

## Employment in the Informal Sector of the Economy

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### Abstract

*In this paper we aim to present some aspects regarding employment in the informal sector of the economy as well as the main aspects that distinguish the informal sector of the economy from the formal sector.*

*We will refer to the structure of the informal sector in terms of occupation, as well as to its main features and traits, focusing on the three main criteria: the social, political and economic criterion.*

*With regard to the structure of the informal sector, we will focus on the three categories of labor force, small enterprises (micro-enterprises) or formal (registered) firms but also part-time and informal activities.*

**Key words:** informal employment, employment in the informal sector

**J.E.L. classification:** J20, J21, J22

### 1. Introduction

Economics now operates only with notions, concepts and phenomena that take place in the *formal economy*, that is, everything that is subject to regulation. In this respect, *informality* could be considered, in my opinion, a lack of *formality*, an unusual phenomenon, an exception to what is considered *normal* in economic science, that is, from *formality*.

As Taleb says, there are two ways to study social phenomena. The first is to turn off the extraordinary and to focus on *normal*, and the second approach involves studying the most unusual forms of a phenomenon to understand it, especially if it has an extraordinary effect. Almost every social life event is caused by rare shocks and fluctuations, but with many consequences. However, almost everything that is studied from social life requires only a *normal* analysis (Taleb, 2009, p.23). For this reason, Taleb recommends that analysts and social experts focus more on *extraordinary* phenomena and rare and less common phenomena. Taleb considers it important to study the extraordinary phenomena, which he calls plastic, *black swans*, as they can bring essential information that can be explained more easily by ordinary events.

Taking a parallel with Taleb's opinion, I think that the study of *informality* can bring extra knowledge that could help researchers and even economic science as a whole by making it easier to understand the context of economic and economic phenomena how formal economy mechanisms work.

Research on the informal sector of the economy is also necessary for the following reasons (Dinga, 2009, pp. 295-296):

- The informal economy has a significant influence on labor supply and demand, money supply in the economy, demand and supply of goods and services etc;
- The informal economy has a significant influence on the economic behavior of all economic actors, namely: individuals, economic agents and the state;
- The informal economy can both replace and complement the formal economy;

- The informal economy is not only conjectural, its existence being as real and perennial as the formal one, which is why it can not be eradicated, but at the very least limited to a level considered acceptable and controllable;
- The informal economy seems to be, together with the bureaucratic system of the state, a regulator of micro- and macro-economic equilibria and imbalances;

## **2. Literature review**

Labor market informalities have been approached in the work of many researchers, but the main studies we report when talking about employment in the informal sector of the economy are those of Keith Hart (1973), John Harris and Michael Todaro (1968) , Gary Fields (1975, 2008), Guilermo Perry, William Maloney and Col. (2007).

## **3. Research methodology**

For this research we used qualitative research methods and emphasis was put on descriptive and explanatory methods.

## **4. Criteria for analyzing the informal sector**

Informality exists all over the world, but its share in the economy varies from country to country, depending on: degree of development, implicit by size of labor productivity, living standard, local tradition and specificity, etc.

Informality is all the more so: the degree of development of the country and the standard of living of citizens are lower, labor productivity is lower, the level of corruption is higher, regulations are more burdensome, law enforcement is more arbitrary and impartial (Perry , Maloney and Co., 2007, p. 18).

A complex analysis of the informal system can be made taking into account three main criteria: political, economic and social criteria (Gerxhani, 2004, pp. 3-6, Harding, Jenkins, 1989).

Depending on these key criteria, a number of other sub-criteria can be defined, which are used to define a mix of informal sector activities.

The main sub-criteria regarding the political aspect are:

- Government regulations;
- Illegal activities;
- Gross National Product (GDP).

These sub-criteria, following analyzes, can show the influence that the informal sector (involving the lack of government regulations, illegal activities and, as a consequence, substantial errors in GDP measurement) has on politics and vice versa.

The main sub-criteria for the economic aspect are:

- the labor market (including undeclared work, no social benefits, no suitable working conditions, etc.). Based on this criterion, we can define the informal sector as the total amount of all revenue-generating activities, excluding those based on contract work and legal regulations.
- undeclared income or tax evasion. The definition of the informal sector, based on this criterion, is the sum of all undeclared taxable income, with the intention of evading taxes.
- the measure of the activity. This criterion refers to the number of non-legally employed persons.
- professional status (self-employed workers, family workers, apprentices, employees, etc.). This criterion is intended to distinguish between employed and self-employed workers.
- the status of an activity towards regulations. This criterion takes into account the relationship of an activity or business to government regulations, whether or not they are legally registered.

