

The Informal Economy: A literature review

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The Informal Economy: An Introduction

In his book *Off the Books: The Underground Economy of the Urban Poor*, Sudhir Venkatesh describes an interconnected web of informal economic activity in a low-income neighbourhood in Harlem, NY. The underground economy allows low-income persons to earn more than they declare. According to Venkatesh, participation in the informal economy is a means of survival for many.

A spectrum of theories attempts to explain why some employers, self-employed persons and employees participate in the informal economy. Depending on the theoretical approach to the causes of the informal economy, which this literature review will explore, participation in the informal economy is viewed as voluntary or involuntary (or somewhere in between). In other words, participation in the informal economy is either an exit strategy chosen by the participant or the result of exclusion from the formal economy.

Regardless of theoretical approach, it is generally agreed that participation in the informal economy has certain benefits but also serious drawbacks. Benefits of the informal economy include the ability for groups and individuals to form economic relationships outside of the bureaucratic red tape of formalizing a business and declaring taxes. As we will see, people often participate in the informal economy in an attempt to gain a livable wage and often don't make enough money to make formalizing their activities worth the time and effort it takes to do so. While participation in the informal economy may be or seem to be the only viable option for a worker or business owner, participation means that the persons is not offered the same rights and protections by the state as formal workers. In addition, they are not entitled to state benefits. Drawbacks of the informal economy identified in the literature include lack of: job security; guarantee of a living wage; and, entitlement to state benefits during periods of unemployment, among others.

Research done by not-for-profits such as Community Links in the UK shows that participation in the informal economy has a complex effect that changes over time. "In the short term, informal work helps people deal with periods of dire poverty, triggered by illness or loss of a formal job, by enabling them to pay for necessities. In the medium term, however, informal work leaves individuals outside the formal labour market, unable to access rights such as the minimum wage and sick pay, and may keep them in poverty." (Barbour and Llanes, 23). P who earn income within the informal economy do not pay into government programs such as the Canadian Pension Plan or Employment Insurance. Thus, working in the informal economy can be a solution to financial difficulty in the short term, but may cause financial precarity in the long term.

Given the general agreement about the drawbacks of the informal economy, many scholars ask: How can the participation in the informal economy be reduced? If one sees participation in the informal economy as voluntary, one would promote stricter penalties for those who choose not to abide by employment and tax laws. On the other hand, if one views participation in the informal economy as the only viable means of survival for some people, then the answer to that question is more complicated, and potentially unsettles the assumption that it should be reduced.

Front-line support workers in non-profit service organizations in the West End of Toronto suggest that low-income persons are engaged in informal economic activities in a

variety of sectors. Some suggest that participation in the informal economy has increased in recent years. This perception leads to many questions: Is working outside of the informal economy a good choice for those who do so in the short and long terms? Is it a choice? How can the vulnerability of workers within the informal economy be minimized? Should and can the government and service agencies do anything to support persons and small businesses in transitioning to the formal sector?

Due to the 'off the books' nature of the informal economy, it is difficult to quantify participation in the informal economy. St. Christopher House's informal economy project began with questions. In its research design, it seeks to gain information through qualitative research in the form of interviews with individuals and groups of persons. The project does not seek to quantify the scope or extent of the informal economy, but rather seeks to ask whether any steps can be taken to improve the economic lives of its participants. This literature review aims to describe the broader context within which this local discussion is taking place. Theorists have theorized about the informal economy and organizations and foundations across the globe have explored the issue within their own locale. This literature review will focus on theories and discoveries that can help shed light on the situation here in the West End of Toronto.

This literature review will begin with a definition of the informal economy. After defining the term, we will briefly explore the scope of the informal economy, its characteristics and, finally, demographics of participation. We will then outline the negatives and positives of participation in the informal economy. Next, we will survey a number of theoretical approaches to the informal economy. These approaches attempt to answer the question: What are the causes to the informal economy? Each formulation of a cause implies a particular solution or set of solutions, which will be discussed in the conclusion of this literature review.

Defining the Informal Economy

Participation in the informal economy can take many forms, from an employee working ‘under the table’ to a construction worker doing a job for cash. Many of us have participated in the informal economy in one way or another, as an employee, employer or consumer. The informal economy can be defined as non-participation in three broad areas where formal compliance is overtly defined by governments and their agencies:

- **Taxation:** e.g. income tax, sales taxes and payroll taxes
- **Social Programs:** e.g. Ontario Works, ODSP, EI, CPP etc., and
- **Regulation:** e.g. criminal code, provincial offences, bylaws and codes related to paid and unpaid work, commissions, credentials and business activity

Early definitions of the informal economy included a wide spectrum of activities from criminal, paid activities to non-monetized work, including work in the home, volunteer work and bartering. More recently, a narrower subcategory of the informal economy has been defined as the paid informal economy. The paid informal economy is understood as **“monetized exchange that is unregistered by or hidden from the state for tax, social security and/or labour law purposes but which is legal in all other respects”** (Williams, 2011, p. 25)

In “Shades of Grey in the Informal Economy,” Jones, Ram and Edwards adopt a similar subcategory as their object of study. In their words: “Such precision is a welcome improvement on some of the early definitions, which, by including all sorts of unpaid categories like domestic labour, tended to overload the concept to the point of meaninglessness” (2006, pp. 357-358). In this definition of the informal economy, otherwise legal activities are done in the context of illegal labour practices such as violations to: minimum wage and vacation pay; health and safety regulations; laws related to hours of work, job security, written contracts, holidays; and immigration laws.

