



Session 2.3

The definition of the informal economy



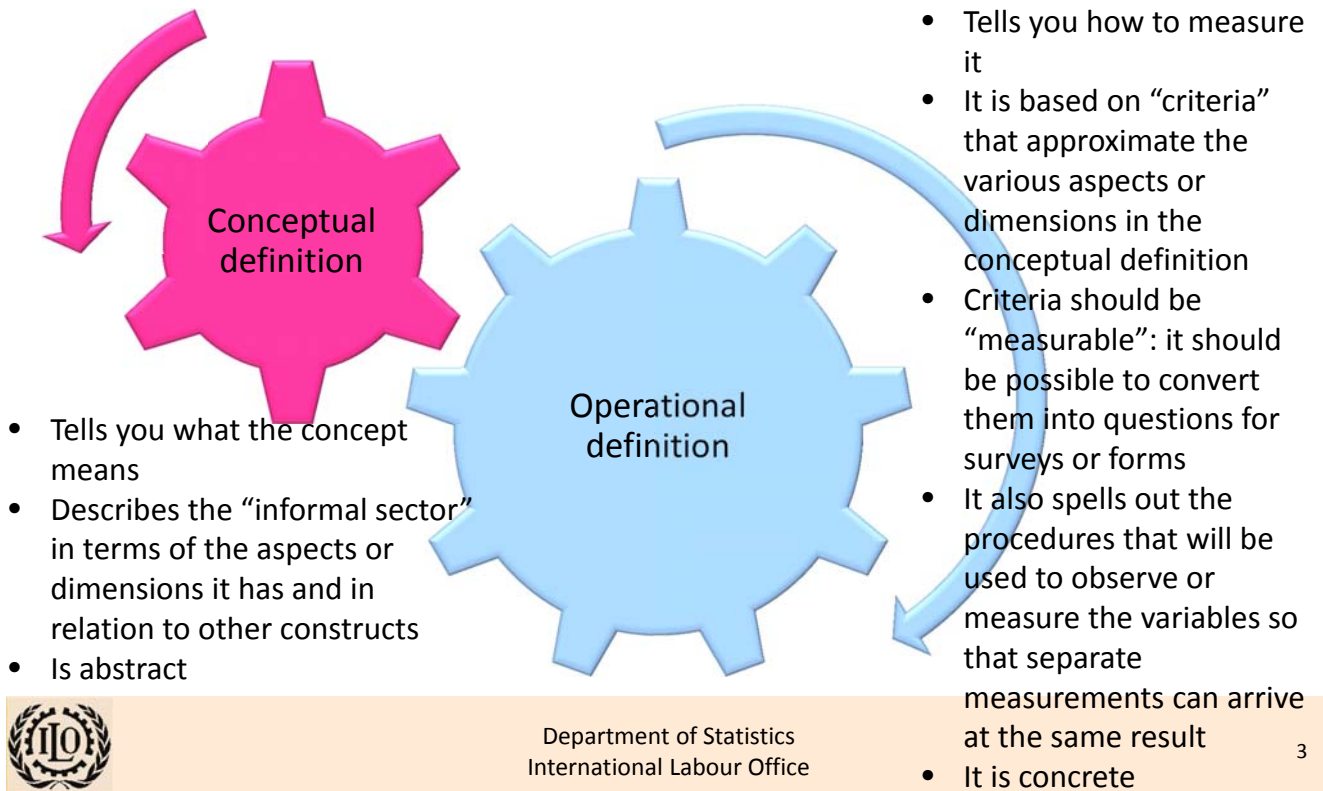
What we will cover in this session

- The definition of the informal sector
 - Concept and operational definition
 - Definition criteria
- How to arrive at a variable based on the definition criteria



International definition of the informal sector

Resolution concerning statistics of employment in the informal sector (15th ICLS, 1993)



Conceptual definition of the informal sector (§5)

Informal sector units ...

- Produce goods or services with the primary objective of generating employment and incomes to the persons concerned
- Operate at a low level of organisation, with little or no division between labour and capital as factors of production and on a small scale
- Depend on casual and family workers, rather than on employees with written contracts and formal guarantees
- Are household enterprises
- Do not intend to evade the payment of taxes or social security contributions, or to infringe labour or other legislations or administrative provisions
 - Should be distinguished from the concept of activities of the hidden or underground economy

Principles

The informal sector ...

