

Rethinking the informal economy

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PICTURE any Indian city or town you know well. Except in its modern commercial and residential areas, the sidewalks are lined by barbers, cobblers, waste recyclers and vendors of vegetables, fruit, meat, fish, snack-foods and a myriad of non-perishable items ranging from locks and keys, soaps and detergents, to clothing. Head-loaders, cart pullers, bicycle peddlers, rickshaw pullers, camel, bullock and horse cart drivers and auto rickshaw drivers jostle to make their way along the streets through the maze of cars, trucks, vans, buses, scooters and motorcycles. On the street corners, even in some residential areas, there are countless small kiosks or stalls that sell goods of every conceivable kind.

Down the crowded lanes are small 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, produce or sell goods from their homes: garment makers, embroiderers, incense stick rollers, cigarette rollers, paper bag makers, kite makers, hair band makers, food processors, and others.

This picture can be invoked for most cities and towns in India and across the developing world. But such workers are not confined to developing countries. New York city has its share of pushcart vendors, street vendors, street-side performers and artisans, horse cart drivers, sweat-shop workers, industrial outworkers, and more. Indeed, industrial home-workers are to be found around the world, including garment workers in Toronto, embroiderers on the island of Madeira, shoemakers in Madrid, and assemblers of electronic parts in Leeds.

Other categories of informal workers common both developed and developing countries include casual workers in restaurants and hotels, sub-contracted janitors and security guards, casual or day labourers in construction and agriculture, piece-rate workers in sweatshops, temporary office helpers, and off-site data processors. Most workers in all of these categories of work are informally employed, without secure contracts, worker benefits or social protection.

Conditions of work and the level of earnings differ markedly among those who scavenge on the streets for rags and paper, those who produce garments on a sub-contract from their homes, those who sell goods on the streets, and those who work as temporary data processors. Even within countries, the informal economy is highly segmented by location of work, sector of the economy and status of employment and, across these segments, by social group and

gender. But most workers in the informal economy share one thing in common – the lack of formal recognition and protection.

During the 1950s and 1960s it was widely assumed 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.¹ This perspective was reinforced by the successful rebuilding of Europe and Japan after World War II and the expansion of mass production in Europe and North America during the 1950s and 1960s. By the mid-1960s, 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.

The Kenya employment mission, through its fieldwork and in its official report, recognised that the traditional sector had not just persisted but expanded to include profitable and efficient enterprises as well as marginal activities (ILO 1972). To highlight this fact, the Kenya 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 year before by a British economist, Keith Hart, in his 1971 study of economic activities in urban Ghana (Hart 1973).

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 these observers continued to believe that the informal sector in Kenya, Ghana and other developing countries would disappear once these countries achieved sufficient levels of economic growth or modern industrial development. Others 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.

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

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 1988). Meanwhile, structural adjustment in Africa and economic transition in the former Soviet Union and in Central and Eastern Europe was also associated with an expansion of employment in the informal economy.

Why does employment in the informal economy tend to expand during periods of economic adjustment or transition? 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 openly unemployed. Also, in response to inflation or cutbacks in public services, households often need to supplement formal sector incomes 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 subcontract (or out-source) the production of goods and services, and global integration reduces the competitiveness of many informal firms or self-employed producers vis-à-vis imported

goods (in domestic markets) and vis-à-vis larger, more formal firms (in export markets) (Rodrik 1997).

II

Although the interest in the informal sector has waxed and waned since its ‘discovery’ in 1972, it has continued to prove useful as a concept to many policy-makers, activists, and researchers concerned with labour issues because the reality it seeks to capture – the large share of the global workforce that remains outside the world of full-time, stable, and protected employment – is so important. At present, there is renewed interest in the informal sector worldwide. This reconvergence of interest stems from the fact that informal economy has not only grown worldwide but also emerged in new guises and unexpected places. For this reason, this renewed interest has been accompanied by significant rethinking of the concept.

In recent years, a group of informed activists and researchers have worked with the ILO to broaden the concept and definition to incorporate certain types of informal employment that were not included in the earlier concept and definition (including the official international statistical definition) of the ‘informal sector’. They seek to incorporate in this new concept or definition the whole of informality, including both enterprise and employment relations – as manifested in industrialised, transition, and developing economies; and the real world dynamics in labour markets today – particularly the employment arrangements of low-income workers.