There are many regulations and laws surrounding employment in Ontario: Workplace Safety and Insurance, minimum wage, laws surrounding vacation pay and sick days, and tax laws. Employers must abide by the regulations and laws and provide the employee a safe working environment and a decent standard of living in exchange for work. The regulations and laws offer, to some degree, protection to the employee. At the same time, the tax laws ensure that the state receives a share of the employer’s and employee’s income. Employees, self-employed persons, and employers who subject themselves to regulations and laws surrounding employment participate in what is referred to as the formal economy.

Unfortunately, by narrowing the definition to a manageable concept, we do not escape complexity. A major part of this complexity is the blurred boundary between the formal and informal. One cannot draw a line between the informal and the formal, with the informal economy neatly on one side and the formal economy neatly on the other. Instead, there is slippage. Many people participate in both the formal and informal economies, often at the same time and within the same profession. Additionally, in some industries such as the hospitality and construction industries, it is said to be standard practice for some transactions to be on the books while others are left off of the books.

The Informal Economy Today: Internationally, Nationally, Provincially, & Locally

The size of the informal economy is difficult to measure because of the unreported nature of the activities. Economists have tried to measure the informal economy and its impact on tax revenue. Different methods produce widely discrepant results (Lemieux, 2007, p. 5). While discussions about complex and technical ways of measuring the informal economy lie outside the scope of this review, we will provide some of the estimates of the size of the informal economy.

Internationally

The International Monetary Fund (IMF) estimates that the informal economy accounted for 14-16% of GDP in 21 advanced economies from the years 1988 to 2000 (Daniels, 2004, p.506). According to the International Labour Office (ILO), the informal economy is more prevalent in developing countries, accounting for between 35 and 90 per cent of total employment and not confined to traditional rural and urban informal sectors. According to the ILO, informal contracts and precarious employment has been increasing within formal establishments as well. As we will see later when discussing theories, some might suggest that 'modernization' will lead to decreased informal employment in developing countries. However, most scholars suggest that it is not a question of progress since the informal economy endures in even the most so-called 'modern' societies.

Nationally

According to Pierre Lemieux, in "The Underground Economy: Causes, Extent, Approaches," estimates of the underground economy in Canada made since 1976 have ranged between 1.4% and 100% of the GDP. The widely discrepant estimates are thanks to both different ways of defining the informal economy and different ways of measuring it (2007, p. 5). In 1992, Statistics Canada estimated the underground economy at 5.2% of the GDP, with the irregular economy and black markets accounting for another 5.2%. In "Estimating the Underground Economy in Canada 1992-2008," Statistics Canada estimates \$444 billion (\$36 billion in 2008) in unreported income, not including illegal activities and tax havens. The 2008 unreported income total represents a 90% growth over the 1992 totals (Statistics Canada, 2011).

Provincially

The informal economy has received some policy attention in recent years. The 2012 Drummond Report and the Ontario Ministry of Labour's Expert on Occupational Health and Safety recently recommended the creation of a provincial strategy. Both provincial reports identified the informal economy as an untapped source of tax revenue for government and a threat to the competitive advantage of other businesses. The Ministry of Labour report also identified the underground economy as a source of vulnerability for many workers, undermining minimum employment standards. In 2004, the Ministry of Labour began targeted enforcement in the construction industry.

Locally

More research needs to be done on the informal economy in Toronto. There is a notable lack of local data. The Informal Economy project seeks to contribute knowledge and analysis of the

incidence, scope, and impact of the underground economy on low-income people in and on our local economy.

Characteristics of the Informal Economy

Legal vs. illegal work

The informal economy, as it is most commonly defined, consists of work that is otherwise legal but is done while violating some other non-criminal law such as tax and labour laws. In a literature review conducted by The Aspen Institute in 2002, an example of a hot dog vendor is cited. The act of selling hot dogs on the streets is not in itself illegal, but if the vendor is not properly licensed, the vendor may be evading health laws and/or tax laws. The authors distinguish this participation in the informal economy from criminal activity, wherein the act itself is illegal (e.g. dealing drugs).

