Informal Employment in Countries in Transition: A conceptual framework

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Abstract

In the past few years the informal sector in countries in transition has increasingly become the focus of research, public policy and the media. The term ‘informal sector’ has been used to describe an extremely wide spectrum of activities, which do not necessarily have much in common, such as tax evasion, corruption, money laundering, organised crime, bribery, subsistence farming, barter, petty trade, and the stealing of state property. This is problematic for the design of public policy as these activities may raise very different (and conflicting) policy issues.

This paper provides a framework with which to analyse these different types of ‘hidden’ activities in order to design appropriate social, labour market, fiscal, and other policies. We build on the concepts and definitions of the System of National Accounts (1993), to develop a new conceptual framework that distinguishes between four types of ‘hidden’ activities:

- **Informal** activities, which are undertaken ‘to meet basic needs’;
- **Underground** activities, which are deliberately concealed from public authorities;
- **Illegal** activities, which generate goods and services forbidden by the law;
- **Household** activities, which produce goods and services for own-consumption.

We provide an example of how this concept of informal activities can be operationalised to analyse *informal employment*, and apply it to the Georgia Labour Force Survey (1999) data. Preliminary results reveal that more than half of Georgia’s employed population works informally.

Keywords: informal sector, transition, labour markets, poverty

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1. Introduction: The Informal Sector In Countries In Transition. Why Is It Important?

In the past few years the informal sector (or economy) in countries in transition¹ has increasingly become the focus of research, public policy and the media. Newspapers cover front pages with eye-catching headlines on its scale, Governments, under pressure from international organisations to improve the state of their public finances, vow to eradicate it, while research increasingly highlights its multifaceted nature, as an important source of livelihoods, the cause of debilitating public deficits, and a dynamic sector which develops in reaction to crippling bureaucracies, corruption and excess regulation.

The informal sector has important implications for public policy from social and labour market perspectives as well as from those of public finance, law and national accounting. From the aspects of poverty, social policy and the labour market, the informal sector is important because it provides a considerable source of income and employment in countries where formal employment opportunities are limited and social security is almost non-existent. Indeed many have suggested that an explanation for why the unprecedented collapse in living standards has not been accompanied by social explosion in the Commonwealth of Independent States (CIS)² is that people have managed to survive by engaging in a multitude of ‘informal’ undeclared activities such as street trading, subsistence agriculture, and unofficial taxi services (see for example Barberia, Johnson, and Kaufmann 1997; Clarke 1999b; Lokshin and Yemtsov 2001; Yakubovich 1999).

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¹ Countries ‘in transition’ include a wide range of countries at different stages of ‘transition’ from planned to market economy, and with very different cultural and historic backgrounds, including those of the Former Soviet Union, Central and Eastern Europe, Mongolia, Vietnam, Laos, Cambodia and China. However, in this paper the term ‘countries in transition’ refers to the countries of the Former Soviet Union and to those countries in Central and Eastern Europe which are less advanced in their transition process and not included in the first wave of EU accession.

² The CIS consists of 13 of the 15 successor states of the former Soviet Union: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan. It excludes the three Baltic States: Estonia, Latvia and Lithuania (see EBRD 2000, p.1).
In many countries of the former Soviet Union, economic transition has coincided with exceptional increases in poverty and inequality. The World Bank estimates that more than half of the population in the CIS-7 (the seven poorest CIS countries) is now living in poverty, with 1999 poverty rates reaching 83% in Tajikistan, 80% in Moldova and roughly 60% in Georgia and Azerbaijan. Moreover, inequality in these countries has increased sharply; the income-based Gini coefficients have doubled from 0.2-0.3 to 0.4-0.6 since 1990 (IMF and World Bank 2002, p.9) and are now comparable to those the most unequal economies of Latin America. The increase in poverty has largely been due to the collapse in output, which coupled with quick and large-scale privatisation, has resulted in contraction of formal employment, reduction in real wages and severe fiscal crises, crippling governments’ ability to provide social security. With no private income from employment and no state social safety net, people have resorted to a variety of informal, low-skilled, precarious activities to survive.

However these low-skilled ‘informal’ activities are heavily stigmatised, particularly in the former Soviet Union, where job status and education are still very highly regarded, and where ‘entrepreneurial’ activity is still somewhat associated with ‘dishonest and criminal way of making money’ (see Dudwick 1999). During the Soviet period status was often more important than money, and prestige, based on one’s education and job, opened doors and secured access to deficit goods and services which money alone could not guarantee. The collapse of formal employment has meant that people have been deprived of the core of their social ties, their guarantee of social protection, their social identity and status. In this respect, informal employment is strongly associated with social exclusion.

Atkinson (1998) distinguishes three characteristics of social exclusion: relativity, agency and dynamics. Informal employment is associated with all three of these characteristics. The informally employed are marginalized and excluded relative to the societies in which they live which regard informal employment as unworthy and disgraceful. Much qualitative evidence points to the fact that the informally employed feel

3 The CIS-7 are Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan.

4 These poverty rates are mostly based on national poverty lines.
powerless to change their lives (see for example Dudwick 1999). They are forced into informal employment to survive, because the ‘State has abandoned them’. Thus they do not voluntarily exclude themselves, but their exclusion involves an external agent. Finally, and perhaps most importantly for the future human development in the region, the informally employed feel excluded also because they feel that they have little prospect for the future (the *dynamic* aspect of social exclusion). Although the level of educational attainment in most countries of the region is still higher than the European average, ten years of employment in low-skilled jobs has meant that informal workers have been ‘de-skilled’ or found their skills have become obsolete in the new market economy, thereby destroying any hope of being able to change their situation in the future.

The relationship between informal employment, poverty and social exclusion is perhaps best exemplified by the, all too common, story of Hamlet, a lecturer in Physics from Tblisi University, interviewed in Batumi (a town on the opposite side of Georgia, along the Black sea coast) where he works as an ‘informal’ driver.

Hamlet gets US$150 a month in salary. He cannot bring his family to Batumi because his 3-year-old daughter’s asthma would be aggravated by the damp Batumi climate. He therefore sends US$80 to his family each month, spends US$50 on rent and lives on the remaining US$20. He sought work in Batumi because “I would have felt ashamed to work as a driver in the capital. Here no one knows me. All the same, it is difficult. Recently, I ran into my former students; I’m ashamed to this day when I recall how I lied, and told them that the car I drive is my own, and that I own this apartment. To this day, they think that I’m director of some firm” (Dudwick 1999, p.19).

