Some theoretical problems of informal economy

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\textbf{Abstract.} The concept of informality started to materialize back in the early 1970s. Though it was a foreign notion for many, it still continues to develop nowadays. The debate over informal economy still persists, many believe that informality is linked to poorer countries and economies, and that it would terminate once they reached decent economic development. But, the evolution of informality theory over the last four decades showcased that it cannot be considered as a temporary phenomenon. Recent developments showed that informal economy has the potential to create jobs and produce revenues, therefore a primary challenge remains development of innovative development policies, and it finds the right support to integrate it in the formal economy. This paper engages in treatment of theoretical problems of informality, focusing on conceptual framework of informal economy.

\textbf{Keywords:} informality, non-official economy, conceptual framework

\textbf{JEL Codes:} E26, Z13

1. \textbf{Introduction}

Informal economy is a phenomenon present in many countries, despite the level of their economic development. The size of its spreading in various countries is uneven. Therefore, informal economy and related problematic have attracted the attention of various researchers.

Most discussed problematic in scientific press commences with the definition of informal economy. Nowadays, despite worldwide undertaken efforts, it has been largely accepted that consensus on the most suitable definition about “informal economy” is missing.

Thus, the study of problematic related to factors that condition the presence of informal economy and its impact in the economy of a country are pivotal.

2. \textbf{Methodology}

Some reference points that have been used for the paper were various theoretical studies of renowned researchers of the field, including Schneider and Este, Feige, etc, as well as the experience of Albania. This study uses official data gathered through various means by prominent Albanian institutions, those made available publicly. The method used for gathering information is direct interview, to gather as much possible

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information. The way this paper was conceptualized was to refer to world literature studies on the problems of informality. Selection of authors aimed to evidence detailed treatment of informality, and placing them vis-à-vis one-another.

3. What is Informal Economy?

The first problem encountered in measuring informal economy is finding a suitable definition for it. In his study work of 1992 Thomas mentions several referential phrases of the theme, such as parallel economy, shadow economy, unregistered economy, grey economy or black economy. In Europe the predominantly used term is black economy. The term used in Holland is zwartwerk, in Germany, schwarzarbeit, in Italy lavoro nero, in France économie au noir. Each of these terms seems to focus on the value; therefore it bears a connotation linked to illegal activity. The term used in Albania is puna në të zezë and it follows the same European trend.

It is important to clarify from the onset of this analysis that despite various researches in theoretical level, “informal sector manifests itself in the streets of various countries, in the citizens within the same country, even in the various parts of the same town.”

The term “informal economy” has found wider use than the term “informal sector” mainly for the following two reasons. According to Chen, Jhabvala and Lund first, formal and informal parts of the economy are that much interconnected with one-another that it is difficult to think of them divided into two separate sectors. Second, the term “sector” is more frequently used to classify industry groups.

According to Feige and Schneider and Enste a frequently used definition is “the entire economic activity which contributes to the calculation or observance of the Gross Domestic Product.” According to this point of view, Smith defines informal economy as “market based production of goods and services, whether being legal or illegal, that escapes detection in the official estimates of GDP.” Or as put otherwise by Feige, “it is that economic activity which generates income that avoids rules, taxation or governmental observation.”

Generally, from practice thus far, an accurate definition seems quite difficult, as Mogensen and others put it “informal economy develops all the time according to the principle of running water which means adjusting to changes in taxes, to sanctions from tax authorities and to general moral attitudes.”

Meanwhile, the criterion used to define “informal economy” varies from its legal, technical, financial and organizational use. Within such diversity we will aim to define the term used for informal economy in such a manner, that it would be used for different purposes.

3.1. Official definition of Informal Economy

International Labor Organization (ILO), headquartered in Geneva, has been one of the most important actors which has greatly influenced the study of informal economy. In 1993, during the fifteenth conference which focused on Resolution Concerning Statistics of Employment in the Informal Sector, ILO offered a
comprehensive definition and widely used on informal economy, as per the following: “Informal economy is widely characterized as consisting of units involved in production of goods and services with main objective of generating employment and revenues for people involved in it.” Based on this, the informal sector is defined as composed of households with market production:

- Informal enterprises owned by those involved in it or enterprises lead by them or those which have not registered in compliance with specific procedures of the national legislation;

- Enterprises of informal employers might be defined according to the size of the unit for a specified level of employment or lack of registration of an enterprise or its employees.

