

PRO AND AGAINST INFORMAL ECONOMY*

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Abstract: *The informal economy is a reality that influences the lives of people directly at the planetary level. The term "informal economy" is used to include all workers and businesses in rural or urban areas working in the informal environment. It is emphasized that informal employees are not able to be recognized and defended by the legal regulations in force. The global changes in the field of information and communication technologies have generated increased labor market competitiveness. Under these circumstances, there has been a more flexible relationship between employees and employers. The main purpose of the article is to examine the pros and cons of the informal economy. Knowing these arguments can be a source of effective measures aimed at counteracting the negative effects that such activities may have. Simultaneously encompasses a theoretical approach to the informal economy, describing areas where it is highlighted, the factors that generate it, its dimensions, the theories put forward by the various economically-specific schools describing this concept, research methods.*

Keywords: informal economy, informal workers, informal enterprises, formal economy.

JEL classification: J46, J80.

1. Introduction

Over time, there have been various attempts to define the concept of informal economy. However, a unanimously accepted definition has not yet been formulated. Smith (1994: 18) defines the informal economy as "market-based production of goods and services, whether legal or illegal, that escapes detection in the official estimates of GDP". Other definitions given to the informal economy argue that "informal economy includes unreported income from the production of legal goods and services, either from monetary or barter transactions - all economic activities which would generally be taxable were they reported to the state tax authorities" (Schneider, 2002: 3), "the informal economy comprises legal economic activities undertaken by small units (individual or family) both in the production of goods and in trade, transport, the provision of services that generate a production provided in the System of National Accounts and which are practiced at the limit of socio-fiscal systems and regulations imposed by the state" (Craiu, 2004: 48). Thus there is a gap between the different definitions assigned to the informal economy. We consider beneficial the emergence of the distinction that can be made between the underground economy and the informal economy, the latter being a subsector of the underground economy. Generally speaking, activities specific to the informal economy are those that involve the production of legal goods and services, but are not registered or regulated of the state.

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The periods of economic crisis or transition have the effect of increasing the workforce in the informal sector due to the closure of certain businesses, generating massive layoffs. Most of the time, those who do not have the opportunity to engage in formal business or set up their own business, choose to work in the informal field (Chen, 2012).

Although the risks to which they are subject are far more prominent, than if they were working in the formal field: precarious work, violation of labor rights, lack of legal and social protection, have no opportunity to be represented in relations with officials, have no access to infrastructure public, low wages, most live below the poverty line. However, employment growth in the informal economy appears in developing countries, and in times of economic development.

The informal economy is found in various areas of activity: agriculture, commerce, industry, tourism, various services, other areas where micro-enterprises operate, where homeworking is viable etc. The socio-professional categories specific to the informal economy are: street vendors, garbage collectors, housekeeping workers, houseworkers, factory workers, micro-enterprise owners, self-employed or employers family, apprentices.

Chen (2012) points out that there are notable differences in gains in the informal economy. Thus, informal employers benefit from the highest earnings, while industrial and home workers have the lowest income. Young people between the ages of 15 and 24, as well as the elderly over 55, are more likely to work in the informal field compared to the average age. Young people choose to emigrate most of the time, but elderly people are more stable in opting for jobs in the informal economy (Voinea et al, 2011).

2. Advantages of the informal economy

The informal sector is an opportunity for those who are unable to find a job in the formal sector, being a way of survival for those living below the poverty line. Income earned by informal workers helps them maintain their families. Most of these have dependent children and older people who do not have other sources of income. However, the informal economy is expanding due to important labor forces, contributing to economic growth. Production in the context of low wages, it encourages growth in exports and the development of industries (ILO, 2002). Those working in the informal economy must be recognized as contributing to state revenue and integrated into government regulations. So, the risks to which they are subject are diminished, they will be able to enjoy rights. The work of informal entrepreneurs is dynamic, with innovative strategies implemented in order to remain in the global competition. Entrepreneurs should be encouraged to develop their businesses by applying expansive policies, so that the way to formalize is made easier. The principles that affects the demand for labour are: "changes in the demand for a firm`s product will be reflected in changes in its demand for labour, the structure of the firm plays an important role in determining its demand for labor, a change in other factors of production that a firm uses will change its demand for labour" (Colander, 2006: 394). A positive and open attitude to complying with state laws is an important starting point. Accepting economic diversity is important for the development of a nation. Informal workers have a tremendous capacity to adapt, which should be harnessed and developed by providing access to innovative educational programs.

