

Economy, Informal

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Glossary

LETS (Local Exchange and Trading

Systems) Operate a currency system as an alternative to the formal economy.

Introduction

The informal economy is open to multiple interpretations leading to many, often contradictory, definitions. Very generally, the informal economy can be considered to be that part of the economy where activities, often occurring on a small scale, take place beyond official recognition and record. Such activities may include small-scale enterprises and trade, street vending (Figure 1), garbage recycling ventures, subcontracting, and homework. Within countries, the nature of the informal economy is highly fragmented by location of work, be it in the home, in a small enterprise or on the street; the specific nature of the activity; and the status of employment. Yet in general, it can be said that all people involved in the informal economy share a lack of formal labor rights and social protection. The informal economy is most commonly found in developing countries where at times up to 80% of the economy might be based upon informal work, much of it self-employed;

however, such informality certainly also occurs in developed countries.

Two other sectors of the economy are sometimes incorporated within the term informal economy, a practice the International Labour Organization (ILO) argues against. First, it is argued that the criminal economy is not part of the informal economy. While there may certainly be illegal or semi-illegal production or labor arrangements within the informal economy, it is suggested that this sector does not cover criminal activities in illegal goods or services such as drug smuggling. Second, the reproductive or care economy, including unpaid domestic work is considered by some not to be part of the informal economy, due to the fact that these activities are not part of the economy for which goods and services are created for sale or remuneration. However, such limits on the sector are debatable as they point to a sizeable grey zone, and others argue just as forcibly that these activities should be included. Likewise, debates continue as to whether subsistence agriculture forms part of this definition, with suggestions that because such activities are so widespread, they need to be analyzed in their own right.

There are many perspectives on the informal economy, and while some have tended to follow one another over time, they are not necessarily in conflict. Yet, while the term 'informal sector' was used in most initial works to describe these activities, it tends to have been



Figure 1 Informal economy street vending, Hanoi, Vietnam.

overtaken in more recent studies by the term 'informal economy'. In the 1990s and current decade, much research tends to build from a range of previous ideas, pulling elements from different approaches when they are relevant to a particular setting. Indeed, it is important to note that informal activities are highly context contingent, a fact stressed persuasively in recent work, with numerous different forms of informality occurring in different places and at different times. In addition, this term pertains to different economic systems, from peasant to wage labor systems, from feudalism to capitalism to communism.

Approaches to the Informal Economy

Dualistic Models

Since their initial appearance in the 1940s and 1950s, dualistic models have tended to occupy center stage in research on the informal economy especially that occurring in developing countries. Often considered a remnant of precapitalist economies, the informal economy was considered by this approach to refer to the activities of 'local' people in colonized countries, not yet integrated into the colonial economic and social structure. As a result, the sector was seen as backward, irrational, and inefficient.

Writing in 1953, Boeke introduced an early concept of dualistic production systems based on an examination of the Dutch East Indies. He defined two social systems: the capitalist, imported from abroad; and the domestic social system. This model was to provide a starting point for much subsequent work including that of Clifford Geertz, who in 1963, identified the 'firm-centered' and 'bazaar' economies in his work focusing on two towns in Java and Bali, Indonesia. The 'firm centered' economic sector involved trade occurring via impersonal social institutions, while the 'bazaar economy' related to local competitive traders often relying upon numerous spontaneous interactions.

In 1971, at the 'Conference on Urban Unemployment in Africa' held at the University of Sussex, UK, Keith Hart coined the specific term 'informal sector' drawing from his work in Ghana. Hart understood the informal sector as being distinct from wage-earning employment (the formal sector), the distinction between the two being the degree of rationalization of work. Labor within the formal sector was recruited on a permanent basis for fixed wages, whereas the informal sector consisted of irregular forms of employment and self-employment. Despite its relative complexity, Hart developed a classification of the two sectors based on the income opportunities available to people in a city. It is interesting however, that his division did make it possible for members of the same household to gain employment in

different sectors of the economy. Shortly after, in 1972, the ILO, in a study based upon work in Kenya, built upon Hart's work while scaling it up to examine the structure of the economy as a whole. While maintaining a dualistic approach, one outcome of their research was to suggest that governments should support informal economy activities because of the important role they play in absorbing unemployment. This marked a notable shift in attitude, from the informal economy being seen as a backward sector in earlier work, to instead being suggested by both Hart and the ILO as a site for efficiency, creativity, and resiliency; indeed, perhaps a solution to economic development and poverty alleviation.

