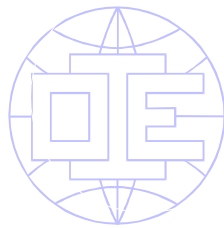


THE INFORMAL ECONOMY

THE EMPLOYERS' APPROACH



INTERNATIONAL ORGANISATION OF EMPLOYERS

*Adopted by the Management Board
on 10 November 2001*

<p style="text-align: center;">THE INFORMAL ECONOMY THE EMPLOYERS' APPROACH</p>

A. DEFINITION AND FEATURES

1. The IOE recognizes that the informal economy consists of:
 - entrepreneurs and workers who are unable to find employment or business opportunities in the formal economy – and in whose case it is a survival strategy – as well as those who choose to remain informal;
 - people who find that the costs of conforming to the regulations and laws in pursuing economic activities in the formal economy often exceed the benefits;
 - people who often cater to relatively poor consumers who require goods and services at affordable prices;
 - people who have had to develop their own norms or rules in place of ones the state has failed to provide, or to which they have no access.
2. The IOE views the informal economy as encompassing the entrepreneurial activities as well as its workers. The term “informal economy” is more appropriate than “informal sector”, as it applies to numerous sectors of economic activity.
3. Certain types of enterprises (e.g. micro enterprises) and work arrangements (e.g. contract work, part-time work, self-employment and temporary work) are not solely parts of the informal economy and should not be defined as such. In most instances, these enterprises and work arrangements are a regulated and productive part of the formal economy.
4. Even though no single definition of the informal economy will suffice due to its complexity and the multitude of forms it takes in different countries, it should nevertheless be recognized that it is characterized by economic activities at different levels of sophistication so that:

- at the lower end are mostly self-employed people trading in basic commodities like food or providing basic transport;
 - at the middle level are those engaged in more organized trade and small and simple manufacturing of basic goods for customers in the informal economy, employing mainly family members;
 - at the upper end are those engaged in small scale manufacturing with low levels of technology, or providing services such as repairs to machinery and vehicles, employing both family and non-family members, and which generally take the form of micro-enterprises.
5. The IOE does not believe that informality is the result of globalization because the origins of the informal economy pre-date the current phase of globalization. It is policy and institutional failures that continue to contribute to informality, thus resulting in the informal economy as a shelter for those who would otherwise have no employment, business opportunities or income sources.
6. The IOE recognizes that the informal economy has both positive and negative characteristics such as:

Positive

- its large entrepreneurial potential, which could flourish if the obstacles its entrepreneurs face can be overcome;
- its capacity to absorb excess labour (as entrepreneurs, self-employed people or as workers) who would otherwise have no employment or income.

Negative

- operations outside the main regulatory and administrative framework, leading to non-conformity with laws and regulations and tax avoidance, thus creating an unfair burden on formal economy employers and resulting in loss of revenue to government;
- lack of adequate social protection, security and labour rights;
- unfair competition with the formal economy;
- relatively low pay, poor working conditions and safety and health standards, low productivity and relatively unstable employment, though many self-employed people and entrepreneurs have incomes exceeding those of unskilled workers in the formal economy.

B. POLICY ISSUES AND OBJECTIVES

7. The main issues and policy objectives should be directed not towards expanding this economy on the basis of its potential to create employment, but to overcome the obstacles the people operating in it face. As such, the concrete issues and objectives include:
- The priority should be to identify the root causes for the existence of the informal economy and the barriers to formalization; thereafter to dismantle the obstacles to “formalization”, and assist the informal entrepreneurs to grow so that their activities, units or enterprises could be more easily covered by social and other legislation and rules.
 - The automatic extension of existing social protection and security systems can adversely impact on society and the economy if they are unaffordable. The workers of the formal economy would pay the consequences.
 - At least the lower end of this economy is unlikely to be formalized, especially in countries which will, in the foreseeable future, continue to experience poverty and inadequate employment opportunities.
 - Efforts to move informal businesses and workers into the formal economy should not result in the destruction of the employment created in the informal economy.

C. LABOUR RIGHTS AND THE INFORMAL ECONOMY

8. While the IOE supports the improvement of working conditions and labour rights for workers in the informal economy, it does not view this objective as solving the main problems that account for the existence and persistence of the informal economy because:
- poor labour conditions and rights are *results*, *not* the causes, of the economy;
 - the causes of informality must be addressed to enable improvement of labour conditions;
 - this economy does not consist only of managed enterprises and workers, but also includes a large category of self-employed people and family-based enterprises and workers.

**D. CAUSES AND CONSEQUENCES OF INFORMALITY
AND BARRIERS TO ENTRY INTO THE FORMAL ECONOMY**

9. The main barriers to entry into the formal economy and the causes of informality consist of the following, many or most of which relate to the absence of a facilitative business environment:
- The absence of, or weak, market supporting and enhancing institutions essential for the proper functioning of a market economy. These institutions may be both formal and informal, adapted to suit the situation and cultures of different societies.
 - Where they exist, these institutions are not always accessible to those operating in this economy.
 - Excessive transaction costs (which are determined by rules and regulations that impact on economic activities) and over-regulation are often the result of poorly designed and obstructive rules that constitute barriers to doing business, and lead to inefficient, ineffective and corrupt public administration systems.
 - The absence of an adequate system of property rights that prevents the generation of domestic capital needed for business development.
 - Lack of access to credit due to the absence of property rights and the failure of the credit market system to service informal economy entrepreneurs, which compels informal businesses to devise their own credit systems or borrow at a higher interest rate.
 - The absence of a facilitative legal system to which the poor have access (e.g. for contract enforcement) and which enables business transactions, and respect for the rule of law.
 - Lack of access to insurance, market information and technology.
 - Inability or failure of governments to develop the policies and institutions required for the formal economy to be able to absorb new job seekers and the unemployed.
 - Migration from the rural to the urban sector, often in search of non-existent jobs.
 - Lack of education and skills to function in the formal economy, as well as widespread illiteracy in some countries. This deficiency causes many workers to be unsuitable for available jobs, and can prevent the creation of new jobs that require an educated and skilled workforce.