Cash Transactions

In order to evade creating a record of transactions, cash is the most common medium of exchange within the informal economy. The informal economy seems to thrive in industries within which cash is a common currency, such as the hospitality, construction and domestic services industries. The construction industry has received much policy attention in Ontario in recent years. The informal economy within the construction industry is seen as a major source of lost tax revenue. In a UK report from 2004, it was estimated that dealing with the informal economy in the construction and domestic consumer services would attend to 85% of all informal work (SBC, 2004).

Subcontracting

An area of research that is identified as deserving further study is self-employment situations that look much like employment relationships but are outside of labour laws, such as delivery persons, home healthcare workers, garment workers, etc. (Workers Action Centre, 2007). Subcontracting within the construction industry raises the same sorts of questions.

Conditions of Labour

Because the informal economy exists outside of labour and wage laws, employees within the economy do not have the same protections as formal employees. There is no guarantee that safety laws are being followed, and thus informal employees are more likely to work in unsafe settings. Employers can similarly ignore laws concerning hours and minimum wage.

Precarious Employment

According to the recent United Way Report/McMaster on income levels in Toronto, "It's More than Poverty," precarious employment is increasingly becoming the norm in today's economy. According to the report, "Only half of the sample in the study that forms the basis for this report described themselves as having a permanent, full-time job with benefits" (p. 4). Other persons are working in employment scenarios in which they are part-time, and/or have no benefits, and/or are self-employed. "At least 20% of those working are in precarious forms of employment" (p. 5) and those working within the informal economy are in the most precarious of precarious employment situations.

Demographics of the Informal Economy

Poverty and the Informal Economy

Not all people working in the informal economy are poor; not all people working in the formal economy are wealthy. According to the International Labour Office, “There is no simple relationship between working informally and being poor, and working formally and escaping poverty. But it is certainly true that a much higher percentage of people working in the informal relative to the formal economy are poor, and even more true that a larger share of women relative to men working in the informal economy are poor” (2002, p. 3).

Many people work both within the formal and informal economies. In some cases, people work or receive assistance within the formal economy but still do not earn a livable income. In such cases, people supplement formal income and social assistance income with work within the informal economy. In addition, there are people who work within the formal economy, but earn minimum wage, who do not make a livable wage. Informal work is taken on to supplement insufficient formal income. Self-employed persons are especially likely to participate in both the informal and formal economies. It is interesting to note that 30% of self-employed workers in the GTA make less than \$20,000 per year (Workers Action Centre, 2007, p. 33).

Newcomers

A UK report argues against a commonly held notion that immigrants “bring informality with them as a cultural trait” (Jones, Ram and Edwards, 2006, p. 361). Instead, the report suggests that the way the formal economy functions in the UK is inhospitable to newcomers, and thus newcomers are more likely to participate in the informal economy in order to earn an income.

Anecdotal evidence from front-line workers suggests that the same is the case in Toronto, with the informal economy providing employment opportunities for legal and undocumented immigrants who often face challenges entering the formal job market.

Temporary workers and workers without an immigration status that entitles formal employment are overrepresented in the informal economy. Losby et al write: “Illegal immigrants are especially subject to exploitation because of their exposure to explicit or implicit threats of being reported to immigration authorities if they object to working conditions or pay” (17).

Women in the Informal Sector

Women are more likely than men to work in the informal sector. Women are particularly overrepresented in certain sectors of the informal economy, such as childcare and household cleaning services. According to Losby et al, this is due to women’s household responsibilities, particularly family responsibilities. Informal work can often be done from home and is flexible enough to be combined with other responsibilities. Some argue that the formal economy fails women because it inadequately accommodates their household responsibilities. In response, women have been at the forefront of rising levels of self-employment during the past few decades (Hughes, 2003, p. 433). As they run their own small businesses, many self-employed women participate in both the formal and informal economies at the same time, within the same business.

According to Nickela Anderson and Karen D. Hughes in “The Business of Caring: Women’s Self Employment and the Marketization of Care,” women who run small businesses often do not keep detailed records of expenses and sometimes underreport revenue when the revenue was received in the form of cash (2010, p. 394)

Education

In Aspen Institute’s “Informal Economy Literature Review”, authors suggest that level of education in urban settings is related to participation in the formal and informal sectors. A higher percentage of jobs within the formal sector are done by persons with higher education, while jobs within the informal sector are more likely to be held by persons with less education. Further, these persons are more likely to receive lower hourly wages. Interestingly, this same correlation does not apply in rural settings where the level of education a person has is not a predictor of participation in a certain sector (p. 23).

Benefits & Negatives of the Informal Economy

The scope of the informal economy has significant effects on various groups of people. The greatest effect is on the workers and self-employed persons within the informal economy. In addition, the informal economy affects employers and local businesses (all those within the same sector whether or not they themselves use informal labour), consumers and customers and the tax system and our social infrastructure. The effects are a hybrid of positive and negative.