In addition to the poverty and labour market aspects, the informal economy is also important from public finance, legal and national accounting perspectives. Tax evasion reduces government revenue and thereby undermines the government’s ability to intervene in the economy, provide social security, and invest in public goods. This in

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5 Barry (1998) argues that it is the ‘involuntary’ characteristic of the act, which distinguishes social exclusion from other types of social isolation.
turn contributes to the informalisation of payments for social services such as health care and education. At the same time, in cases where heavy bureaucracy and corruption stifle the growth of small businesses, the informal sector may prove to be a source of economic growth and taxing it may not always be economically efficient. Illegal and criminal activities undermine the legal system and lead to social instability and a breakdown in law and order. Failure to capture all economic activities in national accounts leads to the underestimation of GDP, which impairs cross-country comparisons of national income, undermines the validity of statistics based on GDP per capita, and can ultimately affect the amount of aid a country receives or contributes, as it is generally based on the level of GDP per capita (e.g. underestimating GDP will lead to higher aid receipts).

So what exactly is the informal economy (or sector)? Although the term has been very widely used, its meaning is far from clear. Indeed it is exactly because it has no precise definition and it can mean all things to all people that the term has been so widely used. Thus, the informal sector (or economy) has referred to street vendors, hawkers and domestic workers in developing countries, tax evasion, drug trafficking and prostitution in western industrialised countries, and petty trade, subsistence farming, the stealing of state property, barter, bribery, corruption, money laundering and organised crime in transition countries.

This paper aims to present a conceptual framework for transition economies, which distinguishes informal activities that are of concern from poverty and social exclusion perspectives from those that are more relevant from legal and public finance perspectives. We begin with a review of the informal sector/economy literature in developing, western industrialised, centrally planned and transition countries. Although comprehensive reviews of the main issues and debates exist in both developing and industrialised countries, no attempts have been made to provide a comprehensive, comparative review of how the informal sector has been defined in all five contexts. The literature review reveals that there is no consensus over what constitutes the informal sector worldwide. We then argue for the need to distinguish between small-scale income and employment-generating activities, which are undertaken to meet basic needs in the absence of formal employment opportunities and a social safety net, from those which are deliberately concealed from the authorities for the purpose of evading taxation or
complying with certain regulations. Not only is this distinction important because these two sets of activities raise different policy issues, but it is also important in order to evaluate the impact of policies aimed at ‘eradicating’ the informal economy (in order to improve public finance, and law and order) on people’s livelihoods.

We build on the concepts and definitions of the System of National Accounts (1993), ⁶ to develop a new conceptual framework that distinguishes between four types of ‘hidden’ (unmeasured, untaxed and/or unregulated) activities:

- **Informal** activities, which are undertaken ‘to meet basic needs’;
- **Underground** activities, which are deliberately concealed from public authorities to avoid either the payment of taxes or compliance with certain regulations;
- **Illegal** activities, which generate goods and services forbidden by the law or which are unlawful when carried out by unauthorised producers; and
- **Household** activities, which produce goods and services for own-consumption and are outside the SNA production boundary.

Given the importance of informal employment from social policy and labour market perspectives, we provide an example of how this definition can be operationalised for the purposes of measuring and analysing informal employment in transition countries. The operational framework is applied to the Georgia Labour Force Survey data (1999), as an example, and the results provide some preliminary information regarding the size and nature of informal employment in Georgia.

### 2. What is the Informal Sector? A Review of Existing Literature

There is no consensus over what constitutes the ‘informal’ sector worldwide. Over the past 30 years, the term has been used in

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developing, western industrialised, centrally planned and transition countries to analyse a wide spectrum of activities that escape taxation, measurement, and regulation. It has been used to describe such diverse activities as street vending, hawking, undeclared domestic work, barter, stealing public property, corruption, tax evasion, the Mafia and organised crime. Below we review, in turn, the main definitions and sources of debate in developing countries, western industrialised countries, the Soviet Union and transition countries.

2.1 The Informal Sector in Developing Countries: A Type of Household Enterprise

In developing countries, the term ‘informal sector’ has broadly been associated with unregistered and unregulated small-scale activities (enterprises) that generate income and employment for the urban poor. There have been two main parts to the informal sector debate: The first, which dominated much of the 1970s and 1980s, focused on the informal-formal sector relationship. Those who supported the ‘duality’ approach argued that there were two distinct urban economies (the poor/informally unemployed vs. the rich/formally employed), while their critics saw these as two aspects of the same, single, capitalist economy. The second, which took off in the late 1980s in Latin America with the publication of de Soto’s (1989) work on Peru, is concerned with the causes of the informal sector: is the primary cause of the informal sector poverty or excess regulation?

The Informal-Formal Sector Relationship: Dualism or Continuum?

The term ‘informal sector’ emerged in the 1970s, at a time of crisis in development theory, following the growing recognition that the ‘accelerated growth model’ had not succeeded in creating employment and eliminating poverty in developing countries.\(^7\) Unprecedented population growth, as of the 1950s, coupled with increase rural-urban migration, and an inability of the industrialisation process to absorb the large numbers of unskilled, illiterate workers resulted in widespread poverty and unemployment (Moser 1994, p.13-14). However, it soon became apparent that the urban poor were not actually ‘unemployed’,

\(^7\) The ‘accelerated growth model, which dominated development thinking throughout the 1950s and 1960s, was based on the assumption that industrial expansion would increase wage-sector employment and that the ‘trickle-down’ effect would ultimately lead to redistribution of resources and income.
but were in fact engaged in a multitude of small-scale, unregistered, unmeasured and largely unregulated ‘informal’ activities.  

The Dualist model:
The first to employ the term ‘informal sector’ was anthropologist, Keith Hart, who described the ‘formal’ and ‘informal’ income-earning opportunities that he observed in Ghana, equating the first with wage-earning jobs and the second with self-employment, thereby setting the stage for the dualist interpretation (Hart 1973, p.67).