These observers have proposed a new definition, concept and terminology that shifts the focus from enterprises that are not legally regulated to employment relationships that are not regulated, stable, or protected. Their new definition of the ‘informal economy’ focuses on the nature of employment rather than 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 secure contracts, worker benefits, or social protection, both inside and outside informal enterprises, including self-employment in informal enterprises (small unregistered or unincorporated enterprises), and comprising of employers, own account operators, and unpaid family workers in informal enterprises.² Second, wage employment in informal jobs (without secure contracts, worker benefits or social protection for formal or informal enterprises, for households, or with no fixed employer), including employees of informal enterprises, casual or day labourers, domestic workers, industrial outworkers (including

home-workers), unregistered or undeclared workers and some sub-sets of temporary or part-time workers.³

The recent reconvergence of interest in the informal economy, and this new definition of the ‘informal economy’, reflects a fundamental rethinking of some earlier common assumptions about the ‘informal sector’. Key elements of this alternative way of thinking are summarised below:

Significance and permanence of the informal economy. The informal economy is growing and is not a short term but a permanent phenomenon; and not just a traditional or residual phenomenon but a feature of modern capitalist development, associated with both growth and global integration.

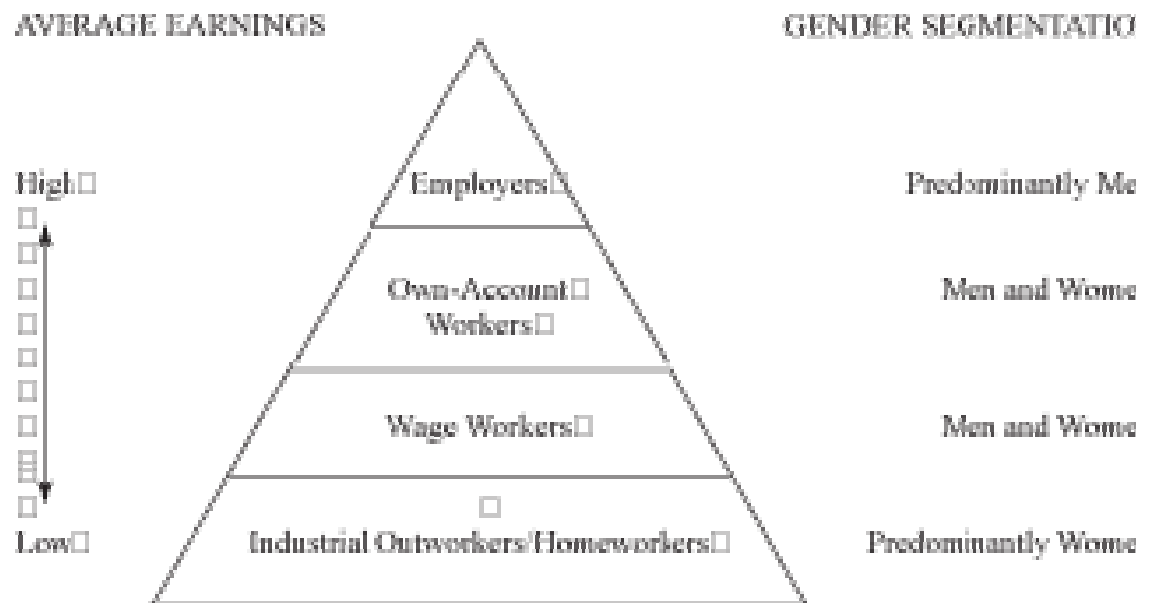
Legality or semi-legality of the informal economy. While production or employment arrangements in the informal economy are often semi-legal or illegal, most informal workers and enterprises produce and/or distribute legal goods and services. Many activities in the informal economy do not generate enough output, employment or income to fall under existing tax brackets, though most owner operators are willing to pay the costs of registration and pay taxes, were they to receive the incentives and benefits of formality (enjoyed by registered businesses). 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 and, most fundamentally, operating outside the statutory legal framework, seen to have more costs than benefits.

Continuum of economic relations. 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 intermediate categories in between. Also, workers and units are known to move relatively easily and quickly across the continuum and/or to operate simultaneously at different points in the continuum. Moreover, the formal and the informal ends of the economic continuum are often dynamically linked.

