

Informality and Illegality: Unpacking the Relationship

WIEGO Network

The informal economy is often associated with illegality. But this assumed relationship is not clearly defined or understood. What aspects of the informal economy are considered illegal: informal units and activities or informal operators and workers? What is illegal about them: the goods and services they produce or how they produce and distribute them? This note seeks to unpack the assumed relationship between informality and illegality - from the perspective of the working poor in the informal economy.

Three points of clarification or definition are in order at the outset. According to the official 1993 definition of the International Conference of Labour Statisticians, informal economic units are those which are not incorporated (not distinct legal entities) and, often also, not registered

(with relevant authorities) and small. According to the data base of national data compiled by the ILO and the WIEGO network, only a few informal self-employed hire workers (less than 5% in most countries) and most work in single-person or family units where the owner/worker is synonymous with the unit. As proposed by the International Trade Union Confederation (ITUC) for the Recommendation on “transitioning from the informal to the formal economy” to be voted upon at the 2015 International Labour Conference, and as used in this note, the term “informal economy” should not include “criminal activities, such as production and smuggling of illegal drugs, the illicit manufacturing and trafficking in firearms, trafficking in persons and money laundering” (ITUC 2014).



John Makwicana after the February 2015 High Court landmark ruling in Durban that confiscation of traders' goods by municipal officials is unconstitutional. Photo: Tasmi Quazi

Illegality

An economic unit or an activity is considered illegal if it violates existing statutes, regulations or ordinances. But violation can range from criminal activities, such as dealing in illicit goods, to non-compliance, such as selling from the street without a license. Also, it is important to define what aspect of the economic unit or activity does not comply with the existing statutes, regulations or ordinances: the goods or services that are produced/disseminated or the processes or arrangements by which they are produced/disseminated.

But what about the self-employed who operate without complying with existing statutes, regulations or ordinances: are they themselves illegal? or only their units, activities or ways of doing things? Under the law in most countries, persons are considered illegal if they reside in a country without official permission to do so: that is, if they are illegal immigrants. But what about the self-employed who do not comply – wholly or partially – with existing regulations? Should they be considered somehow illegal? Most of them are own account workers or unpaid contributing family workers who do not violate labour laws, as they do not hire workers.

Informality

The informal workforce is comprised of both self-employed and wage employed persons. The informal self-employed include employers, own account operators, unpaid contributing family workers, and members of cooperatives/producer groups. The informal wage employed include informal employees of informal enterprises, informal employees of formal firms and households, casual day labourers and contract labourers of various kinds, including industrial outworkers. Informal employees are those who do not have employment-linked social protection.

Illegality and Informal Enterprises/Self-Employed

Informal enterprises and economic units are unincorporated units that also may not be registered with local authorities. These include low-end survivalist units/activities of individuals excluded from formal employment in labor surplus economies (W. Arthur Lewis 1954); dynamic enterprises run by “plucky entrepreneurs” (Hernando de Soto 1986); and/or subordinated units supplying cheap goods and services to formal firms (Alejandro Portes et al. 1989).

Among the informal self-employed, it is important to distinguish between the informal employers who hire others (those who own and run informal enterprises) and own account operators and unpaid contributing family workers (those engaged in single-person or family units). Informal enterprises and informal units, so distinguished, fall along a continuum between partial compliance and non-compliance, including:

- enterprises with hired workers which under-report sales or workers: e.g. partial registration of workers in social security (“off the book” workers)
- enterprises with hired workers which avoid or under-pay payroll and other taxes
- enterprises with hired workers stymied by high barriers and costs of registering with government and/or complying with labour or tax laws (World Bank 2007)
- economic units without hired workers stymied by high barriers and costs of registering with government but for which labour laws and pay-roll taxes do not apply
- economic units without hired workers for which the regulatory environment is inappropriate or irrelevant

Less than 5 per cent of all informal workers in most developing countries, and less than 10 per cent in South East and East Asia, hire workers (Vanek et al 2014). Thus, plucky entrepreneurs comprise a very small share of the informal self-employed. Considered another way, compliance with labour laws and payroll tax codes is relevant for only a small share of the informal self-employed: those who hire others. Also, most informal self-employed – other than the few who hire others – earn less on average than the prevailing minimum or living wage in their respective countries. So many of them earn below the lowest personal or corporate income tax brackets.