Benefits

The informal economy provides a safety net for those the formal economy fails. One positive of the informal economy is that it provides employment when employment might not otherwise be possible. When social assistance programs do not provide enough for people to live on, the informal economy can supplement the state-provided income. It can provide a safety net or buffer. Further, the informal economy can be said to be a space of transition from non-work to work – a site in which employees experience “increased confidence, skills and work experience” (Katungi et al, 2006, p. xl).

The informal economy makes room for flexibility in how one structures one’s work. In some cases, where a worker has childcare responsibilities, or must support elderly family members or family members with disabilities, formal work with its structure and set hours is not always an option.

Some theorists view informality as a necessary stage in small business development. Without it, small businesses would not survive. In “Untapped Enterprise: Learning to Live with the Informal Economy,” Benedict Bellot suggests that “informality may be the necessary incubation period protecting fledgling entrepreneurs from an unforgiving business environment that would otherwise hamper their development or sink their business entirely” (2012, p. 22). In that report’s survey of small business owners, they uncovered the following reasons for trading informally:

I was unaware that I had to register my business	14%
I wanted to earn extra income that would otherwise have been taxed	9%
It gave me the necessary breathing space before I had the capacity to register my business	40%
I wanted to see if the business would be viable first	64%
I didn’t know who to go to about registering my business	12%
Other	17%
Can’t recall/ Prefer not to say	2%

Source: Dellot, 2012, p. 22

Finally, the informal economy is not without norms and rules. To some degree, it might be said that the informal economy allows for more authentic social agreements that are not confined by legalities and formalities.

Negatives

One obvious negative of the existence of the informal economy is lost tax revenue. Attempts to measure the extent of the loss are complicated and beyond the scope of this research. This research focused on the negative impact on the employee within the informal economy. According to the International Labour Office, “Informal workers and entrepreneurs are characterized by a high degree of vulnerability” (ILO, 2002, p. 3). The ILO lists seven essential securities that are denied informal economy workers:

- “labour 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 labour market through independent trade unions and employers’ organizations and social dialogue institutions). (ILO, 2002, p. 2-3)”

Wide Effects of the Informal Economy

The informal economy has positive and negative effects on number of actors within the economic system, including the informal workers and traders themselves, customers and society in general. The below table, replicated from “Supporting People to Legitimise their Informal Business,” provides a succinct portrayal of some of the positives and negatives. The report’s authors, Aaron Barbour and Marien Llanes, are careful to point out that it is not an exhaustive list.

Negative and positive aspects of the informal economy

Negative aspects	Positive aspects
For informal workers or traders	
Lack of access to credit and financial services, partly due to limited credit history.	A source of income to stay out of poverty
No entitlement to labour rights such as minimum wage, sick pay, working hours directives or redundancy rights	Improvement and development of an entrepreneurial spirit and skill that could be transferred to the informal economy
Difficulty in expanding a business which cannot be openly advertised	Flexibility in where, when and how to work and trade (especially important for women, who undertake the majority of child-rearing activity)
May face higher barriers of entry to the formal market on account of an inability to provide employment history to back up their skills	Reduced barriers to entry into employment and trading, because the majority of informal work starts with family and friends

For customers of informal workers or traders

Contractual arrangements between consumers and informal traders may be limited or non-existent; legal rights may not be upheld

A more affordable product or service can be offered to or asked for by customers if payment is made in cash and no receipts change hands for tax avoidance purposes

For society more broadly

Tax avoidance and benefit fraud result in lost revenue and unnecessary spending. This may mean that public funding for other social economic programs may be reduced.

Training of workers and entrepreneurs ‘on the job’ does not require a visible outlay of financial resources, which may alleviate some of the pressure on the state and its agencies during times of reduced public spending.

Loss of regulatory control over the quality of products and services produced and distributed.

Paid favours are exchanged for mutual benefit between friends, relatives and colleagues – sharing the wealth and building social capital.

Wage and cost competition with informal businesses may result in the weakening of employment rights for all workers and downward pressure on the minimum wage

Income generated through the informal economy is spent in the formal economy, contributing to ‘official’ economic growth. Informally earned income boosts the demand of formally produced and distributed goods and services.

Inaccurate employment and earnings statistics which omit informal workers may adversely affect employment and business support policies implemented by local and national governments.

Source: Barbour and Llanes, 2013, p. 25

Theoretical Approaches to the Informal Economy

While various approaches cast a binary between formal and informal economies, a read of the spectrum of literature shows that it is a simplification to declare one economy bad and the other good. Increasingly, scholars suggest that the informal economy is here to stay, and is neither wholly negative nor fully positive. Many suggest that it is a necessary complement to today's formal economy; it is structurally caused to exist because of the nature of our formal economy and income distribution. Some go so far to suggest that it is a positive alternative to the formal economy.

