

Informal Economy Debates: Dominant Schools of Thought

Over the years, the debate on the informal economy has crystallized into four dominant schools of thought regarding the causes, composition, and nature of the informal economy, and what should be done about it. There is merit to each of these perspectives, but each school reflects just a “slice of the (informal) pie.” The informal economy as a whole is more heterogeneous and complex than the sum of these perspectives would suggest.

Below the table, links to holistic frameworks are offered.

| | DUALISTS Introduced by ILO World Employment Mission Kenya 1972 | STRUCTURALISTS Introduced by Manuel Castells and Alejandro Portes 1989 | LEGALISTS Introduced by Hernando De Soto 1989 | VOLUNTARISTS Introduced by William Maloney 2004 |
|---|---|--|--|---|
| Who they focus on | those engaged in traditional and survival activities | petty traders and producers; sub-contracted workers; casual workers | informal enterprises and entrepreneurs | the self-employed, notably entrepreneurs – especially male entrepreneurs – and their informal enterprises |
| How they view the informal economy | As autonomous activities with few (if any) links with the rest of the economy; activities provide income for the poor and a safety net in times of crisis | as subordinated economic units (informal enterprises) and workers that serve to reduce input and labour costs of large capitalist firms and increase their competitiveness | as comprised of plucky entrepreneurs who choose to avoid the unnecessary and burdensome costs, time and effort of formal registration and who need legal rights to convert assets into formal property | as comprised of entrepreneurs who choose to operate informally in order to avoid taxation, commercial regulations, electricity and rental fees, and other costs of operating formally |

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| Causal theory | <p>Informal operators are excluded from modern economic opportunities due to</p> <p>a) imbalances between the growth rates of the population and of modern industrial employment; and</p> <p>b) a mismatch between people's skills and the structure of modern economic opportunities.</p> | <p>Informality is due to the nature of capitalism and capitalist growth: specifically, the attempts by formal firms to reduce labour costs and increase competitiveness; the reaction of formal firms to the power of organized labour, state regulation of the economy (notably, taxes and social legislation) and global competition; and the process of industrialization (e.g. off-shore industries, sub-contracting chains, flexible specialization).</p> | <p>A hostile legal system leads to informal activities and informal, extralegal norms. Cumbersome government rules and procedures create barriers to formalization and thus stifle the productive potential of informal entrepreneurs.</p> | <p>Informal operators who choose to operate informally – or even criminally – after weighing the costs and benefits of informality relative to formality.</p> <p>Unlike the legalist school, this school does not blame cumbersome registration procedures but says informal is a deliberate choice by entrepreneurs to enjoy benefits of informality.</p> |

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| Charac-teristics | 7 Characteristics: <ul style="list-style-type: none"> ▪ ease of entry ▪ reliance on indigenous resources ▪ family ownership of enterprises ▪ small scale of operations ▪ labour-intensive and adapted technology ▪ skills acquired outside the formal school system ▪ unregulated and competitive markets | Focus on relationships of production + activities unregulated by the institutions of society. Informality seen as <ul style="list-style-type: none"> ▪ universal ▪ heterogeneous ▪ on the rise ▪ systemically linked to capitalist/formal firms | A hostile reception, especially from the legal system, leads to informal activities and extralegal norms. Costs of becoming formal: registration + license Costs of remaining formal: taxes + compliance with regulations or laws + higher rates for public utilities Costs of illegality to economy: avoidance of fees and penalties + avoidance of taxes and labour laws Costs of absence of good law to informal workers: not having property rights + not having enforceable contracts + not receiving benefits from formal sector | Costs of formality (avoided): payroll taxes and social protection contributions Benefits of informality: way to earn income while avoiding costs of formality |

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|-------------------------|--|--|---|--|
| Policy Responses | Governments should create more formal jobs and provide financial and business development services to informal enterprises | Governments should regulate both commercial and employment relations to address the unequal relationship between “big business” and subordinated producers and workers | Governments should introduce simplified bureaucratic procedures to encourage informal enterprises to register and extend legal property rights for the assets held by informal operators in order to unleash their productive potential and convert their assets into real capital. | Governments should bring informal enterprises under the formal regulatory environment in order to increase the tax base and reduce unfair competition by informal enterprises. |

In yet another approach, often focused on transitional and developed countries, the informal sector is seen as one in which the activities are illegal, hidden, or underground.

Holistic Frameworks

What is called for is a holistic approach to the informal economy that takes into account all aspects of informality and all categories of informal workers.

- In their 2007 publication called *Informality: Exit and Exclusion*, a team of authors from the Latin American Division of the World Bank proposed a holistic model of the composition and causes of informality: see the [World Bank framework](#).
- In 2009, Ravi Kanbur posited a conceptual framework for distinguishing between four types of economic responses to regulation. See [Kanbur’s holistic framework](#).
- The WIEGO Network has also developed a holistic model of the composition and causes of informality. See [WIEGO’s holistic framework](#).