Given that phenomenon of informality globally includes a diversity of forms, this definition seems to have been useful in a part of informal reality, International Labor Organization 10 accepted that the definition was unable to summarize the entire dimension of informal economy. In fact, during the Conference of Labor Statisticians of ILO 11 it was recommended that further work in understanding the attributes of informal economy was needed. Thus, some politicians and researchers aimed to provide a broader definition on informal economy.

Thus, in his study of 1994, Smith 12 defined informal economy as “market-based production of goods and services, whether legal or illegal, that escapes detection in the official estimates of GDP.” A well-known researcher in this field, Schneider 13 further elaborated this description by describing informal economy as an economic activity which contributes to value added, but which is not registered by the national measurement agencies. Other contributors offered a valuable contribution, such as Hartzenburg and Leimann 14, when they managed to offer a broader definition, according to which informal economy is considered: “all economic activities pursued without the sanction of the authorities; that means those not recorded in the national accounts.” Another difficulty that was faced when trying to provide a definition was the distinction between informal economy and unrecorded sector. Particularly two researchers, Abedian and Desmidt 15 emphasized some of the difficulties in equalizing informal economy with unregistered sector. As, the above-mentioned term, thus no clearly displaying the full nature of informal economy which entails both legal and illegal activities. Therefore Abedian and Desmidt 16 proposed to use the Standard Classification of Industries for data classification.

3.2. Classifications which have been used

Schneider and Enste offered their advice about classification for informal economy. 17 In the following picture national (dual) economy is composed of official economy and unofficial economy.
In their coherent research of 2000, Schneider and Enste\textsuperscript{18} have classified informal economy by drawing a distinction between legal and illegal activities, including differentiation between transactions under each.

The following table which was initially created by Lippert and Walker in 1997, later improved by Schneider and Enste, shows that informal economy is constituted of both monetary and non-monetary transactions, which could be of legal or illegal nature. Noteworthy is the fact that legal activities faced in informal economy usually take place as such for tax evasion purposes.

<table>
<thead>
<tr>
<th>Type of activity</th>
<th>Monetary transaction</th>
<th>Non-monetary transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illegal activities</td>
<td>Trade in stolen goods; drug dealing and manufacture; prostitution; gambling; smuggling and fraud</td>
<td>Barter, drugs, stolen goods, smuggling. Growing and producing drugs for own use. Theft for own use</td>
</tr>
<tr>
<td>Tax evasion</td>
<td></td>
<td>Tax avoidance</td>
</tr>
<tr>
<td>Tax evasion</td>
<td>Barter of legal services and goods</td>
<td>All do-it yourself work and neighbor or relatives help</td>
</tr>
</tbody>
</table>

Also, very important to underscore that in developed countries the term informal economy is mostly linked to illegal activities. While for countries in transition, such as the case of Albania, informal economy is linked to both legal activities and illegal activities.
Along with its prognosis for conceptual completion was noticed that the International Labor Organization\textsuperscript{20} advanced in describing informal economy term under the seven securities, which are generally denied to workers under informal economy, as reported in its 2000 report. These securities are\textsuperscript{21}:

- Labor market security - adequate employment opportunities through high levels of employment ensured by macroeconomic policies;
- employment security - protection against arbitrary dismissal, regulation on hiring and firing, employment stability compatible with economic dynamism;
- job security - a niche designated as an occupation or “career”, the opportunity to develop a sense of occupation through enhancing competences;
- work security - protection against accidents and illness at work, through safety and health regulations, limits on working time and so on;
- skill reproduction security - widespread opportunities to gain and retain skills, through innovative means as well as apprenticeships and employment training;
- income security - provision of adequate incomes; and
- representation security - protection of collective voice in the labor market through independent trade unions and employers’ organizations and social dialogue institutions.

For this reason, ILO\textsuperscript{22} defines informal economy as negative as it does not achieve some basic employment conditions, known otherwise as “decent work.”

