

Merits and Demerits of 'Informal Economy'

MERITS	DEMERITS
1. Contributes indirectly to economic growth	1. Revenue loss to government due to tax evasion
2. Stimulates the formal or official economy	2. Lack of legal control that leads to illegal activities
3. Provides ample employment opportunities	3. Low paid jobs and poor job security
4. Reduces unemployment and poverty	4. No legal and social benefits to workers
5. Generates sizable personal income	5. Lack of economic security
6. Maintains flexibility of production	6. No access to formal sources of finance
7. Helps in meeting market demand of products	7. Unprotected labour laws
8. Puts competitive pressure on formal sector	8. Unrecorded cash transactions to avoid taxes
9. Increase variety of products sold in market	9. Incorrect measurement of GNP
10. Helps bring down market prices of goods	10. Unreported revenues in National Accounts

(Source: ICMA Pakistan Research)

Formal and Informal Employment

The informal sector in every country constitutes a substantial share of GDP and labour force. According to an estimate, the informal sector now encompasses around 60% of global labour workforce or around 40% of global GDP. The informal economy in the developing countries has witnessed massive expansion.

ILO in the third edition of its publication titled "Women and Men in the Informal Economy: A Statistical Picture" [released in April 2018] mentions that over 60 percent of world's employed population, which comes to around two billion people, earn their livelihoods in the informal economy. The Report states that

nations (18%). At regional level, the sub-Saharan Africa tops with 92 of employment workforce in the informal sector.

Informal Workers by Gender and Status in Employment

At the global level, men have higher rates of informal employment than the women. However, in the developing countries women are more in the informal sector (92%) than men (87%). As far as informal workers from the perspective of status in employment suggest that 64% are self-employed as against 36% wage employers. The same trend is witnessed in the developed, developing and emerging countries.

Global Snapshot

Table 1.1: Workers in Informal Sector
[as %age of Total, Rural and Urban Employment]

Countries by income level *	Total	Rural	Urban
World	61	80	44
Developing	90	90	79
Emerging	67	83	51
Developed	18	22	17

* 2018 World Bank definitions based on country levels of gross income per capita

evidence shows majority of the people enter the informal economy not by 'choice', rather as a consequence of lack of opportunities in the formal economy and absence of other means of livelihood.

Regional Snapshot

Table 1.2: Workers in Informal Sector
[as %age of total employment by region [excluding developed countries]

Region	Informal Workers
Sub-Saharan Africa (excluding South Africa)	92
Sub-Saharan Africa as a whole	89
South Asia	88
East and South East Asia (excluding China)	77
Middle East and North Africa	68
Latin America and the Caribbean	54
Eastern Europe and Central Asia	37

According to ILO, self-employment is pre-dominant aspect of the informal economy and a vital source of livelihood for women in the developing world, especially in those areas where cultural norms bar them from work outside the home or where,

Table 1.3: Informal Workers by Sex and Status in Employment

Countries by income level	By Gender (as % age)			By Status in Employment (as % age)	
	Total	Women	Men	Wage-employment	Self-Employment
World	61	58	63	36	64
Developing	90	92	87	21	79
Emerging	67	64	69	37	63
Developed	18	18	19	51	49

According to the ILO publication, the highest percentage of workforce in informal sector is in the developing countries (90%) whereas the lowest share of workforce is in the developed

because of conflict with household responsibilities, they cannot undertake regular employee working hours.

The Case of SAARC countries

The tendency of informality, especially in the South Asian countries, is on the rise. As per ILO study, almost 96% of young people in South Asia are informally employed whereas over 80% of South Asian women in non-agricultural jobs are in informal employment. Table 2 shows the formal and informal employment in the SAARC countries. As evidenced from the

Friedrich Schneider and published in January 2018, provides a research on shadow economies in 158 countries of the world during the period 1991 to 2015. Based on results of IMF Working Paper, the GlobalEconomy.com, <https://www.theglobaleconomy.com> which serves researchers, academics, investors and business people needing reliable economic data on foreign countries, has developed a ranking of 158 countries. As per the country ranking of shadow economy, it transpires that

Table 2: Formal and Informal Employment in SAARC countries

[Source: ILOSTAT]

Sr.	Country *	Total Employment (a)	Informal Employment (b)	Formal Employment (c)	Employment outside the formal sector (d)	Share of Informal Employment in Total Employment (b/a)	Share of informal employment outside the informal sector in total employment (d/a)
1	Bangladesh	36,135.1	32,992.3	3,142.7	25,247.3	91.30%	69.87%
2	India	2,03,093.2	1,51,957	51,136.2	1,34,199.2	74.82%	66.07%
3	Nepal	5,562.9	4,318	1,244.9	2,765.8	77.62%	49.72%
4	Pakistan	37,421.1	26,654.8	10,766.3	25,471.6	71.23%	68.07%
5	Sri Lanka	5,793.8	3,819.6	1,974.2	3,000.2	65.93%	51.78%