A Negative View of the Informal Economy

A formerly popular, now debunked theory referred to by Colin Williams as the "*formalization thesis*" or "*modernization thesis*" held that the informal economy was a remnant of the past. This theory asserted that with modernization there would be increased formalization and the eventual disappearance of the informal economy. This approach saw the "informal economy as a residue" (Williams, 2008, p. 107). In this theory, the informal economy is associated with "'under-development', 'traditionalism', and 'backwardness'" (Williams, 2012, p. 26). Meanwhile, the formal economy is equated with "'progress', 'development', 'modernity' and 'advancement'" (ibid). The formalization thesis endows the formal economy with positive attributes while claiming the informal economy is a negative remnant that ought to disappear with time and development. This theory has been criticized as being Eurocentric, as it often associates the informal economy with developing economies in the two-thirds world. Additionally, the perseverance of the informal economy in so-called developed economies such as those in Europe and North America has challenged the underlying assumption of the theory. If the informal economy is alive and well, and not disappearing any time soon, in North America and Europe, then the formalization/modernization thesis must be challenged or nuanced. In recent years, there has been an "emergence of various theories which transcend the depiction of informal work as a remnant or residue of the past" (Williams, 2012, p. 28).

Another common view of the informal economy sees it as a necessary by-product of the formal economy. Often referred to as the "*marginalization thesis*," this approach views "regulatory evasion as a condition of survival for small firms in essentially unprofitable cracks and crannies of the economy, where they would otherwise be eliminated by market forces" (Jones et al., 2004). According to Williams, the informal economy results from "employers adopting informal work arrangements to reduce costs, such as devolving stages of production to those employing off-the-books workers under degrading, low-paid and exploitative 'sweatshop-like' conditions, exemplified in the garment manufacturing sector" (2012, p. 29).

In the informal economy, price-cutting is often seen as the only option. Sectors in which it is difficult to make a good profit include "abandoned sectors" such as the garment industry, which have been abandoned due to outsourcing to developing economies. In order to compete with cheap overseas labour, the domestic industry is forced to cut corners as well. Growth economies, including the service industry, often experience an oversaturation of providers. In order to compete, employers and companies need to cut costs where they can. In the article

“Shades of Grey,” Jones, Ram and Edwards conducted focus groups in the take-out food and garment industries in the UK. They discovered that employers believe that they have no choice but to cut costs wherever they can in order to survive. They write:

... if these transgressions are to be properly understood, they ought to be seen less as a matter for simple condemnation and more in their true context as a matter of absolute material survival. Given the meagre returns derived from their frantically competitive markets, owners simply cannot afford to pay the legal minimum. ... Following from all this, one of our most revealing findings is that the capacity to operate formally and conform to official rules is closely – we might even argue, entirely – dependent upon profitability, itself a rather rare condition in these areas of the economy (p. 362). ... Certainly we cannot stress too strongly the rigour of the external market constraints within which our respondents must ply their trade and the marginality, which often renders it acutely painful to absorb additional cost impositions (p. 369).

The marginalization thesis holds that profitability is a condition of participation in the formal economy. In tight markets, external market constraints drive employers to participate in the informal economy.

Marxist structural analysis is similar to the marginalization thesis, but exerts that modern capitalism is dependent upon the informal economy. In this analysis, the formal economy is dependent upon the informal economy through an unequal exchange of labour. According to Williams (2008), “in a bid to reduce costs, formal businesses increasingly subcontract stages of production to employers who employ off-the-books worker under degrading, low-paid and exploitative ‘sweatshop-like’ conditions...” (p. 111).

This unequal-exchange and detachment of workers both from the products of their labours and from the regulating laws intended to protect them creates vulnerable workers upon which the cheap goods of capitalism depend. Jones, Ram and Edwards refer to this as the “logic of unequal exchange.” The condition of the informal economies existence is its ability to “provide sub-normally low cost goods and services to firms and households in the formal sphere. Their preparedness to endure exploitation and take the rap for working outside the law enables them to pass on to others the benefits of cost reductions unthinkable in a properly regulated labour market” (p. 359). Locally, the subcontracting business can perhaps be seen as an example of this. Internationally, the garment industry in developing countries can be seen as an exploitative byproduct of capitalism. According to Williams, “The outcome is a polarization of working conditions along the supply chain with those at the end of it in flexible subcontracting arrangements being subjected to highly exploitative low-paid informal forms of working” (p. 111).

Marxist structural analysis is the reverse of the modernization approach. Whereas the modernization approach believes that the informal economy will eventually disappear in the modern economy, the Marxist approach holds that it will not disappear as long as the capitalist structure requires it. Informality is “alive, well and growing in the post-industrial West” (Waldinger and Lapp, 1993, p. 6).

Both the marginalisation and Marxist structural analysis thesis depicts engagement in the informal economy as a necessity rather than a choice. In the ideal worlds of these theses, the informal economy would not exist.

A Positive View of the Informal Economy

Some emerging theories about the informal economy view the informal economy as a positive alternative to the formal economy. In these approaches, the informal economy is seen as “a site of resistance to the formal economy that is growing” (Williams, 2012, p. 28). These approaches view participation in the informal economy as a choice rather than a necessity.