3. Against the informal economy

The negative consequences of the informal economy are related to the inability of governments to collect taxes due to the fact that informal activities are not declared. Thus, the state's income is influenced. The same social security funds are no longer collected, which could have been invested in various areas such as infrastructure, the purchase of goods and services, in order to improve the living standard of the population. A study done in

121 countries between 1976-2009, shows that "political instability, political polarization, and the authority pattern seem to play a role in determining the incentives of government to develop the tax capacity of the state and the development of the informal economy" (Elbahnasawy et al. 2016: 39).

The emergence of disagreements between those working in the informal field and those working in the formal field, because the latter have to bear high taxes, given that informal groups ignore taxes established by law, not respecting the rule of law and government."Informal enterprises create unfair competition for formal enterprises by not paying taxes or social security contributions for workers or avoiding other business costs incurred in the formal economy" (ILO, 2002: 4). A research made in Brazil and Mexico reveals that the mobility of informal workers to the formal field implies lower costs if they are carried out in the same industry. While any mobility between industries at the time of informal entry or status change is less expensive in informal sector (Arias et al. 2018).

Another problem that occurs in the informal field is the deficiencies that arise in working conditions and the protection of employees. Most times, they have to work in precarious conditions, without complying with work standards, hours worked, average salary, no holidays or other incentives. Informal workers do not have social insurance or health insurance, which they could benefit from in the event of accidents at work or death. They face discrimination, corruption and lack of transparency of the authorities' regulations. "Because informal activities are on the fringes of the law, public authorities sometimes confuse them with criminal activities and therefore subject them to harassment, including bribery and extortion, and repression" (ILO, 2002: 3).

"Developing nations of Africa, Asia and Latin America are major source countries for international skilled labour migration into Organization for Economic Cooperation and Development (OECD) countries. This implies that such migrants take up jobs at level much lower than what their skill set can offer based on their professional qualifications. This phenomenon leads to brain drain in source countries and to brain waste in destination countries" (Yewande, 2018: 2). If these workers could use their skills, they would benefit from higher wages, better working conditions and a higher standard of living. A study made in Hat-Yai, a city in South of Thailand, on the informal hair and beauty services workers, shows that they only have basic skills in this area, because the budget does not allow them to pay specialty courses or take free days to participate in such courses. In particular, it is highlighted the need for funds of institutions that prepare such trainees (Peter-Cookey and Janyam, 2017). The basic need for informal businesses is that of funding, because few employers have the opportunity to contract a bank credit. Consequently most of them get to borrow money from other unsafe sources (ILO, 2002).

4. Factors that generate the emergence of the informal economy

The factors that drive employment growth in the informal field are: the inadequacy of legal and institutional regulation to the various changes that occur in the labor market, the policies implemented by the governments of the countries, the strategies adopted by some enterprises to use undeclared work force, in order to minimize the costs that it has to bear, the migration phenomenon towards the urban area from less developed rural area, that offers more employment opportunities, the migration to developed countries, the marginalization of those suffering from contagious diseases such as HIV / AIDS, impossibility to join trade unions or other collective associations (ILO, 2002).

5. Dimensions of the informal economy

The process of assessing the dimensions that the informal economy has in the world is a difficult one, because nations have attributed different interpretations to this concept. "The contribution that developing countries make to the world's gross product is low, although the largest share of the world's population is concentrated in these areas, and there are also raw materials that can be used in industry. In terms of GNP per capita, developing countries and territories are mostly in low-income groups" (Florea, 2006: 31).