Segmentation of the informal economy. The informal economy consists of a wide range of informal enterprises and employment relations. Despite its heterogeneity, there are meaningful ways to classify the informal economy, as above.

The renewed interest in the informal economy, broadly defined, has generated new research on and understanding of the linkages between informality, poverty, and gender. There is a *significant overlap* between working in the informal economy and being poor. But there is *no simple relationship* between working in the informal economy and being poor. The *relationship* between *informal work* and *low income* appears only when informal work is analyzed by economic sub-sectors and by status of employment (employer, own account operator, waged worker).

Perhaps the best way to summarize these linkages is to do so graphically through the following pyramid or 'iceberg'. This 'iceberg' depicts the various segments of the informal economy, categorized by employment status: at the tip is the most visible or best known segment – the employers/micro-entrepreneurs; at the base is the least visible and least understood segment – the industrial homemaker. From available micro-surveys and official statistics, two stylized global facts emerge about the links between informality, poverty and gender. The first is that men tend to be over-represented in the top segment while women tend to be over-represented in the bottom segment, while the shares of men and women in the two intermediate segments tend to be more equal.



The second is that average income or earnings decline as one moves down from the tip to the base of the iceberg. An additional fact, not reflected in the iceberg, is that women tend to earn less even within specific segments of the informal economy due to gender differences in wages and earnings based on the type of activity and the volume of work/output. The net result is that there is a significant gender gap in income within the informal economy, with women earning less on average than men.

III

Compiling statistics on the size, composition and contribution of the informal economy is an extremely difficult exercise. The most serious limitation is that very few countries have undertaken regular surveys on the informal sector and only two or three countries have collected the data that provide for measures of informal employment outside informal enterprises. Further, the available data are not comprehensive. Most countries exclude agriculture from their measurement of the informal sector and some measure only the urban informal sector. In addition, there are 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 comprehensive set of estimates of the informal economy in developing countries using indirect methods where necessary.⁴

* Informal employment comprises one half to three-quarters of non-agriculture employment in developing countries: specifically, 48% of non-agricultural employment in North Africa, 51% in Latin America, 65% in Asia, and 72% in sub-Saharan Africa. If South Africa is excluded, the share of informal employment in non-agricultural employment rises to 78% in sub-Saharan Africa. If comparable data were available for 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 of informal employment. In these countries the inclusion of informal employment in agriculture increases significantly the proportion of informal employment: from 83% of *non-agricultural* employment to 93% of *total* employment in India; from 55% to 62% in Mexico, and from 28% to 34% in South Africa.

* 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 (60-70%) of informal employment (outside of agriculture) than wage employment.

* Informal wage employment is also significant in the developing world, comprising 30 to 40% of informal employment (outside of agriculture).

* Informal employment is a larger source of employment for women than for men in Africa (84% of women workers) and Latin America (58% of women workers). In Asia, the proportion of women and men non-agricultural workers in informal employment is roughly equivalent (65%).

IV

To both reduce poverty and increase growth, a comprehensive and innovative policy response to the informal economy is required. After all, in most developing countries, well over half the workforce and a sizeable share of economic units operate outside the scope of existing legislation, regulations and policies and, therefore, do not receive the incentives, benefits or protection thereof.

What follows is a working policy framework developed by the global research policy network Women in Informal Employment: Globalizing and Organizing (WIEGO). Comprised of membership based organizations of informal workers, labour-related NGOs, research and statistical institutions, and international development agencies, WIEGO seeks to increase the visibility and voice of those who work in the informal economy and to promote supportive policies for the informal workforce worldwide. It does so by promoting improved research, statistics and policy analysis on the informal economy, and by helping to strengthen the research and policy analysis capacity of membership based organizations of informal workers.

Clearly, there is no single policy prescription for the informal economy. Instead, what is both desirable and feasible is a working policy framework, outlining an approach to policy formulation that can be applied in different contexts by different stakeholders. Based on the experience and research of its varied membership, drawing on the lessons learned and the good practices that emerge, WIEGO has developed the following working framework, a framework that it seeks to update and refine on an ongoing basis.