- Labour market rigidities.
 - Failure over several decades of different development models to deliver growth, as well as major debt crises afflicting some countries.
10. Informality results in:
- Restricted access to or absence of organisations to adequately represent the interests of both entrepreneurs and workers.
 - The perpetuation of poverty in some cases, but an escape from poverty in other cases.
 - Endemic corruption.
 - Loss of revenue to government and local authorities.
 - Inefficient use of resources, resulting in lower economic gains than otherwise, with adverse impacts on national growth rates and overall economic and social performance.
 - Relatively poor working conditions.
 - Lack of access to capital, credit and technology.
 - Low levels of productivity.
11. Development and other economic and political policies are not taking account of the needs of people in the informal economy, whether they be owners of the activities or workers. Since this is often the bulk of the economy, many development policies therefore fail.

E. REMEDIES AND SOLUTIONS

12. While not advocating the same remedies or solutions applicable to all countries as policy responses should match the needs and situation in each country, the IOE supports the following solutions as being often relevant to the informal economy situation in many countries:
- Identifying the causes of informality, the barriers to formalization and eliminating these barriers.

- Simplifying rules and procedures; promoting efficient, effective and corruption-free governments; reducing unnecessary transaction costs and creating or reforming market institutions.
- Assisting informal businesses to gain entry to, or to create and develop, organisations through which they can lobby for economic and legal rights.
- Promoting cooperatives based on business principles.
- Providing a system of property rights to enable informal businesses to generate capital and obtain credit.
- Providing affordable social benefits for workers.
- Ensuring that efforts towards formalization do not create other political and socio-economic problems by suppressing micro-enterprises, increasing unemployment and causing loss of income to the poor.
- Reducing the high costs of formalization, and providing short-term incentives and concessions to encourage formalization to offset the initial costs of formalization.
- Developing policies, procedures and institutions that can help informal businesses to access their requirements to function in a market economy such as market information, credit and capital, insurance, markets, technology, productivity improvement services, basic management and skills training, and contract enforcement.
- Promoting governments to examine the basic features of an environment conducive to business, investment and technology absorption, with a view to changing policies and institutions, where necessary, to bring about a facilitative business environment.
- Adopting flexible regulations that recognize new and non-standard forms of employment, not as a symptom of informality, but as ways of doing business which have existed in many countries for generations, even though they do not fit rigid concepts of labour laws.
- Reforming legal systems and ensuring equal access to them.
- Developing regulations that apply to all types of economic activities – e.g. health and safety regulations – so that enterprises are not tempted to move from the formal to the informal economy.

F. THE ROLE OF EMPLOYERS' ORGANIZATIONS IN THE INFORMAL ECONOMY

13. The IOE encourages policies and efforts by employers' organizations to assist the formalization of the informal economy through measures that are appropriate to their own capacities and national circumstances, since such assistance:
 - promotes socio-economic growth development;
 - helps to address policy, legal and institutional shortcomings which would lead to improvements in the business environment and to business expansion;
 - helps to create more, better and productive jobs;
 - promotes small enterprise development;
 - enlarges the potential membership base of employers' organizations;
 - spreads the tax burden more equitably and enables government, through increased revenues, to make productive public investments.

14. Employers' organizations, in collaboration with or through other relevant organizations or institutions, could assist in the transition of parts of the informal into the formal economy in the following ways, especially since the same services needed by small enterprises are often relevant to informal sector enterprises:
 - Developing and implementing a lobbying agenda geared to addressing the causes of informality through simplification of regulations covering business activities, reducing transaction costs, etc.
 - Influencing policy makers to develop policies and temporary incentives to encourage informal economy operators to make the transition to the formal economy and be covered by the normal business regulatory framework.
 - Developing relevant business support services to small operators.
 - Providing operators in the informal economy with the information to which they have little access, such as government laws and regulations affecting business and market opportunities and market information.
 - Assisting informal enterprises to form associations and admitting them to membership.

- Providing basic services in personnel management, productivity improvement, management skills, accounting and entrepreneurship development relevant to informal enterprises.
- Assisting in developing links to larger enterprises, the scope for which has increased due to globalization.
- Initiation of projects or programmes, adapted to the needs of informal enterprises, that have important by-products such as productivity enhancement through waste reduction; improved safety and health; a cleaner environment, and improved labour-management cooperation.
- Facilitating access to finance, insurance, technology, networks and other resources, as well as to public authorities.
- Promoting national policies to achieve universal literacy and primary and secondary education, essential to an educated and skilled workforce required by the formal economy.
- Collaborating with, or developing, institutions through which service delivery could be effected, including entrepreneurship and training institutions geared to meeting the needs of enterprises in the informal economy.

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