

Informality: WIEGO versus The Economist

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Acknowledgment

- Recent Volume.
- Basudeb Guha-Khasnobis, Ravi Kanbur and Elinor Ostrom (editors). *Linking the Formal and Informal Economy: Concepts and Policies*. Oxford University Press. 2006.
- I owe a debt to my co-editors and co-authors, but they should not be held responsible for my errors or deviations!

Two Quotes

- “Thanks largely to baroque regulation, half the labour force toils in the informal economy, unable to reap the productivity gains that come from technology and greater scale.”

– *The Economist (2010)*

- “Economic stagnation and labour market rigidities alone cannot explain the extent of informal employment...”

– *Chen and Doane (2008)*

Informality: The Central Idea

- Activities which are inside the purview of the state and its laws and regulations are formal. Those outside are informal.
- Of course “which laws”, “inside the purview” need to be specified further, but the core idea should be clear.

Informality: The Central Idea

- Hart (2006), about Hart (1973)
- “Following Weber, I argued that the ability to stabilize economic activity within a bureaucratic form made returns more calculable and regular for the workers as well as their bosses. That stability was in turn guaranteed by the state’s laws, which only extended so far into the depths of Ghana’s economy. ‘Formal’ incomes came from regulated economic activities and ‘informal’ incomes, both legal and illegal, lay beyond the scope of regulation.”

Informal versus Formal: A Brief Economists' History

- Lewis (1954): “...the workers on the docks, the young men who rush forward asking to carry your bag as you appear.....”
- Dualism in economic organization—capitalism versus family structures. (Harking back to Marx and reserve army of labor).
- As development proceeds the traditional sector will diminish in size.
- But note: the state as such is largely missing from Lewis.

Informal versus Formal: A Brief Economists' History

- Harris and Todaro (1970). Extremely Influential.
- In one sector, wages kept above “market clearing” by minimum wage laws (or unions) backed up by the enforcement power of the state.

Informal versus Formal: A Brief Economists' History

- So, employment in this “formal” sector lower than otherwise, and the size of the rest of the economy, the “informal” sector, larger than otherwise.
- This allocation is “inefficient” and in some ways “inequitable” (protection of insiders in the formal sector).
- Hence the strong policy conclusion—focus on the removal of the regulation.

Informal versus Formal: A Brief Economists' History

- Right up to date. *The Economist*, 2010, Review of Latin America.
 - “High payroll taxes in many Latin American countries penalize workers in the formal economy, and rigid and over-generous labour laws discourage the creation of formal jobs...”

A Simple Framework

- Imagine a world without state laws and regulations into which laws and regulations are introduced. Economic agents have to decide how to respond. This creates several categories of economic activities:

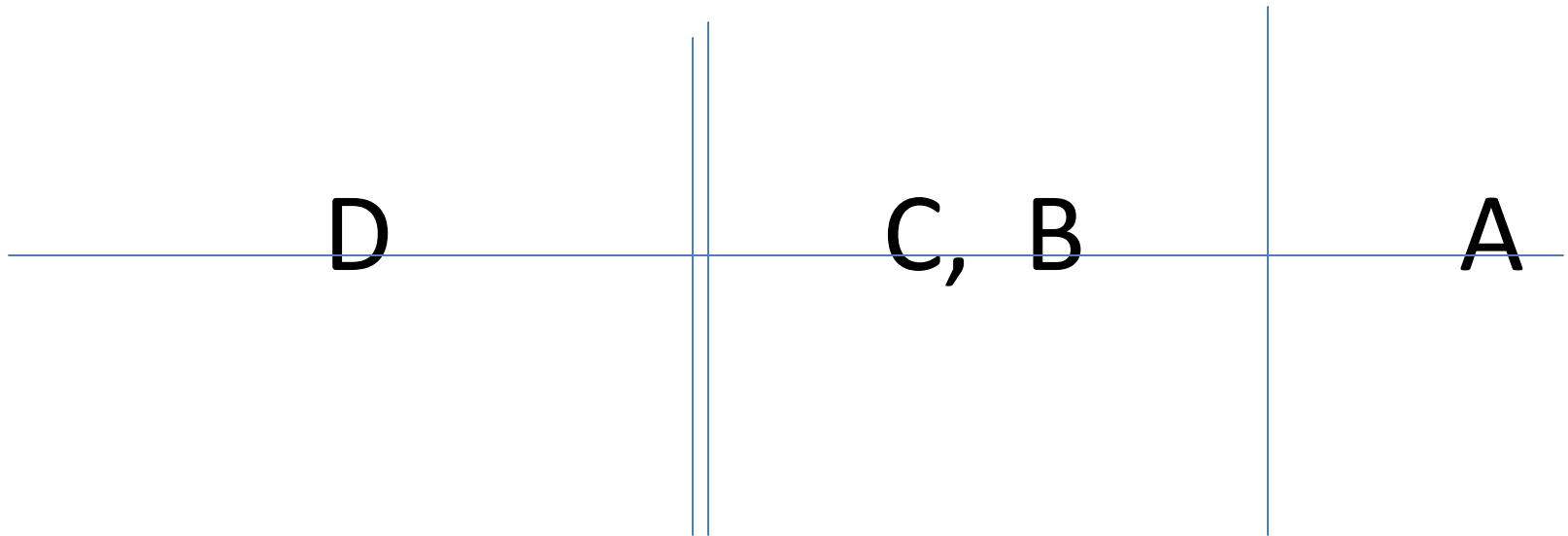
A Simple Framework

- A. Within the ambit of the laws and complying.
- B. Within the ambit of the laws but not complying.
- C. Adjusted activity to go outside the ambit of the law.
- D. Always outside the ambit of the law

A Simple Framework

- Let it be stipulated that this framework is simple.
- Of course there are cross-linkages eg some in D supply those in A etc etc.

A Simple Framework



Back to WIEGO vs *The Economist*

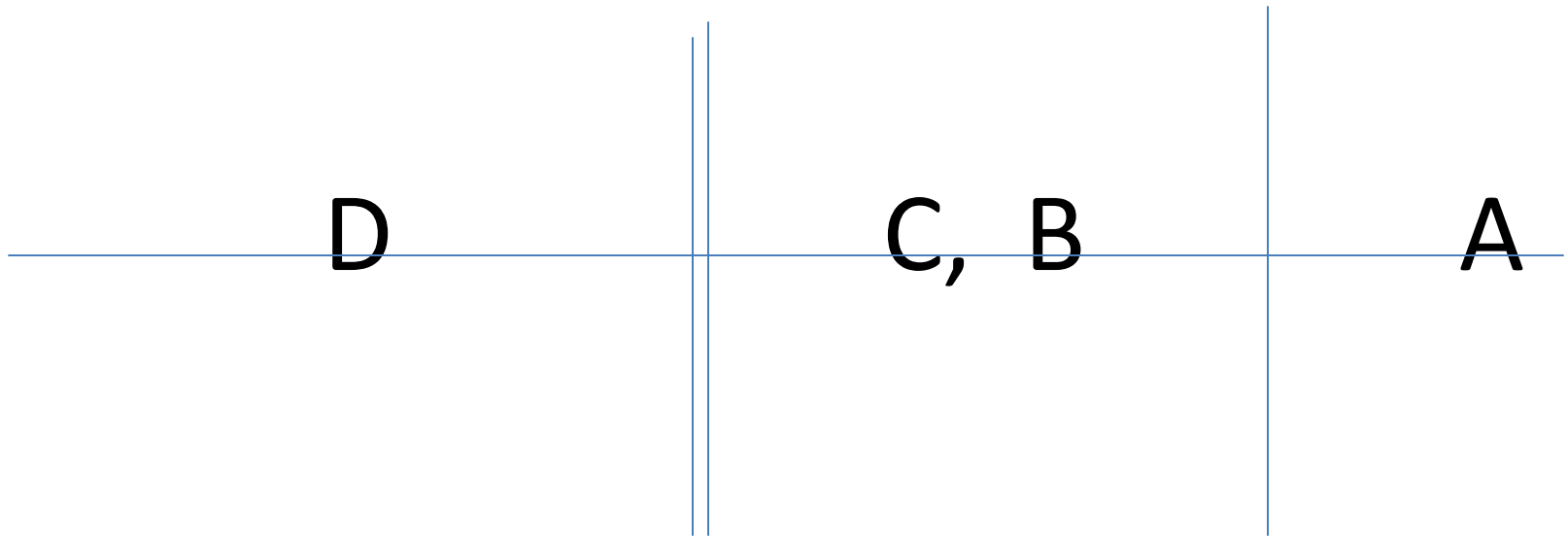
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A Simple Framework



Research Questions

- How big is $B+C$ relative to D ? (Also, how big is B relative to C ?)
- What exactly is the impact of specific laws and regulations on the size of B and C relative to A ?
- How do changes in technology and global trading conditions shift the balance between B , C and A ?
- What are the productivity differences between $B + C$ and A ?

Research Questions

- What are the productivity differences between D and B + C?
- What can increase productivity in D?

Research Questions

- If the objective is greatest sustainable impact on poverty, then is it best to use limited financial, administrative and political resources to (i) raise productivity in D or (ii) reforming regulations to reduce adjustment out of A into B and C?
- I *think* WIEGO would say (i). I *think* The Economist would say (ii).
- I *know* that we do not have sufficient research to provide the answer with confidence.

Thank You!