* SAARC countries excluding Bhutan, Maldives and Afghanistan

Method of computation

- 1) Share of informal employment in total employment (%) = Informal employment / Total employment x 100
- 2) Share of informal employment outside the informal sector in total employment (%) =
Persons in informal employment outside the informal sector / Total employment x 100

table, the share of informal employment in total employment is highest in Bangladesh (91.3%), followed by Nepal (77.6%); India (74.8%); Pakistan (71.2%) and Sri Lanka (65.9%). As far as the share of informal employment outside the informal sector in total employment is concerned, Bangladesh with 69.8% share tops the list whereas Nepal with 49.7% has the lowest share. Pakistan stands at second position with 68 percent.

ILO has defined the 'Informal employment outside the informal sector' as persons who are in their main or secondary jobs namely (1) **Own-account workers** engaged in production of goods exclusively for own final use by their household (2) **Contributing family workers**, irrespective of whether they work in formal or informal sector enterprises and (3) **Employees holding informal jobs**, whether employed by formal sector enterprises, informal sector enterprises, or as paid domestic workers by households. Two aspects need to be explained here about the last two workers.

The informal nature of jobs of 'contributing family workers' is due to the fact that such workers usually do not have explicit or written employment contracts and also their employment is usually not subject to labour legislation, social security regulations, collective agreements, etc. Similarly, the employees are considered to have informal jobs if their employment relationship is, in law or in practice, not subject to national labour legislation, income taxation, social protection or entitlement to certain employment benefits (paid annual or sick leave, etc.) for various reasons.

IMF Working Paper on Shadow (Informal) Economy

International Monetary Fund (IMF) in its Working Paper titled 'Shadow Economies Around the World: What Did We Learn Over the Last 20 Years?' authored by Leandro Medina and

Switzerland has the lowest value with only 6.94 percent in 2015 whereas Zimbabwe has the highest value of 67 percent.

The rankings of the SAARC countries are provided in Table 3.

Table 3: Shadow [Informal] Economy as %age of GDP - Rankings of SAARC Countries

Country	Shadow Economy (% of GDP)	Ranking in 158 countries	Ranking of SAARC countries [1 for lowest and 5 for highest share]
Sri Lanka	35.5%	36	5
Pakistan	31.6%	59	4
Nepal	30.2%	69	3
Bangladesh	27.6%	84	2
India	17.9%	125	1

Note: Highest ranking i.e. 125 means lowest share of shadow economy whereas lowest ranking i.e. 36 means highest share of shadow economy

Sri Lanka: The average value for Sri Lanka during 1991 to 2015 was 45.58 percent with a minimum of 35.49 percent in 2015 and a maximum of 52.94 percent in 1991.

Pakistan: The average value for Pakistan during 1991 to 2015 was 33.1 percent with a minimum of 30.28 percent in 2010 and a maximum of 37.55 percent in 1991.

Nepal: The average value for Nepal during 1991 to 2015 was 37.5 percent with a minimum of 30.22 percent in 2015 and a maximum of 43.39 percent in 1991.

Bangladesh: The average value for Bangladesh during 1991 to 2015 was 33.59 percent with a minimum of 27.42 percent in 2014 and a maximum of 37.12 percent in 1993.

India: The average value for India during 1991 to 2015 was 23.91 percent with a minimum of 17.89 percent in 2015 and a maximum of 28.43 percent in 1991.



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Way Forward

The informal or unorganized or shadow economy in Pakistan is a big business as it is a huge employer and shall continue to play a key role in the future development of Pakistan. Hence, the Government should take it seriously to unleash the potential in informal sector by encouraging the firms and workers in informal economy to make a gradual transition towards the formal and organized sector. In this context, the following suggestions may be considered by the Governments in SAARC countries:

- 1) It is a fact that informality is more prevalent in economies with more cumbersome entry regulations and rigid labor laws. Hence, the policy makers in SAARC countries must restructure their labour market laws and policies so as to avoid further increase in the level of informality.
- 2) The informal sector needs to be organized and its contribution to economic development needs to be recognized through increased awareness in governments of SAARC.
- 3) The vulnerable segments of the society should be provided financial support by the governments in shape of stronger safety nets and greater labor and product market flexibility. The informal firms may also be provided better access to resources.
- 4) Concrete measures should be taken to create a level playing field for both formal and informal workers and firms as well as ensuring greater access to finance and public services to help increase productivity in the informal sector.
- 5) All policy making should be made with underlying objective to facilitate formalization of informal businesses and workers and discourage informalization of the formal economy firms and jobs.