- national statistics and gross domestic product (GDP). The informal system causes distortions in the GDP calculation, as informal activities escape accounting records and are therefore not reflected in GDP.

The third criterion, the social one, has several sub-criteria:

- Social networks or ease of entry into the informal system. It has come to the conclusion that it is very easy to enter the informal system through the *knowledge* method. *Friend of a friend* are keywords and the method of informal entry. This type of social network is very important in dividing the underground economy into different areas.
- Autonomy and flexibility. Many participants in the informal sector, especially in developed countries, choose this sector for more autonomy, flexibility and freedom of movement compared to the formal sector.
- Survival. This criterion is not specific to developed countries, but only to the poor.

## 5. Characteristics of the informal sector

The informal sector differs from the formal one through a series of specific features. In the view of some authors, the most important features of the informal sector are (Perry, Maloney & Co., 2007, pp. 13, 51, Renooy, 1990, Sandmo, 1981, Gerxhani 2004, pp. 18; Fields, 2008, pp. 17:

- high income inequality;
- market power is linked to informality and most often to inefficient institutions;
- the relatively small (on average, slightly more than a year) period in which workers work in the informal sector;
- a higher level of flexibility in the labor market than in the formal system;
- informal activities take place both outside and within the formal system and interact with formal ones;
- is very fragmented;
- low productivity;
- lack of official regulations;
- there is a combination of various informal activities, because sometimes only one activity does not produce enough income;
- represent an important element of masked unemployment;
- there is great ease of entry into the informal sector through lack of bureaucracy;
- represent the gateway to the labor market, especially for young people, unskilled workers and married women and children;
- goods and services are cheaper than in the formal sector;
- is based mostly on social, family networks.

The economic features of the *dual economy* (informal) can be divided into three categories (Dinga, 2009, pp. 299-300):

• **Generative features** - subtask; over-profiling or overpayment of wages, profits or other net results of activities; the subunit report between the cost of the violation of the legal norm and the cost of its observance; the subunit report between the benefits of re-entering the formal economy and the benefits of remaining in the informal economy;

• **Structural features** - the osmotic layer between the primary economy and the dual economy, which could be called an osmotic economy, considered by the author as a laboratory of formal informal economy and a laboratory of the informal economy of its formalization; the illicit nature of resources used or the illicit nature of the use of illicit resources, irrespective of whether the purpose of the activities is illegal or legal; institutional deregulation accompanied by strict ad hoc non-institutional regulations; the presence of corruption as a factor of emergence and protection.

• **Operational features:**

- *Candy Syndrome*, in which the author understands the inclination of dual economic activities to exploit only one section of the generic allocation of resources, that is, that section which brings the greatest global advantage to the recipient of informal activities (eg ignoring environmental protection or protection biological employees);

- *Carapace Syndrome* refers to the fact that the informal economy, once constituted as a set of activities, has major difficulties in expanding or proliferating precisely because of the increased risk of its detection by government observers. From an economic point of view, there are no economies of scale in the informal economy;
- preponderance of interim cash transactions;
- the interference of transnationalization;
- the lack of arrears, mainly due to the use of prepayments in cash; the emergence of a sui generis form of non-institutional, criminal, protection of economic subjects, which often extends to some structures belonging to the formal economy.

The most used characterization of the informal sector is the ease with which it can enter this sector. The informal sector of the economy is preferred by the active population only as an alternative to the formal one, people always prefer to earn some money, even on the black, rather than win nothing. The important features of labor market dualism refer to the fact that the formal sector offers attractive salaries and working conditions, while the informal sector offers those unattractive. This leads to a first characterization of the informal economy: workers prefer formal jobs and accept to work in the informal sector only as an alternative.

Another point is that the informal economy has its own duality by combining these two characteristics (Fields, 2008, p. 15).

A broad empirical research has shown that labor income in the informal sector is small. For example, Sudarshan and Unni (2003) think that job in the informal sector is a *survival activity for the very poor people* and the measure of the informal sector is high, accounting for 35-85% of non-agricultural employment in Asia, 40-97% in Africa and 30-75% in Latin America Caribbean region (Fields, 2008, p.16).