The most popular methods used to measure the size and mode of development of the informal economy are the following: chestnut method, monetary method, analysis of labor market statistics, households, analysis of national accounts, tax method. Friedrich Schneider (2002) asserts that there are three different methods used at the modal level: direct approaches, indirect approaches, the model approach. Direct approaches are based on the application of surveys and samples, following discussions with volunteers, tax audits and other compliance methods. Another direct method to estimate the informal phenomenon is based on studying the difference between declared earnings and the objectives the state has set at the fiscal level. Indirect approaches use various macroeconomic indicators to get information on developing the informal field. The model approach examines in particular the effects of the informal economy on the labor force, money market and output.

Table 1: The size of informal economy of 15 OECD – European Countries

		Informal Economy in % of GNP 1999/2000	Informal Economy (current USD in billion) 2000	Informal Economy GNP per capita
1	Austria	10,2	189.7	2572.4
2	Belgium	23,2	531.4	5693.3
3	Denmark	18,2	291.4	5875.0
4	Finland	18,3	218.5	4598.8
5	France	15,3	1996.1	3736.3
6	Germany	16,3	3030.6	4094.6
7	Greece	28,6	329.2	3420.6
8	Ireland	15,8	126.7	3580.3
9	Italy	27,0	2880.1	5443.2
10	The Netherlands	13,0	477.8	3246.1
11	Norway	19,1	306.0	6595.2
12	Portugal	22,6	233.3	2513.1
13	Spain	22,6	1248.4	3408.1
14	Sweden	19,1	428.7	5183.7
15	Switzerland	8,8	223.3	3356.3
	Average	18	894	4150

Source: Schneider (2002: 16)

Table 1 shows that countries like Greece 28.6 %, Italy 27%, Spain 22.6%, Belgium 23.2% have a higher percentage of the informal economy of GNP, unlike the other countries with lower percentages, Switzerland 8.8%, Austria 10.2%, Germany 16.3%. The reasons that could explain this difference, relate to high costs to enter the formal field and difficulties

encountered in applying the regulations, the preponderance of seasonal activities carried out in countries with a larger share of the informal economy.

Table 2: The size of informal economy of 23 African Countries

	Informal Economy in % of GNP 1999/2000	Informal Economy (current USD in billion) 2000	Informal Economy GNP per capita
Algeria	34,1	172.6	538.8
Benin	45,2	9.7	167.2
Botswana	33,4	17.6	1102.2
Burkina Faso	38,4	8.3	80.6
Cameroon	32,8	27.2	190.2
Cote d' Ivoire	39,9	34,4	239.4
Egypt, Arab Rep.	35,1	349.8	523.0
Ethiopia	40,3	25.5	40.3
Ghana	38,4	18.5	126.7
Madagascar	39,6	15.1	99.0
Malawi	40,3	6.7	68.5
Mali	41,0	9.3	98.4
Morocco	36,4	118.1	429.5
Mozambique	40,3	14.4	84.6
Niger	41,9	7.6	75.4
Nigeria	57,9	212.6	150.5
Senegal	43,2	18.5	211.7
South Africa	28,4	348.3	857.7
Tanzania	58,3	52.4	157.4
Tunisia	38,4	71.3	806.4
Uganda	43,1	26.5	129.3
Zambia	48,9	13.6	146.7
Zimbabwe	59,4	42.4	273.2
Average	42	70	287

Source: Schneider (2002: 6)

As can be seen, the share of the informal economy of GNP is higher in African countries, such as: Zambia 48.9%, Nigeria 57.9%, Tanzania 58.3%, Zimbabwe with a maximum of 59.4%, unlike of the European countries with lower percentages of the informal economy in GNP, such as Austria 10.2%, Germany 16.3%, the Netherlands 13.0%, France 15.3%, Switzerland with a minimum of 8.8%. There is a major difference between the United States and African countries in terms of the share of the informal economy of GNP as can be seen in Table 3. In sub-Saharan Africa, the percentage of the informal economy is increased in countries like: Niger 41.9 %, Benin 45.2% Zambia 48.9%, Nigeria 57.9%, Tanzania 58.3%, Zimbabwe 59.4% as can be seen in Table 2. African countries have a share of the informal economy so high because: the vast majority of people in these regions live from informal activities such as selling various products on the market, processing food, carrying out activities across borders, the degree of economic regulation, lack of education, the HIV/AIDS pandemic.