Williams identifies three subperspectives within this approach, which, while they all see the formal economy as a positive economy that is engaged in by choice, are in tension with one another. The three perspectives are: the *neo-liberal perspective*, *green perspectives*, and *post-capitalist theories*.

In the *neo-liberal perspective*, the government’s overregulation of the market is the cause of the informal economy. Responding to the lack of free market space, participants in the informal economy carve out this space on their own, by choice. Neoliberal theorists argue that decreasing government regulation would reduce the size of the informal economy. A related theory to this approach suggests that the regulations are too complex and difficult to understand, thus creating unnecessary roadblocks to participation in the formal economy.

Green perspectives and *post-capitalist theories* both suggest that the informal economy is growing today because of the choices of many who are dissatisfied with the modern, capitalist free market. According to these theories, people are rightly seeking alternatives to the formal economy that are more local, sustainable and environmentally sound. People are seeking community-based economies as positive alternatives to the formal economy (Williams, 2012).

For many, the informal economy can be seen as a source of social cohesion, with persons entering into informal contracts and agreements directly outside of the formality of rules and regulations. In many cases, this can result in more flexible working arrangements that recognize the humans are more than the sum of their economic contributions. For example, the informal economy makes it possible for some people to fulfill their family obligations while doing informal, paid work such as childcare. In addition, the economy allows persons to provide and buy goods at lower prices. In conclusion, the informal economy can be viewed as an intentional response by low-income persons to a formal economy in which they cannot take part.

Beyond the Either/Or of Positive or Negative

The theoretical approaches discussed rely on an either/or assumption: either participation in the informal economy is involuntary – the result of exclusion – or voluntary – the result of a chosen exit strategy. Research tells us that both scenarios are true in the real world. After interviewing 600 people, Williams et al conclude that: “... either/or explanations need to be transcended. Informal employment is neither universally driven by exclusion nor exit. Instead, some participate mostly due to exclusion, others mostly for exit rationales, and some for a combination of the two, with different mixtures across different populations and types of formal employment” (2011b, p. 729).

Further, the approaches oversimplify the informal economy as either negative or positive. On the negative side, the informal economy is viewed as a site of exploitation and oppression. On the positive side, the informal economy is said to be a site of freedom and agency. It is important to neither demonize nor romanticize the informal economy. Informal

economies are characterized by acts of good faith and trust and also, at the same time, by inequalities, injustices and abuses, just like the formal economy. Workers are especially vulnerable within the informal economy, because work arrangements are outside of regulations that guarantee that workers are paid a minimum wage, work legal hours and work within a context that abides by health and safety regulations. If one adopts a positive view of the informal economy, one cannot ignore these serious problems. At the same time, these problems do not necessarily mean one must view the entire informal economy as negative. Either/or approaches to the informal economy should be avoided.

The chart on the next page summarizes the various theoretical approaches described above.

Theoretical Approaches to the Informal Economy

Negative Views of the Informal Economy			Positive Views of the Informal Economy		
Formalization/ Modernization thesis With modernization, the informal economy will eventually disappear. It is a backwards remnant of the past.	Marginalization thesis The informal economy exists in parts of the economy that are not profitable enough. Participation in the informal economy is an attempt to cut costs and maximize profits.	Marxist-Structural Analysis Similar to the marginalization thesis with a Marxist analysis: the formal economy is dependent upon the informal economy through an unequal exchange of labour	Neoliberal perspective Government's overregulation of the market is the cause of the informal economy. Decreasing government regulation would reduce the size of the informal economy.	Post-Capitalist theories The informal economy is growing today because of the choices of many who are dissatisfied with the modern, capitalist free market. People are rightly seeking alternatives to the formal economy that are more local and community based.	Green perspective A post-capitalist theory in which people seek alternative economies that are more sustainable and environmentally sound.
<p>The above theoretical approaches rely on an either/or assumption: either participation in the informal economy is involuntary – the result of exclusion – or voluntary – the result of a chosen exit strategy. The approaches oversimplify the informal economy as either negative or positive. On the negative side, the informal economy is viewed as a site of exploitation and oppression. On the positive side, the informal economy is said to be a site of freedom and agency.</p>					
<p>Beyond an either/or perspective: The informal economy as both negative and positive</p> <p>It is important to neither demonize nor romanticize the informal economy. Informal economies are characterized by acts of good faith and trust and also, at the same time, by inequalities, injustices and abuses, just like the formal economy. Workers are especially vulnerable within the informal economy, because work arrangements are outside of regulations that guarantee that workers are paid a minimum wage, work legal hours and work within a context that abides by health and safety regulations. If one adopts a positive view of the informal economy, one cannot ignore these serious problems. At the same time, these problems do not necessarily mean one must view the entire informal economy as negative.</p>					

Social and Public Policy Alternatives

How the state should choose to deal with the informal economy is not a simple question. It cannot be a matter of trying to get rid of it entirely, on the one hand, and simply allowing it to be, on the other. As we have seen, the informal economy has both positives and negatives. After researching the informal economy, one could conclude that reducing participation in the informal economy is not a realistic or desirable end goal. However, taking a laissez faire approach would allow the informal economy to grow unchecked, and would result in a great loss in tax revenue and lead to an unprotected workforce.