Almost immediately after the informal economy/sector concept first appeared, criticism of the approach also emerged. One of the strongest concerns was that by placing the informal economy in opposition to the formal, an artificial dichotomy was created. In addition, these approaches were accused of social evolutionism, or having a 'modernization take' on the economy, with assumptions that informal ways of making a living would eventually be subsumed by the modern capitalist economy. Subsequently, a number of modifications to this initial work was made, including the work of Milton Santos who, in 1975, spoke of the urban economy as consisting of two circuits or subsystems, an 'upper' and 'lower' one, structured in a closely linked relationship. He described the upper circuit as using imported capital-intensive technology and consisting of banking, export trade and industry, modern urban industry, trade and services, wholesaling, and so on. Most of the relations of this circuit were seen to operate at a national or international level. On the other hand, the lower circuit consisted of small-scale, non-capital-intensive activities using locally adapted technologies. This circuit was dominated by the poor, and was well entrenched in the urban realm. Although appearing independent, it was argued that these circuits were closely interlinked with the lower circuit maintaining a dependent relationship with the upper circuit.

Petty Commodity Production Critiques

While the approach based on the informal/formal economy dichotomy was being developed by Hart, the ILO, and others from the 1970s, the increasing wealth of information linking those operating in the informal economy to those involved in other sectors of the economy forced many researchers to seek alternative frameworks. The most prominent of these emerged from a neo-Marxist critique of utilizing informal economy terminology in developing countries, and subsequently the 'modes of production' approach became popular.

Neo-Marxists saw informality as being a result of the unequal development of capitalism, with the informal

economy playing an essential role in providing a low-wage reserve of labor, a strategy theorized by Karl Marx as the maintenance of a disposable 'industrial reserve army'. While essentially still dividing the urban economy into two parts – the capitalist and precapitalist modes of production – the neo-Marxist 'modes of production' approach paid closer attention to interfirm relationships, while being more pluralistic in nature. Several forms of precapitalist mode of production were recognized, one being labeled 'petty commodity production'. This aspect of the model became increasingly popular as a tool with which to examine the development of, and relationships surrounding, what had previously been called the 'informal economy'. Instead of having a benign, autonomous, or complementary relationship with the formal economy, this approach identified a relationship in which the petty commodity production sector was exploited and subordinated by the formal economy. Two main exploitative relationships were identified: first, the informal economy was considered an extension of the productive network of large firms, providing a pool of cheap and flexible wage labor; and second, it subsidized the formal economy by providing cheap goods and services to the labor force therefore enabling large firms to pay low wages.

However, this neo-Marxist approach was not immune from criticism either, critiques including that it viewed socioeconomic transformations as a product of external determination, and as such ignored local histories, structural differences, and diverse possible responses. As such, there was little room in the approach for local agency. Yet at the same time, it did not take long for some authors to feel that the traditional dualistic approach and the neo-Marxist approaches were intersecting, given that the features of those undertaking work in the informal economy were basically the same as those undertaking petty commodity production.