Table 3: The size of the informal economy of 4 OECD Countries

		Informal Economy in % of GNP 1999/2000	Informal Economy (current USD in billion) 2000	Informal Economy GNP per capita
1	Canada	16,4	1101,1	3465,3
2	United States	8,8	8646,3	3000,8
3	Australia	15,3	580,1	3096,7
4	New Zealand	12,7	58,5	1649,7

Source: Schneider (2002: 18)

The United States has one of the lowest weights of the informal economy of 8.8% equal to that of Switzerland. New Zealand, Canada and Australia are highlighted in Table 3, with a low percentage of the informal economy, like the United States of America. These countries have a low level of informal economy, because they have implemented various policies aimed at reducing tax evasion.

6. Theories on the informal economy

Chen (2012) lists four schools of thought who have formulated various theories about the informal economy, describing the specific aspects that define it:

- The Dualist school
- The Structuralist school
- The Legalist school
- The Voluntarist

6.1. The Dualist school

Dualists perceive the informal economy as a way of survival in the times of recession of those who live in very low incomes. They believe that the source of the phenomenon of the informal economy is the discord between the number of those who want to engage and the changes in the industrial, as well as the existence of a shortage of skills, making them difficult to adapt to the modernization of society.

6.2. The Structuralist school

Structuralists believe that capitalist firms manage to resist global competition, thanks to micro-enterprises whose employees are working to reduce costs. Unlike dualists, structuralists support the existence of strong connections between the two economies, both formal and informal. Employers and enterprises in the informal field have the role of providing goods and services at low cost to those in the formal field. Therefore, it is necessary to balance existing links, between micro-enterprises and large-scale firms.

6.3 The Legalist school

Representatives of the Legalist school highlight the decisions made by informal micro-enterprises to reduce costs, avoid time-outs, generated by the recording process. Thus, without property rights, they are unable to turn their assets into capital that could be used for economic purposes. It encourages simplification of registration procedures, in order to facilitate access to the formal economy.

6.4. The Voluntarist

The voluntarists claim that entrepreneurs are discouraged, because they do not see a positive relationship between benefits and costs, when they want to register their

businesses. Representatives of this economic trend consider that the informal economy and the formal economy are separate realities that do not influence each other.

7. Conclusions

In this article, we have shown that there is no unanimity of views on defining the informal economy. It highlights difficulties in measuring the dimensions of the informal economy and the effects it has on the formal economy. Different economic methods can help us estimate its size. Although, there are many difficulties in measuring the dimensions of the informal economy and analyzing the effects this phenomenon has on the formal economy, there is progress. We have identified the causes that generate the phenomenon of economic informality. Knowing the pros and cons of the informal economy is very important. Governments have tried to take various measures to manage the negative effects that such activities may have. Thus, measures can be taken to reduce excessive bureaucracy in order to encourage the registration of informal enterprises, the cost of business transactions, the reduction of social security and health insurance contributions, the creation of programs to facilitate access to education, training those skills needed to find a job in the field of formal economics, and to adapt more easily to social and economic realities. Another goal to be achieved is to remove discrimination against people suffering from HIV-AIDS or other communicable diseases. The majority of such reactions arise from other citizens, because of the lack of information on these issues. It is not only people who suffer, but also family members who are often children or elderly people who fail to sustain themselves. In such a situation prevention programs are also important, preventing the spread of such diseases. Opening up a dialogue between authorities and informal workers is necessary to get to know the realities of the informal field of work and to give them the opportunity to express their needs. The informal economy is different, but not irreconcilable with the formal one, because it responds to the needs of society, to an existing demand on the market. Micro-enterprises in the informal field generate new job creation.

The informal economy seems to have been in various forms, in almost all economic areas. Theories of the informal economy converge to the idea that a more careful analysis of this reality is needed to identify alongside the negative aspects and potential positive aspects.

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Bio-note

Lavinia Stan is a *PhD student* of the *Doctoral School of Economics, University of Oradea*. As a PhD student, Lavinia focused on studying the labor market and the effects of the informal economy on it.

Florica Ștefănescu is a *professor* of the *Doctoral School of Economics, University of Oradea*. The author is a member of various professional associations and research teams.