A third approach is to find the right balance of the informal economy. This approach follows from the marginalization theory and holds that the informal economy will inevitably exist in some marginal sectors without sufficient profit margins. Accepting that this is the case, this approach asks how we can minimize the negatives associated with the informal economy. In addition, within this approach, to the degree that the state chooses to take measures to reduce the size of the informal economy, it should also choose a harm reduction approach to minimize the harm on people currently employed within the informal economy. We've seen that the informal economy serves to some degree as a safety net where social assistance programs have fallen short, so the state should ensure to have an alternative safety net in place if it were to take away sources of income within the informal economy. According to Sevgul Topkara-Sarsu of Woodgreen Community Services in Toronto, seeing the informal economy as a positive buffer for the poor, we risk creating an excuse to avoid social change.

Finding the informal economy's appropriate size involves some repression of the economy since leaving it unchecked is not a viable option. As we have seen, especially in the Marxist structural analysis and marginalization approaches, participation in the informal economy is seldom voluntary on the part of the worker. However, participation can be said to be voluntary on the part of the consumer, who demands lower prices for goods than are appropriate in the formal economy. Further, participation can be said to be often voluntary on the part of the employer or contractor. In some cases, contractors who participate in part in the formal economy subcontract jobs to informal economy workers. Public policy approaches to repressing the informal economy miss the mark when they target the person who is employed in the informal economy. According to the Joseph Rowntree Foundation report, *People in Low-Paid Informal Work: Need not Greed*, "Punitive measures employed to 'tackle' this activity have limited success where poverty drives the decision to work informally. There is much to gain from developing strategies towards informal work that take into consideration people's level of need and access to opportunities, and regard people as untapped potential within the economy" (xi).

Stricter punishments for income tax evasion may not be as effective as punishments that are directed at the consumer and/or employer. As we have seen, working within the informal economy can to some degree be seen as involuntary. State efforts of repression should be directed at the voluntary actions of persons who have a choice thanks to their income levels. Potentially, this approach could lead to higher prices for consumers and the formalization of sectors that are currently associated with the informal economy. In summary, if participation in the informal economy is not voluntary for the people working in it but

voluntary for those consuming the products, then the onus is on the consumers to choose not to participate. One report suggests “transferring the responsibility for tax evasion from the producer to the consumer when any large cash payments take place” (Dellot, 2012, p. 8).

Further, it can be argued that the way in which the current social assistance program is set up encourages people to work under the table. Not declaring income is a temptation when the government retains 50% of income earned by those on social assistance. The recent change to the system that allows those on social assistance to earn \$200 per month without a reduction in social assistance received will, hopefully, reduce the need for people to hide income. However, as we noted earlier, social assistance levels do not constitute a livable income for recipients, even with the addition of an allowable income of \$200 per month.

In addition to penalties for consumers, a public awareness campaign aimed at consumers could reduce the demand for artificially low cost goods. According to Jones, Ram and Edwards: “... the pathology lies in the market or rather the double standards which, as we have earlier argued, welcome the availability of sub-normally cheap goods and services while deploring as pariahs the inevitably uneconomic businesses which produce them” (2006, p. 362). Educating conscientious citizens about the double standard could reduce the demand to some degree. Unfortunately, the continued demand for low-cost goods made in informal economies in developing countries demonstrates that public awareness campaigns do not seem to be significantly effective.

In addition, this approach would seek to challenge the ways in which the informal economy is structured such that certain groups of people are more susceptible to working within it and thus are more vulnerable than other groups of people. As we have seen, newcomers and women are more likely to participate in the informal economy than non-newcomers and men. To some degree then, the informal economy is socially constructed and, thus, with political will, could be reduced. Public policy approaches should concentrate on creating pathways for participation in the formal economy for newcomers in particular.

Earlier, we learned that the profitability is a prerequisite for businesses to abide by labour laws. “Not being compelled to exist below the threshold of profitability, the owners of these firms feel able to go about their business entirely transparently, without cutting legal corners or resorting to any of the customary subterfuges used to disguise revenues, wage payments and numbers of employees” (Jones et al, 2006, p. 362). One option, then, is state support for industries in which it is difficult for companies to make a profit. Tax relief for such industries and other supports such as minimum wage supplement programs could enable them to meet minimum wage, health and safety and employee benefits regulations.