- Is a characteristic of economic units
- Is part of the SNA "household" sector
 - The informal sector is part of, and coherent with, the System of National Accounts (SNA)
- Only includes units that produce for sale (even if only partly)



The informal sector is a characteristic of economic units

- We talk about informal sector units, or informal units
 - As opposed to enterprises, establishments, local units
 - Because many are household-based or mobile
 - Because it is difficult to identify with certitude establishments within enterprises in the informal economy
- Workers are classified in the informal sector
 - Based on the characteristics of the economic units where they work
 - This means that if an economic unit is informal, ALL its workers are in the informal sector
 - And persons who work in units outside of the informal sector are excluded from the informal sector, even if their jobs are precarious
 - Workers may work in an informal sector unit in one job and in a formal sector unit in another job

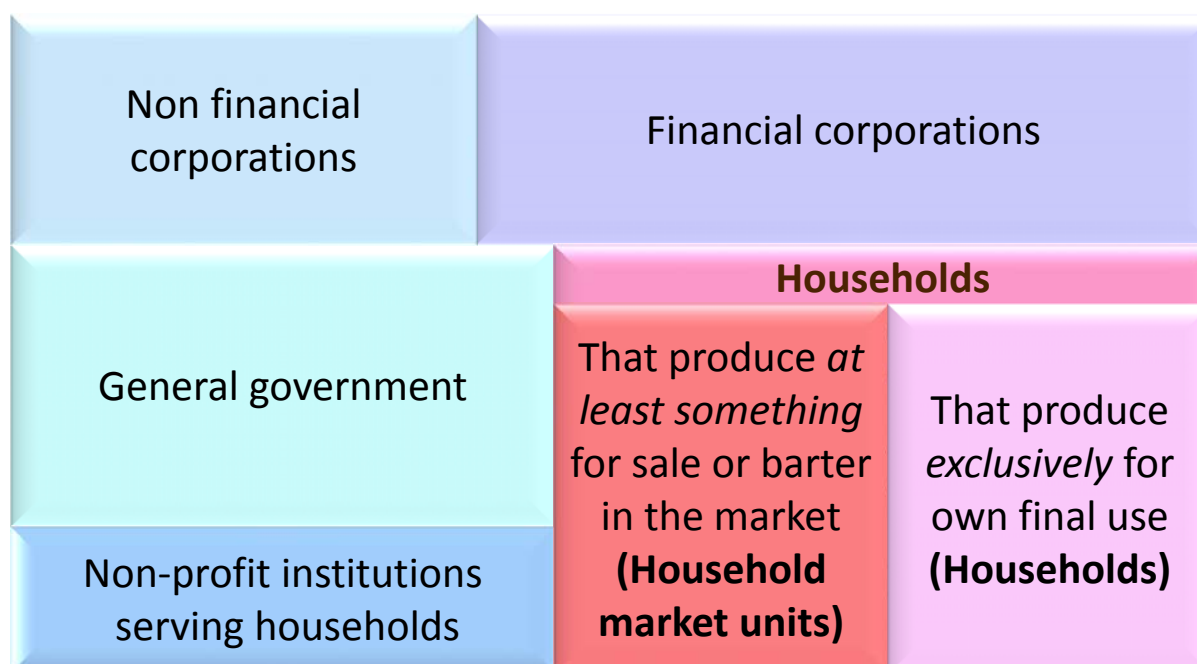


Informal sector units are part of the “household” sector

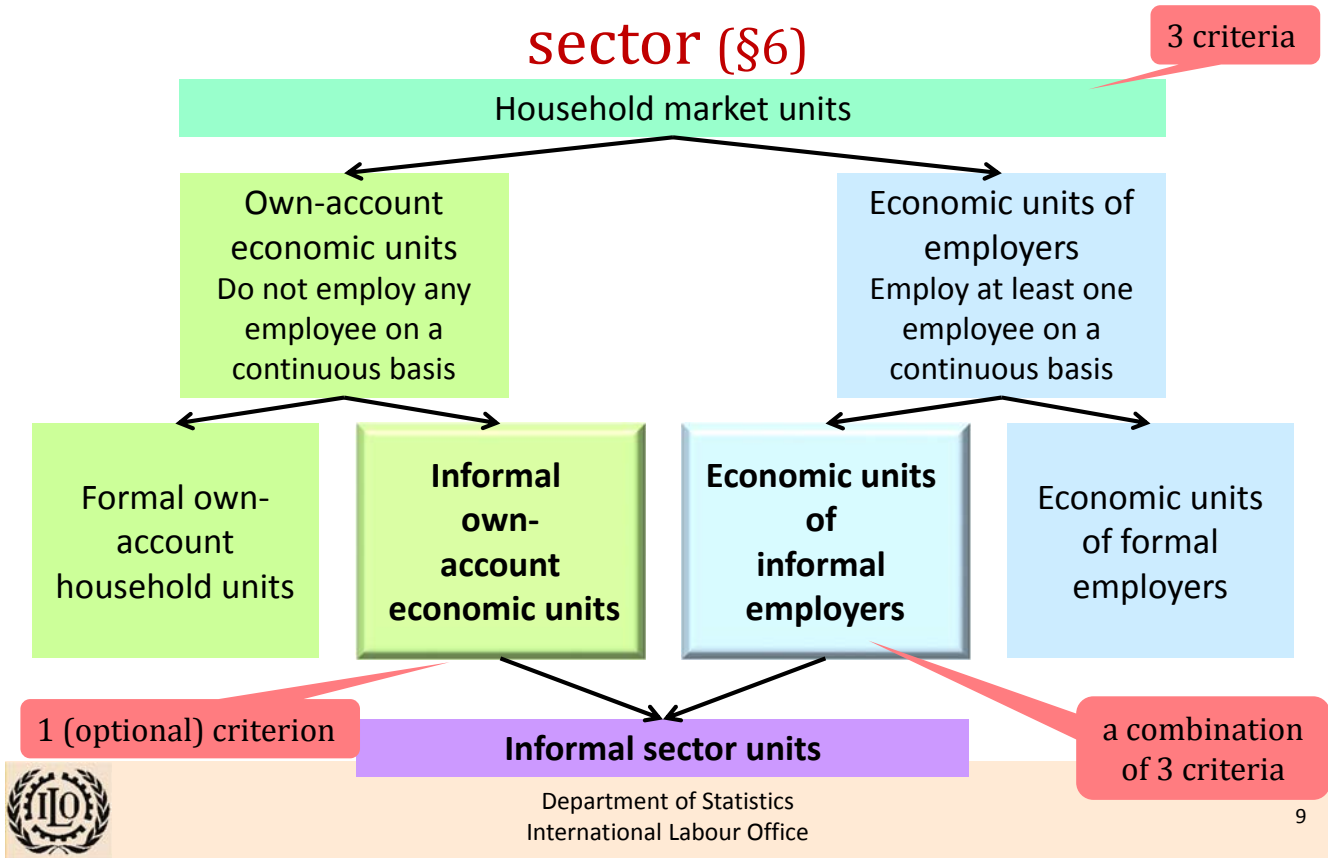
- The “household” sector is one of the institutional sectors used by the SNA to classify economic units:
 - Government, Corporations (financial and non-financial), Non-profit institutions serving households (NPISH) and Households
- Economic units in the “household” sector :
 - Are not constituted as separate legal entities (are owned by persons)
 - Do not have complete accounts as required by the government in the country (i.e., excludes quasi-corporations)
- To be in the informal sector economic units in the household sector have to produce at least some goods and services for sale or barter
 - When they produce goods and services exclusively for own final use they are excluded from the informal sector!!
 - Households that produce goods exclusively for own final use
 - Households that employ paid domestic employees