However, it was the International Labour Office (ILO) that was to disseminate the concept, through its very influential ‘Report on income and employment in Kenya’ (1972), which suggested there that there existed a marginal, poor, ‘informal’ sector of the urban economy, which produced goods and created employment and income for the poorest of the poor. The informal sector was seen as a separate, autonomous sector, which was defined in contrast to the formal one through seven distinguishing characteristics. Thus, for instance, where formal sector units were characterised by large-scale production, incorporation, and the use of capital-intensive technologies, informal sector units involved small-scale production, were unincorporated and family owned and used labour intensive technologies (ILO 1972, p.6). In contrast to Hart’s emphasis on the individual, the ILO’s focus was exclusively on units (or enterprises), thereby establishing the basis for most future interpretation of the informal sector in developing countries as a set of units.

In order to measure the size of the informal sector in developing countries, the definition was operationalised by using a set of multiple criteria. This proved problematic, however, as each criterion could be employed alone or in combination with others to define a universe of its own (see Lubell 1991; Sethuraman 1976; Sethuraman 1981).  

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8 This raised important questions regarding the definition of ‘employment’ and ‘unemployment’ in a development context. Is the concept of ‘unemployment’ relevant in a context where unemployment insurance is essentially inexistent and people engage in informal activities to survive? And can the concept of ‘employment’ be limited to official, ‘formal’ employment? These questions are the source of much research and debate in developing countries.

9 The operational definition of the informal sector included: (a) all enterprises or production units with less than a maximum number of workers (usually ten) or (b) enterprises with more than the suggested maximum number of workers that specified at least one of the following additional criteria: they
these drawbacks, this definition, based on multiple-criteria still holds today and forms the basis of the ILO revised definition adopted in the ‘1993 Resolution Concerning Statistics of Employment in the Informal Sector’ (ILO 1993b, par. 7-9).

An alternative dualist interpretation was offered by PREALC, the ILO’s World Employment Programme in Latin America. Like the ILO-Geneva, PREALC viewed the informal sector as a marginal, unprotected sector of the economy in which people survive. However, in contrast to the ILO-Geneva’s focus on the enterprise, PREALC concentrated on income and employment. Two alternative typologies were used: the first, based on status in employment, included domestic servants, casual labourers, the self-employed, and all persons working in enterprises employing a maximum number (4-10) of persons. The second included all persons whose income is below a minimum level (usually the minimum wage) (Souza and Tokman 1976, p. 356-357).

Finally, other dualist approaches have defined the informal sector in terms of its position vis a vis ‘state protection’. Weeks, for instance, argues that informal sector units operate outside the formal system of benefits and of formal credit institutions, while formal sector units are officially recognised, nurtured, and regulated by the State, through such mechanisms as tariff and quota protection, import tax rebates, selective monetary controls and licensing measures (Weeks 1975). Similarly, Mazumdar (1976) distinguishes between informal, ‘unprotected’, urban labour and formal, ‘protected’ urban labour and, more than a decade later, Roberts (1990, p.35) argues that the informal sector is ‘the means by which people make out in the absence both of state provision of basic

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operated illegally; they worked on an irregular basis; they were located in a temporary structure or in the open; they did not use electric power; they did not depend on formal credit institutions; they did not rely on formal distribution network, or; most of their workers had less than six years of schooling (Sethuraman 1981, p.22).

10 This new definition is discussed in detail in part 3.2 below.

11 Note that there is considerable debate as to whether informal sector employment can be equated with poverty. Many have argued that not all informal workers are poor (successful informal entrepreneurs for instance) and that not all poor work in the informal sector (low-paid industrial workers for instance) (see Cartaya 1994; Portes and Schauffler 1993; Thomas 1995).
welfare services and of private mutual interest associations which defend their members and advance their interests’.

**Informal-Formal Continuum**

Critics of the dualist model have argued that formal and informal activities are not separate and independent, but rather parts of one overall capitalist system in which informal activities are subordinate to, and dependent on, the formal sector.

The Marxist critique, for instance, rejects the whole concept of ‘informal sector’, preferring the term ‘petty commodity production’ to refer to these activities, which, it argues, exist at the margins of the capitalist mode of production but are integrated into and subordinate to it (Birkbeck 1979; Bromley and Gerry 1979; Moser 1994; Portes 1978). Two main exploitative relationships are emphasised. On the one hand, the informal sector is simply an extension of the production network of large firms, providing a pool of cheap and flexible wage labour through self-exploitation.\(^\text{12}\) On the other, it subsidizes the formal economy by providing cheap goods and services to the labour force, therefore enabling large firms to pay extremely low wages (Allen 1998, p.9).

Within this framework, Portes, Castells and Benton (1989, p.300) suggest that at least three types of activities can be distinguished: direct subsistence activities, informal activities subordinate to production and marketing in the formal sector, and autonomous informal enterprises with modern technology and some capacity for capital accumulation. Similarly, Bromley and Gerry question the adequacy of the formal-wage-employment vs. informal-self-employment dichotomy. They suggest that there is a continuum from stable wage work to true self-employment, passing through 4 categories of ‘casual work’: short-term work, disguised wage-work, dependent work and finally true self-employment (Bromley and Gerry 1979).

\(^{12}\) A well-known example is offered by Birkbeck’s 1978 study of informal garbage collectors in Cali, Columbia. It shows the extent to which collectors, the most ‘marginal’ of workers, are connected with modern capitalist production. Informal garbage collectors supply sorted and packed plastic, paper, bone and glass to informal deposit owners, who in turn pass on the product to wholesalers that supply the large orders of industrial firms. The firms dictate the final price and each intermediary along the chain takes a share, with the collectors receiving the lowest share, and no work protection whatsoever (Birkbeck 1979).
Similarly, in her work on Zaire, MacGaffey calls for the introduction of a new conceptual framework; that of the ‘Real Economy’, which includes the totality of economic activity, and not just its component parts. She argues that the division of the economy into formal and informal sectors is arbitrary and unrealistic, and that ‘what has previously been thought of as a marginal sector of the economy is in fact the principal means by which it operates’ (MacGaffey 1991, p.7).

Finally, in an attempt to reconcile the two interpretations, Sethuraman (1981) argues that the concept of dualism does not necessarily deny the presence of interdependence. Thomas suggests that ‘formal’ and ‘informal’ should be exhaustive and mutually exclusive categories (in order to classify agents), but they are not required to be independent. In fact, as Moser points out, the debate is not so much on whether or not the informal sector is independent, but on the nature of the formal-informal relationship. Where the dualist approach assumes a benign relationship and therefore advocates the development of closer links through subcontracting and credit, the petty-commodity production school assumes the relationship is exploitative and consequently advocates an increased autonomy of petty commodity production and cutting the links with large-scale capitalist enterprises (Moser 1994, p.12).

