-operatives at every level should be encouraged and supported.
- It should be *context-specific* based on the reality of different categories of informal workers in specific locales and industries. It should recognize and support both the self-employed (differentiating between microentrepreneurs and own account operators) and wage workers in the informal economy. The lack of recognition and understanding of these basic components of the informal economy often hinders the development of appropriate policy. Further, taking into account local and national circumstances is critical to developing appropriate policy.
- It should be *gender sensitive*, taking into account the roles and responsibilities of women and men in the informal economy. In most regions of the world, a larger share of the female than of the male workforce is in the informal economy and, within the informal economy, women tend to be concentrated in lower-return segments than men. As a result, even within the informal economy, there is a

significant gender gap in earnings and in the benefits and protection afforded by work. Understanding relations between men and women, their different positions in the economy and their access to and control of resources is crucial to understanding the informal economy, where a gendered approach is a pro-poor approach. Supporting women's work will, in effect, lead to support for poor households and poor children.

- It should be based on an informed understanding of the *economic* contribution of informal workers and serve to *mainstream* the concerns of the informal workforce in those institutions that deal with economic planning and development. In the past, the management or regulation of informal activities has often been relegated to social policy departments or, in urban areas, to those departments (such as the police or traffic) that deal with law and order issues. Locating governance of the informal economy in traffic, health, policy or social departments ignores its economic aspects. Institutions that govern the informal economy should be those dealing with economic planning and development.

Of course, formulating appropriate policies is never an easy task. However, with the involvement of the organizations that represent informal workers, it is likely to succeed. The way forward has to be one of negotiated solutions, and these negotiations have to be about rights and responsibilities. While the inclusion of the voice of all stakeholders in making policy is essential to its success, the input of informal workers and their organizations, based on recognition of their right to organize, is crucial.

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