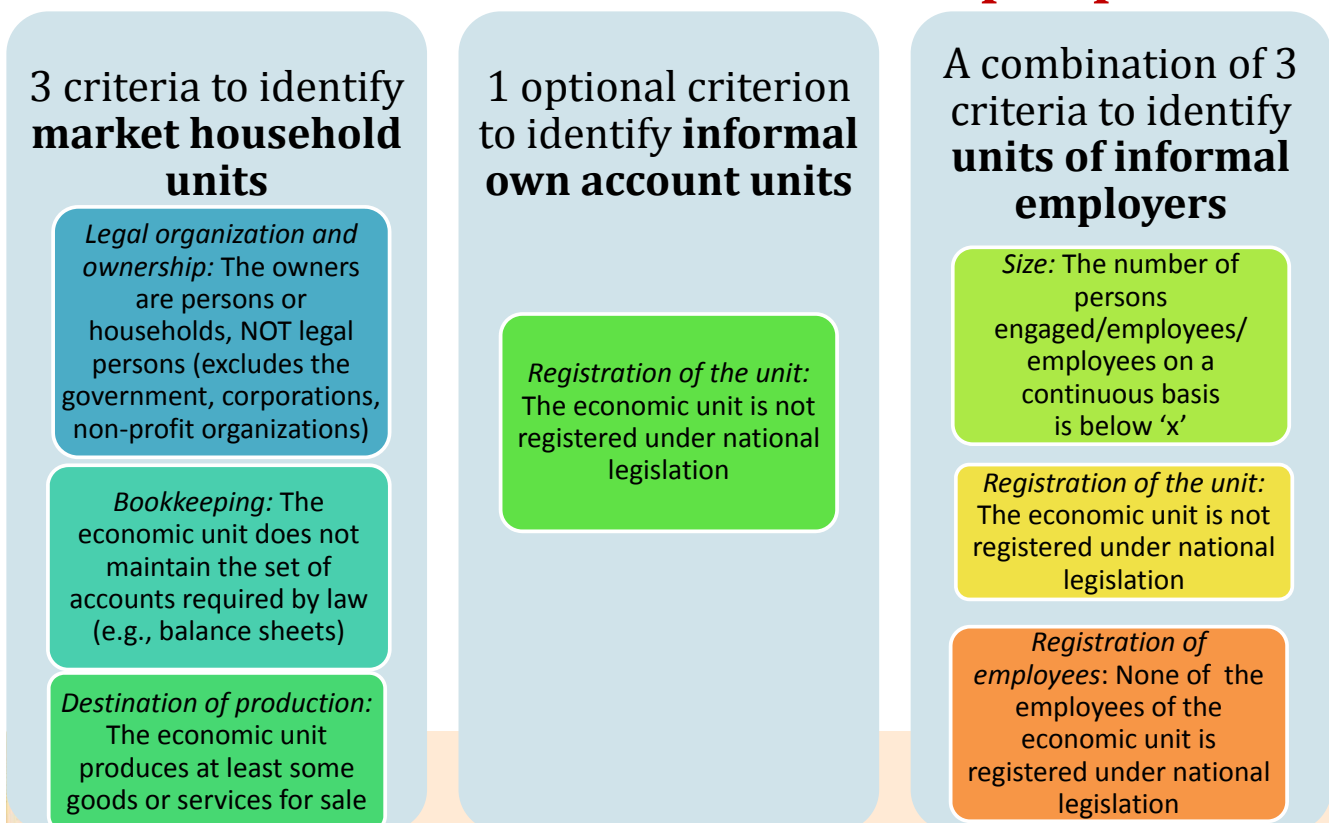
Informal sector units produce for sale or barter



Operational definition of the informal sector (§6)



Definition criteria and their purpose



The meaning of the “bookkeeping” criterion

- Each country has a different set of requirements for economic units
 - Corporations, Governments and NPIs are generally expected to maintain a full set of accounts, including balance sheets of assets and liabilities
 - So that there is a clear distinction of the production activities of the economic units from the other activities of their owners
 - So that it is possible to identify flows of income and capital between the enterprises and the owners
 - So that economic units can pay taxes on their production
 - Unincorporated economic units (usually small units) may not be expected to maintain any accounts or may be expected to maintain some accounts, even if not so detailed
- The criterion needs to be adapted to national realities
 - So that only those that are not keeping any type of accounts **as required** are included in the scope of the informal sector



The meaning of the “registration” criterion

- Registration needs to occur at the national level, not at the local level:
 - Factories’/ commercial acts
 - Tax/social security laws
 - Professional groups’ regulatory acts
 - Laws or regulations established by national legislative bodies
- Registration enacted by local authorities to obtain trade licenses or business permits is not relevant
 - Because they are governed by administrative regulations that may vary from region to region and in time
 - Because they do not affect the way the units operate and behave

All corporations are registered, but an unincorporated unit may also be registered: registration is not equivalent to becoming a corporation!!