THE CAUSES OF THE INFORMAL SECTOR: EXCESS REGULATION OR POVERTY?

Much of the debate on the informal sector in the past decade has focused on its causes. Is the primary cause of the informal sector rural-urban migration and urban poverty or is it excess regulation, taxation and a

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13 MacGaffey suggests that the real economy should consist of: ‘the recorded economy, that is, all economic activities that are recordable and reported and that are gathered by statistics; the non-monetised economy that is, all activities concerned with the non-monetised production for self-consumption; and all the remainder, which is monetised (though operating with a variety of currencies and also through barter), unrecorded, and inadmissible (because it is more or less legal) (MacGaffey 1991, p.10).

14 A similar argument has been presented by Harding and Jenkins (1989) for western industrialised countries. They suggest that there is no such thing as a separate ‘black’ or ‘hidden’ economy, but that formal and informal activities co-exist and are part of the modern capitalist economy. There are simply varying degrees of formality and informality depending on the context and most social interaction partakes of a degree of each (Harding and Jenkins 1989, p. 175).
heavy state bureaucracy? The position taken on this question largely determines the definition used, and ultimately the policy recommended.

Poverty
The ILO-Geneva and PREALC approaches emphasise the survival nature of informal activities, arguing that poverty is the cause of the informal sector. In their view, activities are undertaken as an alternative to open unemployment since, in the absence of social security benefits, individuals cannot afford to be unemployed (Souza and Tokman 1976, p.355-356). Informal activities are seen as marginal, and workers are vulnerable, as they are unprotected by labour laws. Thus, they argue, the primary path to development and to poverty alleviation is macroeconomic policy that emphasises expanding modern sector employment and incomes (Rakowski 1994, p.36). Some have emphasised the ‘discrete logic of production’, which differs from that prevailing in the formal economy, in that ‘the accent is on employment generation and not on seeking suitable investment opportunities for the sake of realising a return on investment’ (Guerguil 1988, p.60; Sethuraman 1981, p.16). We will later argue that this ‘discrete logic of production’ (to use Guerguil’s terminology) which characterises informal activities and distinguishes them from formal ones, can also be used to distinguish ‘informal’ activities undertaken to meet basic needs from larger scale ‘underground’ activities deliberately concealed to avoid the payment of taxes.

Excess Regulation
In the late 1980s, De Soto introduced a new dimension to the study of the informal sector. In his best selling book, ‘The Other Path’, on ‘the informals’ of Peru, de Soto highlights the role of excess regulation and the state bureaucracy in creating the informal economy (de Soto 1989). The informal sector consists of ‘potential entrepreneurs’ who are forced to operate illegally because of flaws in the tax system and in other laws and regulations. Although he highlights the role of rural-urban migration, it is essentially the ‘mercantilist’ state, which only exists to protect the interests of itself and big business, which is responsible for in the existence of the urban informal sector. Informality is therefore the ‘popular response, which successfully breaks down this legal barrier’ (de Soto 1989, p.11).

As noted by Rakowski (1994, p.31), de Soto’s work marked a shift away from seeing the expansion of the informal sector as a problem for
development, to an emphasis on the informal sector as an asset or solution to economic crisis and poverty. Thus, in Bromley’s words, de Soto argues that through the combination of deregulation, debureaucratisation and privatisation, ‘the size of the state apparatus can be reduced and the quality of life of every citizen improved, and the nation’s vast entrepreneurial potential unleashed’ (Bromley 1994, p.138).

This view of an informal sector defined as the set of ‘illegal’ activities, resulting from excess taxation and regulation, has been the basis for numerous studies of the informal sector in Latin America in the past decade. Loayza, for instance, uses an empirical model of the informal sector, defined as all ‘untaxed’ and ‘unregistered’ activities, to show that its size depends positively on the level of taxation and labour market restrictions, and negatively on the quality of Government (Loayza 1997).

A third approach, the so-called ‘structuralist approach’, combines elements of both the de Soto ‘legalist’ interpretation and the PREALC poverty-based one (see Castells and Portes 1989; Portes 1978; Portes, et al. 1989; Portes and Schauffler 1993). The informal sector is viewed as a product of state regulation, which essentially supports the modern formal sector. Firms ‘go underground’ (i.e. large firms subcontract to small firms or engage in illegal hiring practices) to lower the costs associated with protective labour legislation. However, the structuralist approach argues that the elimination of state controls would remove the informal firms’ competitive advantage, which stems from their ability to escape tax and labour regulations, and would therefore not result in the expansion of entrepreneurial activity and reduction in poverty that is suggested by de Soto. Nevertheless, they recognize that more deregulation and greater flexibility is needed to enable firms to adjust to changes in the economic conditions, but argue that it should be supplemented with policies aimed at reducing survival activities through capital investment in the modern industrial sector (Portes and Schauffler 1993, p.55).

In summary, the legalist and poverty-based approaches essentially define two different groups of activities and consequently give rise to different policy recommendations. In the ILO/PREALC approach illegality is a related characteristic of informality, but the basic defining
one is its ‘discrete logic of production’. In the de Soto approach illegality is the basic defining characteristic and the ‘production rationale’ of informal enterprises is no different from that of formal ones. Guerguil argues that these two definitions only slightly overlap. Some activities performed to generate basic household income, such as domestic work, may not be illegal, whereas other activities which are illegal are not carried out with a production logic different from that of the formal (capitalist) sector (Guerguil 1988, p.61).

2.2 The Informal Sector in Western Industrialised Countries: Unmeasured and Untaxed Production

Whereas in developing countries the debate on the informal sector has been mainly conceptual, in western industrialised countries, it has been methodological, focusing principally on measurement techniques. Moreover, whereas in developing countries there is disagreement over what constitutes the informal sector, but agreement over what to call it, in western industrialised countries there is general agreement over what it is but absolutely no agreement over what to call it. Thus the terms ‘informal’ ‘black’, ‘underground’, ‘unrecorded’, ‘hidden’, ‘shadow’ ‘irregular’, ‘subterranean’, ‘parallel’, economy have all been used to essentially describe income or production, which escapes taxation and/or GDP estimates.