The overarching policy goals of an informed policy approach should be to: *promote informal enterprises* – to increase their assets, productivity and competitiveness through a mix of service provision (micro-finance and business development services) and policy interventions; *improve informal jobs* – to secure the rights of workers through extending the scope of existing legislation, promoting collective bargaining agreements and/ or enforcing labour standards; *protect informal workers* – to provide insurance

coverage for illness, maternity, property, disability, old age, and death through extending existing schemes and/or developing alternative schemes; and *promote the 'voice' of informal workers* – to promote the organization of informal workers and their representation in relevant policy-making or rule-setting institutions.

The policy-making process should be participatory and inclusive – consulting informal workers and their organizations and involving as many different stakeholders as possible. It should also allow for policies to be developed through negotiation between appropriate government departments and relevant stakeholders, based on a shared understanding of the economic importance of informal workforce and informal enterprises.

As noted earlier, virtually all policies affect one or other segment of the informal economy. But four policy areas have particular impact on the informal economy: (i) *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); (ii) *labour policies* – the scope of labour legislation, labour policies, and collective bargaining agreements should be expanded to cover all categories of workers; (iii) *urban regulations* – appropriate regulations and equitable allocation of urban space should be developed through a consultative process and negotiated settlements between all stakeholders; and (iv) *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.

In developing a policy approach in different settings, the following guiding principles should be kept in mind. Adopting a *context-specific* approach: Local and national circumstances are the most important determinants of appropriate policy. Adopting a *gendered* approach: Relations between men and women, their different positions in the economy, and their access to and control of recourse are crucial to understanding the informal economy. In the informal economy, a gendered approach is a pro-poor approach. Supporting women's work will, in effect, lead to support for poor households and poor children. Adopting a *democratic and participatory* approach: Those who work in the informal economy should be involved in the formulation of relevant policies. The inclusion of the voice of all

stakeholders in making policy is crucial to its success. The way ahead has to be one of negotiated solutions; and these negotiations have to be about rights and responsibilities. The input of informal workers and their organizations is essential, based on recognition of their right to organize. *Mainstreaming governance* of informal economy: Institutions that govern the informal economy should be those dealing with economic planning and development. Locating governance in traffic, health, police, or social departments ignores its economic aspects. The goal must be to, over time, simplify the institutional mechanisms governing the informal economy and integrate them as far as possible with those dealing with the formal economy. Promoting a *dual policy focus* that recognises and supports both informal enterprises/own account workers and informal jobs/paid workers. The lack of recognition and understanding of these two components of the informal economy often hinders the development of appropriate policy. Of course, developing appropriate policy is never an easy task. However, with the involvement of the organizations that represent informal workers, particularly women, it is likely to succeed.

V

How does India fit into this global picture? From a global perspective, several aspects of the informal economy in India stand out: in absolute terms, its sheer size and significance and, in relative terms, its increasing visibility in official statistics and official policy circles. In regard to its visibility, it is not a mere coincidence that India is the birthplace and home of the largest trade union of informal workers in the world, namely, the Self Employed Women's Association (SEWA). More fundamentally, the informal economy is where the poorest and most disadvantaged groups in India secure their livelihoods, so that any analysis of the process of accumulation and class formation in India needs to understand these processes through the lens of the informal economy. Also, the sheer size and continuing growth of the informal economy in India challenges a key neo-liberal assumption about the informal economy, namely, that it would decline as economies liberalized and grew.

The informal workforce in India is an estimated 370 million workers, nearly 93% of the total workforce.⁵ The informal workforce is comprised of three main segments: informal employment in agriculture (including small farmers and agricultural labour), informal employment in informal enterprises (including employers, own account workers, and employees), and informal employment outside informal enterprises (including industrial homeworkers sub-contracted

by formal firms and domestic workers engaged by households).

Women account for about one-third of the total informal workers. Informal employment is particularly significant in agriculture, trade and construction accounting for 94-99% of workers in these sectors. Although data is not available on the contribution of informal employment outside of informal enterprises, the informal sector alone, or the unorganized sector as it is called in India, accounts for 60% of NDP, that is, the Gross Domestic Product minus depreciation.