In other words, for many informal self-employed labour and tax laws are not very relevant. What is more relevant are the statutes, regulations and ordinances, especially in cities, of who can do what and where. Urban planning and municipal statutes, regulations and ordinances in many cities and countries are biased towards formal firms, formal housing, and the urban middle class making it difficult for most informal self-employed to comply or even operate. Consider street vendors. If municipal governments and city planners do not recognize them or issue licenses to only a small percentage of them, many street vendors are forced to operate outside the law and, in some cities or countries, are treated as criminals for doing so.

In sum, whether informal self-employed comply – partially or not at all – with existing statutes, regulations and ordinances is a complex issue: as existing statutes, regulations and ordinances are often not applicable for, biased against, and/or hostile towards them. In other words, many informal self-employed operate semi-legally or illegally because the regulatory environment is too punitive, too cumbersome, not applicable or simply irrelevant.

Illegality and Informal Wage Employment/Wage Workers

Informal wage workers are those who do not have employment-based social protection: that is, those whose employers do not make contributions to their social protection. Informal wage workers, so defined, include informal employees, casual day labourers, and contract workers of various kinds, including industrial outworkers. Informal paid workers of these various kinds include:

- those who have never had formal jobs with employment-based social protection
- those who once had formal jobs but their contracts have been informalized

It is important to highlight that informal wage workers of whatever type may work for formal firms, informal enterprises or households (as domestic workers); or for global value chains led by large multi-national corporations. Informal wage employment in formal firms includes workers who work in the premises of formal firms and those who work outside the premises of formal firms (as outworkers of various kinds). In many countries, the fastest growing segment of informal employment is informal paid employment for formal firms.

Further, in the case of informal wage workers, it is important to understand and address who is not complying with the law, wholly or partially: the informal wage worker and/or her or his employer whether recognized, disguised, or linked to the worker through sub-contracting chains. In many cases, it is the employers, whether in formal firms, informal enterprises, households or value chains, who choose to hire their workers informally to avoid pay roll taxes, social protection contributions, and other mandated worker benefits.

Informality, Formal Firms, and Governments

There are long-standing debates on who or what drives informality. One group argues that informal workers chose to operate informally, while another group argues that modern capitalist firms chose to hire workers informally and to buy goods and services from informal firms: keeping both informal workers and informal firms subordinated to the formal economy. The reality is that both of these perspectives are correct: as the informal economy is so large and diverse. Whatever the causal explanation, the informal economy is clearly linked to the formal economy in multiple ways through both employment and commercial relationships.

There are also long-standing debates on the relationship between government and informality. One group of observers attributes the rise of informality to excessive state regulations (de Soto 1986). While another group attributes the persistence of informality to the lack of state enforcement of existing laws – and studies why non-enforcement differs from one context to another (Kanbur 2009). Still others focus on the relationship between government and formal firms: arguing that the state allows or encourages formal firms to operate informally and/or that the state and formal firms often collude to exclude informal enterprises from public space or public resources. Again, all of these perspectives have merit because the informal economy is so diverse – as are its links to formal firms and governments.

In sum, informality defined as the lack of full compliance with existing laws should be associated not only with the informal workforce – but also with formal firms and governments. Indeed, both the public sector and private formal firms are known to make or negotiate exceptions to existing laws in their own interests.

Legality and Informal Workers

Finally, it is important to underscore that informal workers find that operating outside the statutory legal framework is associated with more costs than benefits. Most informal self-employed 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 firms); and most informal paid workers would welcome social protection contributions and other worker benefits from their employers (enjoyed by formal workers). From the perspective of the informal workforce, formalization ideally should mean being able to operate within the protective, not the punitive, arm of the law and, thereby, to gain the benefits of formality, including: economic opportunities, economic rights, social protection as well as being organized and exercising representative voice.

About WIEGO: Women in Informal Employment: Globalizing and Organizing is a global network focused on securing livelihoods for the working poor, especially women, in the informal economy. We believe all workers should have equal economic opportunities and rights. WIEGO creates change by building capacity among informal worker organizations, expanding the knowledge base about the informal economy and influencing local, national and international policies. Visit www.wiego.org.