Definitions have mainly been income-based. Two such definitions can be identified: (1) The national production or income that is missed by the statistical offices when they calculate the value of national product, and, (2) the revenue not reported to, and discovered by the tax authorities, which is produced in underground activities (Tanzi 1999, 344). On the one hand, Tanzi, Macaffee and Feige all (more or less) define the ‘underground’, ‘unobserved’ or hidden’ economy as the GNP that is not measured by official statistics because of un-reporting and/or underreporting (although Feige also includes activities which escape registration due to convention - e.g. household activities) (see Feige 1983; Feige 1979, 1980; Macaffee 1982; Tanzi 1982; Tanzi 1983). On the other, Gutmann defines it as ‘the economic activity or transactions that escape taxation’ (Gutmann 1979, p.14).

15 The ILO/PREALC’s Viktor Tokman points out that the majority of enterprises are neither fully illegal nor fully legal, but that there exists a spectrum of positions with ‘legal’ and ‘illegal’ merely being two extremes (Tokman 1992, p.5-6).
As noted by Tanzi (1999), these two approaches do not necessarily measure the same thing as tax evasion and GDP are measured in different ways, and it is therefore possible to have a lot of tax evasion without understating GDP. Cowell (1990) provides a useful framework to understand how these concepts are related to one another. He distinguishes between total economic production and officially defined production, or production which falls within the System of National Accounts (SNA) of a country. The second is a subset of the first and excludes activities such as housework and do-it-yourself work. He then shows how the black economy intersects both these production boundaries but also includes activities such as benefit fraud and evasion of taxes on capital gains, which are not productive activities, and therefore fall outside the production boundaries. Thus, unmeasured GDP includes that part of the black economy, which overlaps with total economic production but not with officially defined production, which by definition is allowed for in the SNA and therefore estimated, whereas untaxed revenue includes all of the black economy (i.e. both that which overlaps with total economic production and that which is outside of it) (Cowell 1990, p.15).

Others, such as Dallago (1990) and Thomas (1992; 1995), have used a definition of the ‘irregular’ economy based on legal status rather than income. Dallago, for instance, defines the ‘irregular’ economy as activities which are ‘deliberate attempts to evade or avoid the rules (laws, regulations, contracts and agreements) that apply to a particular context, the purpose being to achieve a goal that is permitted, tolerated, or at any rate not explicitly condemned in the economic system concerned’ (Dallago 1990, p. XVIII).

However, the core of the debate in western industrialised countries has been on empirical methodologies. Apart from a few direct methods (such as the tax auditing approach), most methods used have been indirect (i.e. using available statistics). There have been three main approaches: monetary, expenditure-income discrepancy, and employment census methods.

Monetary approaches, which have been the most common, are based on Cagan’s (1958) currency-ratio method, which assumed that transactions in the underground economy are conducted in cash and that changes in the ratio of currency to money supply could partly be explained by changes in the size of the underground economy. Gutmann (1977; 1983),
elaborates this model and develops the *currency demand deposit method*, based on the assumption that there exists a base period in which little subterranean activity existed, and attributes changes in the ratio of currency to demand deposits to changes in the level of subterranean activity. The difference in the currency ratio relative to the base period is multiplied by the actual income velocity of money to arrive at the estimate of the size of the irregular economy (Gutmann 1977, p.27). Feige and Tanzi also use similar methods. Feige, who uses a *transactions-ratio method*, argues that not only cash, but also cheques are used in the irregular economy, and defines total transactions to be the sum of both. Moreover, he suggests that while incomes may be concealed from he authorities, underground activities will show up in transactions. Hence, a comparison of transactions and income may be used to provide information about the underground economy (see Feige 1979). Tanzi combines regression analysis and the *currency-deposit method*, by setting currency holdings to current and deposit accounts as the dependent variable, and various factors, which influence the demand for money, as the independent variables. He then compares currency holdings, with a tax variable, to currency holdings at zero taxes and multiplies the excess currency by the income velocity of money to arrive at the size of the underground economy (Tanzi 1983, 290).

There have been two other, less common, methods used to estimate the size of the underground economy. The *expenditure-income discrepancy method* compares production and consumption data, either at the national or household level, to derive the size of the underground economy. Macafee argues that by comparing income measures of GDP, which are primarily based on tax declarations, and expenditure measures of GDP, which are primarily derived from industrial and household surveys, one can obtain a reasonable indication of the size of the ‘hidden’ economy (Macaffee 1982, p.148). Smith (1986), for example, uses both macro economic data (national accounts) and micro economic data (family expenditure data) to find evidence of discrepancies between income and expenditures for the UK. Finally, the *‘employment census methods’*, involve comparing the official rate of employment and the employment rate as calculated by other means. Examples include comparing employment figures from population surveys to those obtained from surveys of establishments, or comparing employment
figures from demographic data to figures of employment derived from the data used in the national accounts.\footnote{Charmes (1993) uses this approach to derive the size of the informal sector in Morocco, Tunisia and Egypt. He compares national statistics on the active population (using the population census or a household survey) to statistics on firms in these countries.}

What is worrying is that these methods give considerably different estimates of the underground economy. Frey and Pommerehne find that in the United States, the underground economy estimates for 1976 range from 4% of GNP if one uses the expenditure-income discrepancy approach to 22% if the transactions-ratio method is used (Frey and Pommerehne 1982, p.18). Similarly, Smith (1986, p.84-85) finds that for the UK, the range of estimates of the size of the black economy extends from 2%-4% of GDP if expenditure-income discrepancy methods are used to about 15% if monetary approaches are used.

2.3 The Soviet Second Economy: the ‘Private’ Parallel Economy

The informal economy in transition countries is not new. There has long been a parallel, private, unregistered and untaxed part of the economy, which during the Soviet period was referred to as the ‘second economy’.

It was Grossman (1977) who was largely responsible for the spreading of the term ‘second economy’, which he defined as comprising ‘all production and exchange activity that fulfills at least one of the two following tests: (a) being directly for private gain; (b) being in some significant respect in knowing contravention of existing law’ (Grossman 1977, p.25). Others have adopted definitions based on ideology. Los (1990) defines the second economy as ‘all areas of economic activity which are officially viewed as being inconsistent with the ideologically sanctioned dominant mode of economic organisation’ (Los 1990, p.2; see also Shelly 1990, p.12).