The approaches discussed thus far suit marginalized, profit-deficient sectors. In “Shades of Grey in the informal economy,” Jones et al highlight the diversity within the informal economy. They note that some players within the informal economy are making high profits, and making a voluntary choice to stay within the informal economy. Informal economic activity is “part of a heterogeneous labour market with a hierarchy of its own” (p. 317). Employers who have the profitability to consider abiding by labour laws should be forced by the state to do so. According to Jones, Ram and Edwards, companies within their case studies that chose to abide by minimum wage laws found it less costly than they had originally feared (p. 371).

In conclusion, the diversity of the informal economy, which is entered by some by choice and others involuntarily, calls for a complex set of remedies.

Support, not Punishment, to Promote Formalization

This literature review is intended to provide a view of the wider context of which the informal economy in the West End of Toronto is a part. The focus of our study is not high-income tax evaders, but rather persons who are doing what they can to earn a livable income. If one assumes that everyone has a right to earn an income to support themselves and their family, and if formal jobs are not accessible, then working within the informal economy is a reasonable and arguably necessary choice. The question then becomes how can the government help those who are informally employed by promoting and guaranteeing their rights? Further, how can the government and non-profit organization support the transition to formalization without jeopardizing income levels. Urban centres around the world in so-called developed countries have thriving informal economies, so Toronto is not alone in facing this issue. Below are some examples of remedies offered in the literature:

Changing the tax system

According to the UK Joseph Rowntree Foundation in their report “People in low-paid informal work: ‘Need not greed’” the “tax system should not force people to choose between survival and informality” (xii). They suggest that persons with very low incomes should not be taxed. Further, they argue that the transition from receiving social assistance benefits to earning an income and being taxed should be smoothed, with an increased range within which persons can earn an income without being taxed. The report also suggests that tax breaks for certain organizations and persons would promote formalization and that voluntary sector organizations should be allowed to employ persons on social assistance in work that benefits the local community.

Changing to the social assistance system

The Rowntree report suggests that the benefit levels should be raised in order to cover basic living costs. Further, they argue that what is called the “Earnings Disregard” in the UK be raised. In Ontario, an earnings exemption of \$200 was introduced in the most recent budget tabled by Kathleen Wynne’s government. Beyond \$200 per month, income earned by persons on social assistance is clawed back a rate of 50%. Some would suggest that this earning exemption be increased or the percentage of income that is clawed back be prorated as income increases.

Improving support systems for newcomers

Access to the formal economy is made more difficult for newcomers to Canada for a variety of complex reasons. Support should be targeted at new immigrant communities to make it easier to find work within the formal economy. This includes training and assessment and recognition of foreign credentials.

Provide universal childcare

The Rowntree report suggests that universal childcare would decrease the demand for informal work. Oftentimes, informal work is chosen because it offers flexibility. Workers find that it is the only option within which they can attend to their family responsibilities while working. The

report adds that family-friendly employment policies would make the formal economy more hospitable to persons with family obligations.

Simplify formalization procedures

Benedict Dellot, in “Untapped Enterprise: Learning to Live with the Informal Economy,” a report produced by the Action and Research Centre, suggests simplifying the business establishment process. They suggest that the complicated system of registering a business and costly registration prevent many small business owners from formalizing. They suggest “creating a program where businesses can be established in a very short time-frame (1-2 hours) face-to-face” (7). Further, increasing the threshold at which businesses must apply for an HST number (currently \$30,000) could increase the incubation period in which businesses can grow their legs before committing to existing in the long term.

Early intervention programs

“Untapped Enterprise” suggests creating early intervention programs that target young people who are at risk of entering informal self-employment. For example, such programs could be put into place in training programs for the construction industries.

These are just a few of the examples of possible remedies that can be found in the Rowntree report and other literature. In later stages in this project, we will ask which remedies would better the situation in the West End of Toronto?

Possible Social Policy Responses:

- Change the tax system to make working informally less necessary/attractive
- Change the social assistance system to allow for recipients to have modest income without a reduction in assistance
- Improve support systems for newcomers and improve systems by which foreign credentials are recognized
- Provide universal childcare so that family obligations are not automatically a barrier to formal work
- Simplify formalization procedures for small business to reduce the time and effort required to formalize businesses
- Create early intervention programs to provide education to young people in sectors with high participation rates in the informal economy

Key Questions for Further Research

This literature review paints a general picture of theories about the informal economy. There remain many areas that would benefit from further research. In particular, we would like to focus on the local informal economy in Toronto. Little has been written about the informal economy on a local level.

We would like to ask questions such as what are the positive and negative aspects of the informal economy for low-income people living or working in downtown central-west Toronto. How can we develop policy alternatives and/or demonstrations to achieve improvements locally and beyond? Is it better to do nothing than something? How do participants in the informal economy view state intervention? How can we minimize the risk of negative unintended consequences? What policy alternatives have been developed already that would be suitable to apply in central-west Toronto?

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