Because of its sheer size, Indian researchers and statisticians have long recognized the importance of the informal sector, that is, all enterprises outside the organized sector comprised of government/semi-government institutions, registered enterprises and recognized educational institutions. India is also one of only two or three countries in the world that have collected data that provide a base for measuring the conceptual whole of informal employment, that is, both inside and outside informal enterprises. This is due in part to the fact that in the mid-1990s, India was asked by the UN Statistical Commission to convene the International Expert Group on Informal Sector Statistics (called the Delhi Group) and, in that capacity, has played a lead role in the push for the new broad definition of the informal economy. This is also due in part to the fact that since the mid-1990s, an informed group of users – led by SEWA in collaboration with two leading research institutions (NCAER and GIDR) – has requested and worked with the National Sample Survey Organization to develop surveys for the improved measurement of the informal economy.

Given the visibility of the informal economy in official statistics, and given the pressure from informed activists and researchers, the Government of India has set up two recent commissions that have drafted legislation and/or recommended policies in support of the informal economy, notably, the National Commission on Self Employed Workers and the recent National Commission on Labour. Also, recently, the Ministry of Labour adopted a National Policy on Street Vendors. And one or two state governments have drafted legislation and/or policies in support of informal workers, most recently, the Government of Madhya Pradesh.

In India, official statistics do not collect data on the incomes of workers. As a proxy for income, however, a recent study computed the value-added per worker from a survey of the informal sector (Unni 2001). In rural areas, the average annual income of all workers in informal enterprises was below the poverty norm. In urban areas, although the average income of *all* workers in informal enterprises was above the

urban poverty norm, the earnings of *own account* workers was below the urban poverty norm.

For all India, the scale of operation of the enterprise had a great effect on the capacity to earn and generate incomes. Workers in informal enterprises with hired workers earned far more on average per year (US\$816) than workers in own account operations (US\$375) (Ibid.). In brief, the chances of being poor if one works in informal enterprises is very high for all workers in rural informal enterprises and for all own account workers in India.

For several decades, from the 1950s-1980s, neo-liberal economists assumed India had a large informal economy because it pursued an import substitution strategy, it enforced excessively protective labour legislation and its economy grew slowly. Over the last decade, India has enjoyed a growth rate in gross domestic product of about 6.5% per annum. However, a recent Task Force on Employment Opportunities set up by the Planning Commission in India in 2001 pointed out that even a continuation of the GDP growth at this rate is not likely to bring about significant change in the employment situation. This is because much of the growth has been capital and information intensive rather than labour intensive. For example, there has been limited growth in formal employment in the manufacturing sector. Also, as public enterprises are closed or downsized many of the retrenched workers have not found alternative formal employment. As a result, a growing proportion of the workforce in India is informal.

In sum, from a global perspective, the informal economy in India represents a very important and interesting case that serves to illustrate the key elements of the new understanding of the informal economy. Given the size and significance of the informal economy in India, and its linkages with both poverty and growth, it would be difficult to fully understand the workings of India's economy, its development strategy and associated transformations without understanding the informal economy. Thus, from a national perspective, deepening the understanding of the informal economy in India would appear to be an important – indeed, essential – exercise.

Footnotes:

1. The formal or modern sector is comprised of regulated small and large enterprises (operating out of factories and/or offices) and of regular, stable and protected employment.
2. In the earlier conceptualization of the informal sector, informality was seen as a characteristic of enterprises not of employment relations. For this reason, the 1993 ICLS definition of the informal sector includes all employment, both formal and informal, inside informal enterprises. Formal employment within informal enterprises is a relatively rare phenomenon. In line with the expanded concept of informal economy, the term 'informal

enterprises' is used in this report instead of 'informal sector' except in two sections. The term 'informal sector' is used in the section on contribution to GDP in Chapter 2A in conformity with the framework used to distinguish the contribution of the informal sector within the household sector; and in Chapter 3A because the three countries – India, Mexico, and South Africa – directly measured employment in the informal sector.

3. Temporary and part-time workers who are covered by labour legislation and statutory social protection benefits are not included in the informal economy (see Section 2a for a discussion of the benefits of temporary and part-time workers).

4. This section draws exclusively 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, South Africa, Mexico, and OECD countries written by, respectively, Jeemol Unni, Debbie Budlender, Rodrigo Negrete, and Françoise Carre.

5. It should be noted that not only India, but all of the countries in South Asia, are noted for the size of their informal economies. The two regions of the world where the informal economy represents over 80% of the total workforce are Sub-Saharan Africa and South Asia.

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