Thus, we can divide the ‘second economy’ activities into those that were legal, but ideologically unacceptable and therefore officially discriminated against, and those that were illegal. The most common legal second economy activity was the cultivation of private ‘garden’ plots. Private agricultural production was permitted not only for farming households that worked on collective or state farms, but also for many workers of industrial and other sectors, including those in urban
areas who were allocated plots outside the city limits on which they could build their *dachas* (summer houses) (see Braithwaite 1994, p.6; Grossman 1982, p. 256). Research has shown that private plot production was an important source of additional income, especially as it was often sold (illegally) on the black market (see Grossman 1982; Grossman and Treml 1987). Grossman and Treml estimate, for instance, that if private plot production were considered, then the Soviet Union’s actual agricultural production in 1977 would have been approximately five times the official figure (Grossman and Treml 1987, p.292). Other types of legal private activity included the construction of private housing (however it became illegal when it involved the acquisition of materials on the black market and the illegal hiring of construction workers), and the private practice of certain professionals such as physicians, dentists, teachers, and tutors (Grossman 1982, p.256).

The illegal second economy consisted of four types of activities: (1) stealing from the state, (2) speculation, (3) illicit production and (4) underground enterprises (Grossman 1982, 249). *Stealing from the state*, which involved stealing anything from enterprise light bulbs and toilet rolls to output produced, was widespread. Grossman relates:

‘All sources agree that it is practised by virtually everyone. All also agree that the public takes it for granted, attaches almost no opprobrium to it – and on the contrary, disapproves of those who do not engage in it – and sharply distinguishes between stealing from the state and stealing from private individuals’ (Grossman 1982, 249).

Similarly, Simis claims that ‘the mass of the population does not look upon theft from the state as real theft, as stealing someone else’s property’ (Simis 1982, p.253).

Apart from the stealing of state property, stealing from the state also included so-called *left-hand work* (the earning of informal income at the formal workplace). Simis explains that left-hand work ‘is usually done during working hours, using state tools, equipment and means of transport’ (Simis 1982, p.261). It was widespread and considered a normal aspect of working life. Simis and Kurkchiyan use the example of bus drivers to illustrate left-hand work in Georgia and Armenia respectively (Kurkchiyan 2000, p.86; Simis 1982, p.265). Bus drivers had an official wage, which served to guarantee basic security, however it was accepted (and expected) that their main source of income came from
charging passengers for fares and not issuing tickets or receipts. At the same time, they had to pay bribes to get good routes, to avoid inspection of tickets, for bus maintenance, and so on. Kurkchiyan argues that any driver who did not partake in left-hand work would not have been able to survive and that ‘it was not possible to live outside the alternative economy other than at great cost, not only in terms of income, but also in terms of social mobility and integration in society’ (Kurkchiyan 2000, p.86). She argues that the official and the second economy were two inseparable and essential parts of the Soviet economy; while the first provided a basic standard of living, the second complemented it and ensured a reasonable lifestyle for the population.

Finally, another example of ‘stealing from the state’ was *embezzlement*, which was a direct product of the shortage of goods. Thus, employees of State-owned stores or restaurants would take rare goods and re-sell them for a profit, or they would set them aside for their favoured customers, from whom they could expect good tips (Grossman 1982, p.250; Shelly 1990, p.13).

The second illegal second economy activity, which also resulted from the shortage of goods, was *speculation*. Grossmann relates: ‘given the invariable maldistribution by the state of goods over time and space and chronic shortages of many items in the USSR, the opportunities for black market trading for profit are nearly unlimited’ (Grossman 1982, p.251). However, despite its pervasiveness, speculation was considered a very serious offence and punishable by the death penalty (Simis 1982, p.267). Nevertheless, it was normal for people to have their ‘own speculator’, who would come around the workplace or home to sell consumer items such as clothing or food.

A third illegal ‘second-economy’ activity was *illicit production* (or moonlighting). This was production that took place for private gain outside official working hours (as opposed to left-hand work which took place *during* working hours). ‘Moonlighters’, particularly those working in construction, were referred to as *shabashniki*. They were typically men who worked in construction trades or as agricultural workers on state and collective farms. Shelly suggests that *shabashniki* accounted for half of the construction workers in some regions of the USSR (Shelly 1990, p.16).
Finally, the last type of illegal second economy activities were *underground enterprises*, or formal enterprises that were simultaneously involved in anything from small-scale ‘plan manipulation’ to large-scale illegal production. Berliner (1952) argued that the main motivating factor for a Soviet manager was not the wage, but the ‘premium’, a bonus paid in return for fulfilling the planed output target. This often led to a behaviour that was contrary to the interests of the State. Common techniques used by managers for fulfilling the output targets included: inflating statements of material requirements, arranging to have the firm’s output plan set at a level well below capacity, producing the wrong assortment of products, falsifying accounts, lowering the quality of the output and, misappropriating funds (Berliner 1952, p. 348-356). However, these techniques were also commonly used for illegally producing extra output, which was then sold for private gain. Through their study of a Georgian biscuit factory, Mars and Altman, find that similar techniques were used for parallel production and that the extra produce was then sold by ‘making a deal’ with the retailer, who would sell them in shops next to the ‘official produce’ and share the profits with the factory managers (Mars and Altman 1987, 201-205).

Another common example of illicit production in state enterprises was the hiring of so-called *dead souls* (or ‘ghost workers’). These were workers who took on a second job but never appeared at their place of work and then shared their secondary wages with their employer (Shelly 1990, p.17).

Finally, *corruption* has also been included in the study of the second economy, either as an integral part of it or as a closely related activity. Grossman identifies three types of corruption: the daily ‘petty bribing’ of Soviet authorities, and particularly of law enforcement officials; the tradition of *prinosheniye* (literally ‘bringing to’), which involved the regular bringing of valuable gifts to one’s supervisors; and the purchase of lucrative official positions (Grossman 1982, p.251-252). Another, widespread form of corruption was *blat*, or the use of personal influence to obtain favours to which a person or firm was lawfully entitled. Berliner argues that *blat* was common in all aspects of firm’s activity, and that its need was so great that special people were hired, the so-called ‘*tolkach*’ (‘pushers’), who were responsible for ‘pushing’ for the firm’s interests. The *tolkach* often lived in Moscow, or in some other large city, and had very good personal connections. They were carried on the
books as enterprise ‘representatives’ and often worked for several firms at a time (Berliner 1952, p.356-358).