Trying to synthesize these approaches, authors such as Mazumadar (1976), and Bromley and Gerry (1979) created a framework based upon the vulnerability of workers. The informal economy was perceived as a labor market phenomenon identifying a specific dichotomy between the unprotected informal economy and the protected formal economy. Formal economy protection arose from the actions of unions, governments, or both acting together. Formal workers tended to have stable wages, protection via labor laws, and perhaps health and pension benefits. In comparison, the informal economy was characterized by industries that were 'unprotected' by company policy, government regulations or trade union action, and to which entry was relatively easy. Such workers, many of whom Mazumadar noted were rural to urban migrants, were often employed on a daily basis, and could be undertaking piecework for larger firms. Some authors placed the self-employed in a separate

category again, noting that such work created different forms of vulnerability.

Neoliberal/Legalist Approach

In 1989 the seminal work *The Other Path* written by Peruvian Hernando De Soto was translated into English. De Soto argued that informal activities were not due to the dynamics of the labor market but were a consequence of excessive state regulation. To support his arguments, De Soto and his research team undertook a widely cited experiment to try to register a small garment enterprise in Lima, a process that involved over 100 administrative procedures and took almost a year of continuous effort. Neoliberal/legalists see members of the informal economy as the hope for the future for capitalist economic development. They argue that what is needed is a reduction in state interference in the market and the elimination of the maze of regulations that are commonly associated with establishing an enterprise. Alternatively, critics of this approach state that an unregulated economy would not be the best solution, as the approach ignores the structural subordination of small enterprises and traders.

Structuralist Approaches

Given the climate of global economic restructuring during the 1980s and 1990s, it is not surprising that a structuralist approach, rooted in neo-Marxist traditions, emerged partly in response to recessions in a number of developed countries, structural adjustment reforms, and increased competition from newly industrializing countries. Indeed, this was a time when post-Fordist modes of production were becoming increasingly apparent in developed and advanced developing countries, with many workers pushed from formal employment into the informal economy. This approach, generally speaking – as there are many variants – rejected all notions of economic dualism and focused instead on the linkages amongst formal and informal production. Proponents of this approach argued that the informal economy was very much a result of capitalist firms attempting to evade state regulations regarding taxes and social legislation such as maintaining minimum wages, safety standards, and providing social benefits. Firms attempt this by implementing flexible labor arrangements such as networks of subcontracting, outworking, and piecework. The use of such labor practices, involving growing part-time or casual work, tend to impact the most on the labor sector made up of vulnerable workers such as women, youth, and immigrants. In many cases the state has been supportive of such moves, especially in developing countries where informal practices are accepted so that a country can obtain comparative advantages with more regulated nations.

While the structuralists would argue that there are significant differences in the social and economic composition of the informal and formal economies, the neoliberal/legalists argue that these differences are legal, rather than structural, and are of the state's making. Structuralists wish to push for improved worker conditions, while neoliberal/legalists argue that worker protection will lead to a loss of employment opportunities. Nevertheless, proponents of both approaches tend to agree that the linkages between the sectors work to disadvantage those in the informal economy.

Small-Scale Enterprises

Since the 1980s another body of work to have emerged is that focusing upon the economic activities of small-scale enterprises. This is a diverse body of literature that tends to focus on concepts such as 'informalization' rather than the 'informal economy'. This literature is highly relevant to discussions on the informal economy because of the fact that small enterprises are so often the setting for informal labor practices, which may often cut across family/enterprise boundaries, as well as often being unregistered and outside formal recognition by the local state. Within this realm of studies, there has been a concentrated body of literature focusing upon clusters of small enterprises, in areas such as the 'Third Italy', as well as developing countries such as Indonesia. Some have drawn from these studies to apply arguments emerging from flexible specialization literature to small enterprises operating in developing countries – with mixed results as to the applicability of such a concept. Work on small enterprises in general, however, unlike many informal economy studies in the past, tends to take a closer look at individual actors, highlighting the importance of the social embeddedness of economic activities. Such an approach allows for the inclusion of important variables such as gender, ethnicity, class, religion, and local politics in studies of how people mobilize resources and use social networks to not only get by, but often to get ahead as well. The important role of such small-scale enterprises as a social safety net was especially notable after the beginning of the economic crisis in Southeast Asia in 1997 when thousands of people previously employed in formal work entered the realm of small enterprise and trade in Thailand and Indonesia. Indeed, here, as well as in Latin America in the 1980s, during structural adjustment in Africa, and economic transitions in the former Soviet Union and Eastern Europe, it has become plainly clear that employment in small-scale enterprises and trade, and the informal economy as a whole tends to grow during times of economic crisis.