Relevance of “registration” to define the informal sector

- Registration should identify economic units that do not conform with the legal and administrative framework in force in the country
 - It does not necessarily mean that these units are expected to pay taxes or provide full accounts
- It is not useful when :
 - The administrative and legal framework in the country does not expect all units to be registered
 - Respondents are not able or not willing to provide information about registration in a survey
 - There are changes in regulations or in their application that will affect the size of the informal sector as measured



The Delhi Group recommends to view registration as a characteristic of the informal sector and not as a defining criterion

Relationship between registration, bookkeeping and legal organization

- All corporations are registered, pay taxes and keep full accounts
- Some unincorporated enterprises may be registered and may keep full accounts
 - Known as quasi-corporations
- Some unincorporated enterprises may be registered but may not keep full accounts
 - Because the law only requires simple accounts for them
 - Because the law does not require any accounts or because the law is not followed
- When unincorporated enterprises are not registered, they will most probably not keep full accounts



Meaning of “small size” criterion

- No size was specified in the international standard
 - It is a proxy to low level of organisation and small scale operation
 - Should take into account the size limits used in formal sector establishment surveys
- Small size is to be determined based on ...
 - The number of employees employed on a continuous basis
 - This is the ideal measure but the information may not be easily reported
 - The total number of employees, including those employed on an occasional basis
 - The total number of persons engaged during the specific reference period, including the entrepreneur, the business partners, and the contributing family workers



Relevance of “small size” to define the informal sector

- Size should identify units that operate small scale and in a more traditional way
 - Governments and unions will tend to concentrate on larger units, so smaller units are often not in their radar
 - They tend to use more traditional production methods
- It may not be useful when:
 - It does not reflect the organization or objectives of the economic units
 - There are many formal units which are small and many informal units which are large
 - But do not discard it!! Complement it with other criteria: registration, place of work