3.3. Conceptual framework for the informal economy

As a need for current development, researchers most recently started to use the term \textit{informal economy}, in order to cover a broader base which includes several types of informal employment, not included in the previous ILO 1993 definition. Enlarging the definition was tightly linked to new nuances under informal economy.

In the conceptual framework for informal economy, informal employment has been included within and outside of informal enterprises. Informal employment in informal companies constitutes and is represented by individuals in small enterprises, which are either unrecorded or un-incorporated. Informal employment outside of informal companies involves those individuals who work for formal enterprises, family businesses, or not the same employer, thus undefined employer. According to the expanded concept, informal employment is understood to “include all remunerative work, both self-employment and wage employment, that is not recognized, regulated, or protected by existing legal or regulatory frameworks and non-remunerative work undertaken in an income producing enterprise”\textsuperscript{23}.

Another meaningful fact is that besides heterogeneous character of informal economy, it is also possible to use classification according to the type of economic units or status of employees. Informal economic units could be micro-enterprises, family businesses, and operations which hire a person. Workers in the informal sector are sometimes actual employees of informal enterprises, but more often than not they are domestic workers without regular contracts, casual workers without fixed employers, temporary workers who get paid through agencies, part-time workers for fixed employers and unregistered workers.\textsuperscript{24}

In the following table is presented the expanded conceptual framework:
Production units by type

<table>
<thead>
<tr>
<th>Production units by type</th>
<th>Jobs classified according to employment status</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Own-account workers</td>
</tr>
<tr>
<td></td>
<td>Informal</td>
</tr>
<tr>
<td>Formal sector enterprises</td>
<td></td>
</tr>
<tr>
<td>Informal sector enterprises</td>
<td>3</td>
</tr>
<tr>
<td>Households</td>
<td>9</td>
</tr>
</tbody>
</table>

Fig. 3: International Labor Office (2002:13)

In the table, the red cells represent jobs that by definition do not exist in the type of production unit in question. The yellow cells represent jobs which, by definition, exist in the type of production unit in question but which are not relevant to the present study. The un-shaded cells represent the main focus of the study. They refer to types of jobs that represent the different segments of the informal economy:

- **Cells 1 and 5** consist of family workers with no contract of employment and no legal or social protection arising from the job, in formal enterprises (cell 1) or informal enterprises (cell 5). Contributing family workers with a contract of employment, wage, social protection, etc. would be considered employees in formal employment.

- **Cells 2 and 6** consist of employees who have informal jobs whether employed by formal enterprises (cell 2) or informal enterprises (cell 6).

- **Cells 3 and 4** consist of own-account workers (cell 3) and employers (cell 4) who have their own informal enterprises. The informal nature of their jobs follows directly from the characteristics of the enterprises they own.

- **Cell 7** is made up of employees working in informal enterprises, but having formal jobs. This may occur when size is used as the criterion to define whether or not the enterprise is informal.

- **Cell 8** consists of informal producers’ cooperatives.

- **Cell 9** consists of producers of goods for own final use by their households (e.g. subsistence farmers).

- **Cell 10** is made up of paid domestic workers employed by households in informal jobs.
The definition of the informal sector is based on the blending of the above-mentioned and on the conceptual framework by ILO’s in its paper of 2002. Thus informal economy is defined as “all transactions of goods and services, whether legal or illegal, that contribute to overall economic activity but are currently not recognized by official GDP statistics.”

4. Conclusions

The study of theoretical problems of informality consists of a specialist’s work factor, not only for further approaches, but also for explaining the problems of informality in and for solving complicated situations under the economic practice of various countries.

The study of theoretical problems of informality constitutes an important factor for the work of specialists operating in the field of informal economy. Thus a cognizant and cautious study of informal economy definition takes great importance, not only for further theoretical addresses, but also for explaining other problems related to informality and solving complicated situations in the economic practice of various countries.

Through the study of conceptual framework another meaningful evidence could be noted, as described by the fact that besides informal economy’s heterogeneous character, it is always possible to use this classification according to types of economic units or status of employees.

5. References (Endnotes)