Social Networks and Social Embeddedness

Closely associated with the work on the informal economy and small enterprises is a body of literature that is

even more heterogeneous, drawing upon interdisciplinary research from geography, economic anthropology, sociology, and economics. In essence, this research demonstrates that a common feature of informal activities is that they are facilitated by a wide variety of noneconomic actions, including reciprocal social relations involving kinship, friendship and neighborhood networks, and household, community, and other informal ties. Relations of production, consumption, and exchange in informal economies are therefore often deeply entangled in noneconomic relationships of trust and solidarity. The social networks view thus focuses on the organizational role of social ties, and rather than regarding informality as an absence of regulation *per se*, sees it as an alternative form of regulation functioning external to the framework of formal state bureaucracy. In more ways than one, this approach draws upon what social scientists with a substantivist leaning have argued since the 1950s, that is, there is no economy without cultural context, and local practices such as kinship ties and ethnic networks of trade partners are important elements in which the economy is unavoidably embedded.

Social networks play a role in social cohesion, the building of trust, and in defining community identity. They frequently operate within a framework of moral ethics that ensures mutual obligation and the right to subsistence for all members, acting as a 'safety net'. Such work is often closely associated with that on social capital, the networks and ties that can help people 'get ahead'. This approach is also being increasingly drawn upon for recent studies of informal small-scale enterprises and trade.

Social network and social embeddedness contributions offer perspectives that contest the traditional economic dualisms of work/nonwork, economic/noneconomic, public/private, and monetary/nonmonetary. Instead, these approaches recognize that informal activities frequently take place in domains that straddle and combine these dimensions. Following such an approach it could be argued that the informal economy includes a number of activities that involve no transfer of money at all, such as barter, the exchange of domestic labor, mutual-aid networks, and Local Exchange and Trading Systems (LETS), the latter operating a currency outside of the formal sector, to date most commonly found under this name in the UK.

The Causes of the Informal Economy

Naturally, as there are numerous definitions, approaches, and groups of participants, in turn there are a multitude of reasons put forward as to why the informal economy exists. Some of the more common explanations include government failures, for example, to provide adequate

social support and labor regulations, or more broadly to satisfy societal needs; or alternatively, excess regulation of the economy by the state. Over-urbanization and the inability of urban areas to absorb rural–urban migrants into ‘regular employment’ is often argued to play a role, especially in developing countries, China and India being key current examples. Economic restructuring and globalization are also often put forward as key causes of informal economy growth. Finally, another cause is people operating within the informal economy simply as an act of resistance to formal systems and the surveillance that so commonly comes with them.

Geographical Perspectives

The work of geographers has spanned all of these different approaches to the informal economy. For example, Terry McGee, one of the most foremost human geographers writing on Southeast Asia, has been a key supporter of the petty commodity production approach arguing that the dualistic approach was too simplistic, masking the realities of economic relationships in cities in the region and beyond. Indeed, geographers are valuable contributors to this field of study, bringing with them a concern for how local, on-the-ground realities are interwoven with economic and political changes at broader spatial scales, including national, regional, and global transformations; an understanding of the importance of place-based specifics to informal economy attributes; and an awareness and understanding of the heterogeneity of the livelihoods and survival mechanisms of those working in this sphere.

See also: Economic Geography; Globalization, Economic; Informal Sector; Informalization; Livelihoods; Networks; Networks, Urban; Political Economy, Geographical; Slums; Third World.

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Relevant Websites

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Informal Economy, International Labour Organization.
- <http://www.wiego.org>
Women in Informal Employment: Globalizing and Organizing (WIEGD).