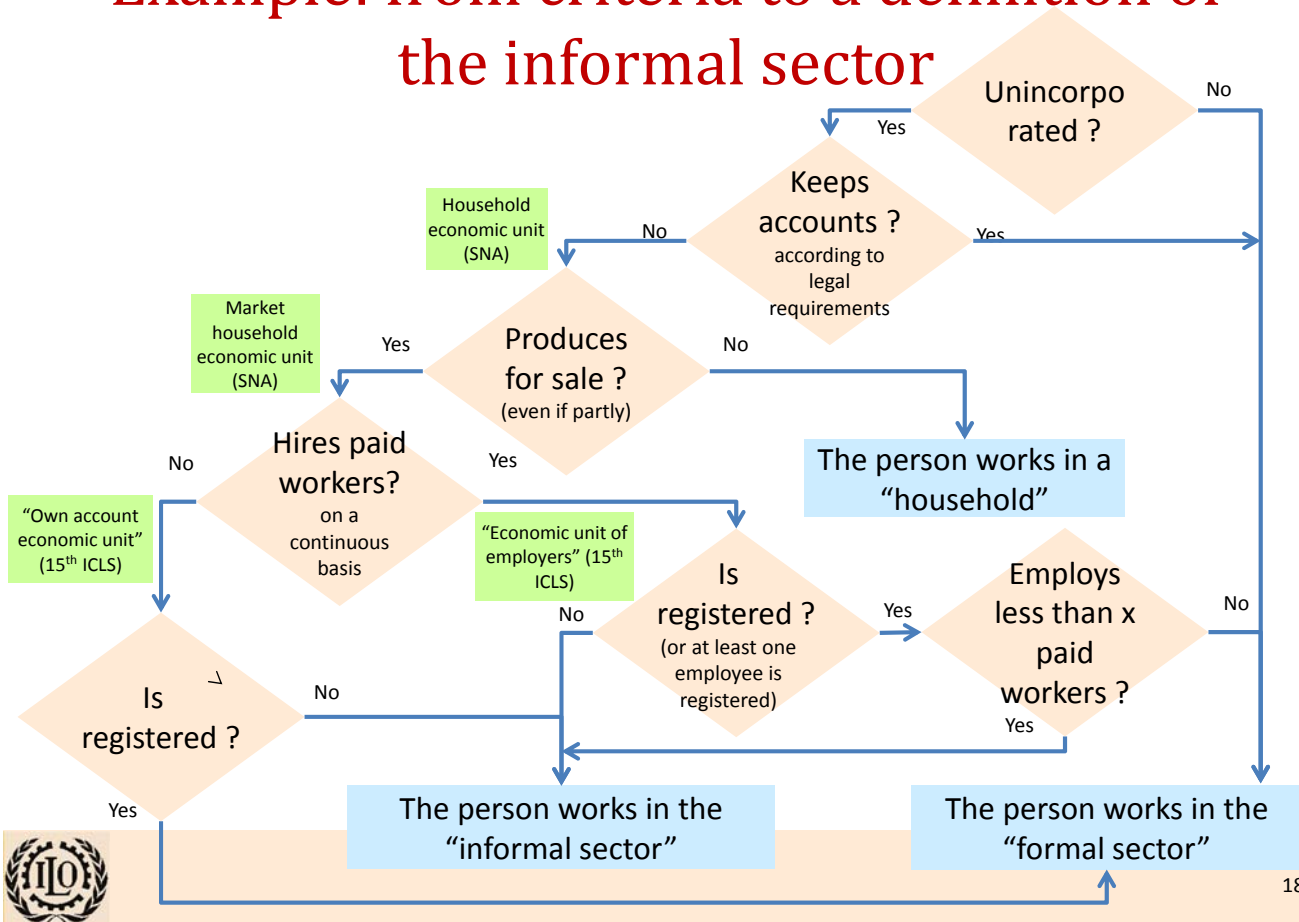


Meaning of “registration of employees” criterion

- A unit is informal if **none** of its employees is registered for tax or social security purposes
 - A unit is formal if at least one of its employees is registered for tax or social security purposes
 - But a unit is not necessarily informal if at least one employee is not registered for tax or social security purposes
 - But only if ALL its employees are not registered
- Very relevant where the registration of employees entails the registration of the enterprise employing them with the social security institution



Example: from criteria to a definition of the informal sector



Other criteria that can or have been used

These criteria **cannot** be used to define the informal sector on their own but may be used when information on main criteria is not available

- Place of work
 - Consider only those economic units that are located in the owners' dwelling, in the street, that are itinerant, etc.
 - Exclude economic units that have fixed visible premises, such as offices, factories, etc. – may be very restrictive!!
- Registration of economic units with sales tax authorities
 - Exclude economic units that are registered in this way
 - But the informal sector is not about paying taxes, but about coverage by formal arrangements – may be too restrictive!!
- Industry
 - Exclude those economic units that are in agriculture, in export oriented activities, in typically formal sector activities, etc.



Units included/excluded from the informal sector

- Excluded are households that produce exclusively for own final use
 - Paid domestic employees are therefore excluded
 - BUT: self employed domestic workers may be included if they satisfy the definition criteria
 - Subsistence agriculture, construction of own dwellings, manufacture of wearing apparel, furniture, water and fuel collection, etc.
- Included are (if they satisfy the criteria for inclusion):
 - Agricultural and related units
 - Units that provide professional and technical services for sale
 - Own producers of goods when some of the production is sold or bartered
 - Units that carry out illegal and underground activities



Challenge: international comparability

- Definition criteria allow different national definitions
 - Different industry coverage
 - Different set of criteria
 - Different cut-off points for size, when used
- Differences in national practices
 - Exclusion of secondary jobs
 - Inclusion of paid domestic employees
 - Exclusion of professionals and technicians



QUIZZZZZZZZZZZ!!!!

- An informal sector economic unit is a production unit operated in the owner's home
- All small economic units are in the informal sector
- A person is in the informal sector if he/she has a precarious job
- All migrant workers are in the informal sector
- A person can work both in the formal sector and in the informal sector



QUIZZZZZZZZ!!!!

- Informal sector units exclude
 - Farms
 - Large corporations
 - Units that do not keep full accounts
 - Units that do not sell anything
 - All employees who are registered with the social security
 - Workers who work in the government but who are not registered
 - Unpaid workers in prisons
 - Paid domestic employees
 - Unpaid trainees in the government
 - Home-based workers who work for a multinational