Thus, the second economy was heterogeneous and pervasive; it involved everyone, from the top government official to the poorest citizen. As Shelly points out:

At the top, were the large-scale underground businessmen, whose success depended on their ties to members of the official elite. Below them were the large numbers of small-scale private businessmen, moonlighting professionals and full time black marketers. Many of these relied on their ties with mid-level government functionaries, for success. At the bottom were those numerous citizens who supplemented their incomes through some form of illegal or semi-illegal activities such as petty theft in factories or putting aside merchandise for favoured customers (Shelly 1990, p.23).

As we will see below, many have argued that it is the legacy of the second economy and, more specifically, of the incentive structures that dominate it, which has been the cause of such an extensive informal economy during the transition period and which is in part responsible for the failure of formal economic policies.

2.4 The Informal Sector in Transition Countries: Household Enterprises, Untaxed Production or Second Economy?

In the past ten years, since the break-up of the Soviet Union, the informal economy in transition countries has increasingly become the focus of both policy and academic research. This is the result of a growing concern with corruption, tax evasion and crime as well as with an unprecedented increase in poverty and inequality. Given this wide spectrum of concerns, studies have used a variety of definitions of the informal sector (or economy) depending on the question they are addressing. Moreover, the term ‘informal sector (or economy)’ has been used interchangeably with ‘unofficial’, ‘hidden’, ‘underground’ and ‘shadow’ economy.

Studies of the informal sector in transition can broadly be grouped into three groups, depending on the issues they address. In fact, they can be seen as reflecting the three different approaches discussed so far. The concept of the informal sector adopted by the first group of studies resembles that used in ‘developing countries’, the one adopted by the
second group resembles that of the ‘second economy’ and the third is similar to approaches used in western industrialised countries.

The first group consists of those whose aim has been to understand how people survive during the transition period, given the collapse of real wages and persistent arrears in their payments. In these studies the informal economy (or sector) is essentially the set of survival strategies. For example, Johnson, Kaufmann and Ustenko identify six types of survival strategies used in Russia, which they also refer to as ‘informal activities’: (1) having another job; (2) using a dacha or other plot of land to grow food; (3) working as private taxi driver; (4) renting out one’s apartment; (5) business trips abroad (to purchase goods for resale), and; (6) renting out one’s garage (Johnson, Kaufmann, and Ustenko 1997, p.185-186). Similarly, Clarke (1999a; 1999b; 1999c), broadly defines the informal sector in Russia as including unregistered primary and secondary employment (including small-plot agricultural production), but argues that in fact it has not provided a social safety net for the poorest, as informal work is more of ‘an additional security for those who are already well placed to weather the storm’ (Clarke 1999b, p. 20, 33). Lokshin and Yemtsov (2001) also find that the higher the level of a household’s human capital, the more likely it is to use ‘active’ coping strategies (such as secondary work, cultivation of garden plot, or renting out of one’s own apartment) and that these strategies are more successful in offsetting economic shocks than the ‘passive’ strategies (such as cutting back on food and clothing expenditures) used by households with lower human capital.

Others have adopted the ‘traditional’ ILO definition of the informal sector and applied it to the transition context. Anderson, for example, in a study of the informal sector in Mongolia, defines it as ‘small-scale, usually family-based, economic activities that may be undercounted by official statistics and may not be subject, in practice, to the same set of regulations and taxation as formal enterprises’ (Anderson 1998, 2). He limits his definition, however, to legal activities, ‘monetised’ transactions (thereby excluding household production) and the urban sector.

The second group of informal sector studies consists of those who have analysed the transformation of the Soviet second economy into the present informal economy. These definitions, like those the second economy, are much broader, including a variety of activities such as barter, survival strategies, left-hand work, bribery, corruption, money laundering, tax
evasion and corruption. Kurkchiyan, for instance, includes ‘tax evasion, stealing from employers, illegal contracts, bribing politicians and officials, money laundering and so forth’ (Kurkchiyan 2000, p.96). She argues that the present ‘informal economy’ has evolved from the long-established Soviet tradition of informal relationships, and suggests that although the new market economy may officially be the product of the legislative reform, the behaviour is in fact dominated by the informal sector, which today accounts for the largest share of the total economy (Kurkchiyan 2000, p.93-97).

Indeed, there is much evidence of the persistence of ‘second economy’ practices in the present (informal) economy. Ledneva, for instance, argues that both blat (or the use of personal networks in order to obtain goods and services in short supply or to influence decision-making) and pripiski (false reporting) are as widespread now as they were in the Soviet Union (Ledeneva 2000, p.7). Similarly, Birdsell’s analysis of ‘covert earning schemes’ is essentially the persistence of left-hand work. She identifies two types: the manipulation of official business transactions to realise monetary earnings, and the exploitation of the ‘grey zones’ at the fringes of the workplace, including the diversion of customers for a private client base, and the pocketing of fees for services rendered through the firm (Birdsell 2000, p.5).

Feige, who has been one of the main contributors to the debate on the measurement of the underground economy in developed countries, also highlights the legacy of the Soviet system in determining the character and scope of the informal, or underground, economy during the transition period. He defines ‘underground economies’ as ‘non-compliant behavior with institutional rules’, suggesting that there are several types of underground economies depending on the institutional rule being violated. He thus distinguishes between ‘unreported’ economies when fiscal rules are violated, ‘unrecorded’ economies when income-producing activities are concealed from national accounting, and ‘illegal’ economies, when the criminal laws are violated (Feige 1997, p.25). In his view, formal policies have failed in the former Soviet Union, because they are based on the incentive structure of formal institutions, whereas the dominant incentive structure is that of informal institutions, which are a result of the Soviet system of non-compliance. Gaddy and Ickes present a similar argument to explain the failure of enterprise restructuring in Russia, and the emergence of a dual economy. They suggest that while the first economy is private and restructured, the
second is paternalistic and un-restructured, and based on ‘informal activities’ such as barter, tax offsets and survival activities (Gaddy and Ickes 1998, p.2).