The key idea of free entry into the informal sector is that all who want a job can have it. "Work" includes both entrepreneurs and employees. Barriers to entry into the job market are virtually non-existent. In certain situations, especially in the urban sector, all that the active population has to do to work is to invest minimum amounts in certain products or services that they then sell. In the case of families or communities living in rural areas, it is mandatory to keep these products for their own consumption (Fields, 2008, p17).

The existence of jobs available in the informal sector can be a strong tool in explaining the comparable or even lower rates of unemployment in developing countries than in developed countries (Turnham 1971, 1993).

The standard definition of unemployment considers that a person is unemployed if he has not paid any work paid during the last week, not even for an hour. In poor countries where there are no unemployment insurance schemes, most poor people can not afford to earn more than a week's income. So, to the extent that the poor can quickly find an opportunity to earn money in an informal job, they will take it. That's why, in those economies, unemployment is relatively low. Because of the easy way to get such jobs, other ways of setting wages based on labor productivity need to be found (Fields, 2008).

In another paper (Perry, Maloney et al., 2007), informality is seen as the manifestation of the relationship between economic agents and the state and more precisely as a process of *exit or exclusion* from the labor market. Workers can voluntarily step out of the formal labor market when they consider that informal work brings them more cost-benefit advantages or can be excluded from the formal labor market when bureaucracy is excessive or when firms decide to fire.

## 6. The structure of the informal sector

The structure of the informal system, depending on the composition, includes the workforce, small enterprises, or firms in the formal (registered) sector but also partially engaged in informal activities (Perry, Maloney & Co., 2007, pp. 21, 22, Ruffer & Co. 12).

The workforce includes:

- workers, especially elderly and young people, who would prefer a job in the official (formal) system but are unable to find one;

- workers who have voluntarily abandoned formal employment in order to start a business on their own, where they are their own managers and where they can earn higher income and can at the same time avoid paying taxes and duties;
- women, especially married and with children, leaving the formal sector and moving into the informal sector, primarily for non-pecuniary benefits (such as job flexibility that allows them to cope with both their professional, and domestic.)

Small businesses (micro-firms) include:

- firms that either do not intend or do not have the growth potential and therefore do not want and do not need to get in touch with state institutions;
- companies that would like to develop but who are struggling with the regulations and excessive costs imposed by the formal system and then seek to find their solution in informality.

Formal firms. Although they are legally registered, they are actively engaged in formal, part-time activities, which place them in the informal sector, such as:

- declare lower incomes to pay reduced taxes;
- do not draw up contracts for all workers, so some are paid *on the black*, thus avoiding social insurance payments.

The structure of the workforce operating in the informal system is made up of two categories of workers, namely self-employed workers and employees (Perry, Maloney & Co, 2007, pp. 5, 51, 81).

• **Workers on their own - they are relatively well paid, and include:**

- small family businesses,
- independent professionals (doctors, lawyers, teachers, etc.)
- workers with some professional skills (craftsmen, construction workers, drivers, etc.)
- unskilled workers (sweepers, other street activities, etc.).

• **Informal employees include:**

- workers in domestic work,
- unskilled workers in small enterprises,
- workers from large firms working illegally;
- contract workers who do not receive a regular salary, but who are paid at a percentage, commission.

In the case of micro-firms operating in the informal sector, they have the following characteristics (Pery, Maloney & Co., 2007, pages 51, 60, 151):

- is a family business;
- have one, maximum two workers;
- (most) work in the construction, manufacturing and service sectors;
- have a very high failure rate because the business owner does not, in most cases, have entrepreneurial skills and does not properly appreciate the difficulties and costs of the business. This is true both for underdeveloped and developed countries.

## 7. Conclusions

As a conclusion, we can state that most of the studies in the developing and developed countries, concerning the informal sector (the share in the total labor force, its structure and the option of companies and workers to work informally) looks like:

- there are significant differences between the measure of the informal sector, in the sense that the measure of the informal sector is much higher in developing countries;
- there are significant differences between the motivations of companies and workers to opt for the informal system according to the level of development of the state of which they are part;
- there are significant differences between the structure and size of the informal sector in each country, and this depends on the macroeconomic policy applied in each state and on the culture and predisposition of citizens to informality;

- there are significant differences between the motivations of workers within each country, depending on: the sector of activity (urban or rural), gender, age, education and qualification level, traditions, site specificity, subjective desires.

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