For most authors in this group, the ‘second economy’ definition is still valid, as most of the private sector can be considered informal. Braithwaite (1994) and Sik (1992), for instance, both adopt ‘second economy’ definitions to describe the informal sector in transition. Braithwaite includes ‘all activities outside the state sector undertaken for private gain and/or unregistered for taxes, etc. with the authorities’, while Sik uses the lack of regulation as the main defining criterion (see Braithwaite 1994; Sik 1992). Similarly, Commander and Tolstopiatenko argue that the economy can be divided into two sectors: the informal sector, which is comprised of private activities that are largely untaxed, and the formal sector, comprised of state activities (including privatised state enterprises) that face a set of payroll taxes (Commander and Tolstopiatenko 1997, p.4). Moreover, they suggest that all part-time work can be considered informal, or ‘undeclared’, and all full-time work is formal and subject to payroll tax.

The third group of studies on the informal economy in transition countries has focused on the measurement of unrecorded GDP and/or tax evasion. These definitions have generally been narrower than those of the second group, but have nevertheless been very broad, including all income or production that escapes taxation or measurement and thereby encompassing both survival activities and large-scale tax evasion. Some have focused on measurement, while others have tried to explain what causes enterprises or individuals to operate informally. Studies that have tried to measure the informal economy have arisen from a suspicion that GDP in the Former Soviet Union is highly undervalued and that measures of the aggregate collapse in output greatly overestimate the real slump in GDP (Dobozi and Pohl 1995, p.17). Kaufmann and Kaliberda define the ‘unofficial’, or ‘informal’, economy as ‘the unrecorded value added by any deliberate misreporting or evasion by a firm or individual’ and use the ‘macro-electrical approach’, first applied by Dobozi and Pohl (1995), to estimate the size of the ‘unofficial’ economy in Central and Eastern Europe and the CIS. They argue that electricity consumption provides a good measure of overall economic activity and compare the level of income, which should have been produced given the level of electricity consumption, to official measures of national income. Their estimates suggest that in 1994, the unofficial
economy accounted for approximately *one quarter* of GDP in Central and Eastern Europe and *one third* in the countries of the former Soviet Union, reaching up to 65-70% of GDP in Georgia (Kaufmann and Kaliberda 1996, p.2, A4).

An alternative to the Kaufmann and Kaliberda (1996) model is presented by Lackò, who argues that *household* electricity consumption (rather than *total* electricity consumption) provides a better measure of the informal economy, as it permits the isolation of the structural changes during transition, that may be responsible for part of the increase in overall electricity consumption (Lackò 2000, p.122). She adopts a definition of the ‘underground’ economy proposed by Carter (1984), which includes ‘activities that are assumed to be measured but escape official registration or measurement’ (Lackò 2000, p.119). Her estimates are slightly more conservative than those of Kaufmann and Kaliberda, with CEE countries such as the Czech Republic and Slovenia having 22-23% of their national income ‘unreported’ while CIS countries such as Ukraine and Georgia had unofficial economies accounting for 53% and 57% of GDP respectively.

Others have tried to explain what *causes* enterprises to operate ‘informally’. Johnson, Kaufmann and Shleifer (1997), for instance, find that high tax burden, onerous regulation and low tax collection are associated with large shares of unofficial activity, as well as with poor public goods (such as police protection and enforcement of contracts), and poorer economic growth performance during transition. Later, Friedman, Johnson, Kaufmann and Zoido-Lobaton (1999) argue that in fact, entrepreneurs go underground, not to avoid official taxes but to reduce the burden of bureaucracy and corruption. Finally, Kolev (1998) points out that there are two different causes of informal employment and therefore two main categories of the informally employed. On the one hand, there are those who could be at ease in the regular job market, but who are driven into the informal sector because of the disincentive effects of the tax system, and on the other, those who are forced into it in order to survive in the new circumstances and cope with their low regular earnings (Kolev 1998, p.6).

### 2.5 In Summary
A review of the literature has highlighted that there is no consensus over what constitutes the informal sector (or economy) worldwide. In *developing countries*, the term has largely been associated with urban
household enterprises whose main purpose is to generate income and employment for the households concerned. The main policy and research questions have been: (1) the extent to which the informal sector is independent or integrated with the formal, capitalist economy, and (2) the extent to which informal enterprises are ‘survival activities’, caused by poverty and lack of formal employment opportunities, or ‘potential capitalist enterprises’ that are being held in check by excessive bureaucracy and regulation.

In *western industrialised countries*, the term has been used to describe all income or production that escapes taxation and/or GDP estimates, while the focus of the debate has been on how to measure it. In the *Soviet Union*, the corresponding ‘second economy’ referred to the private, and often illegal, activities, which were inconsistent with the dominant ideology, and included activities such as small plot agricultural production, stealing from the state, speculation, illicit production and underground enterprises.

In *transition countries*, not only have other distinct definitions been used, but also there has been little debate *per se* on what constitutes the informal sector. Thus, each piece of research has simply used the term to define its area of interest. Although this is mainly due to the relative novelty of the ‘transition context’ (just over ten years have passed since the collapse of the Soviet Union), it is time for a discussion on what is meant by the ‘informal’, ‘underground’, ‘unofficial’, or ‘shadow’ economy in the transition context. As illustrated in this review of existing literature the term ‘informal sector/economy’ has been used to describe an extremely wide spectrum of activities, which do not necessarily have much in common, from tax evasion, corruption, money laundering and organised crime to bribery, subsistence farming, barter, petty trade, and the stealing of state property. Below we argue that such a broad term is not particularly useful for policy purposes and that a conceptual framework is needed to distinguish between these different activities.


The lack of consensus on the definition of the informal sector (or economy) is a result of the fact that it has been approached by a
multitude of different disciplines. The informal economy is of interest to labour statisticians, national accountants, legal specialists, social policy experts, anthropologists, macro economists, and others. Each piece of research uses the term to define its own particular area of interest. Although there is no need for a unique definition of the informal economy per se, we argue that for policy purposes it is important to distinguish crime and deliberate tax evasion from small-scale activities that individuals undertake to meet basic needs, and propose a conceptual framework to distinguish between informal, underground, household and illegal activities. We suggest that from poverty, social policy or labour market perspectives, it is interesting to analyse informal employment and provide an example of how the informal sector definition can be operationalised to obtain a typology of informal employment. We apply this typology to the Georgia Labour Force data (1999) as an example.

3.1 Why so Many Definitions and Why is a Conceptual Framework Needed?

The diversity in definitions of the informal sector is a result of the fact that different units of observation and different criteria of informality have been used. We can identify four main units of observation: enterprises, activities, income and people. Similarly, we can identify three main criteria used to determine informality: registration (mainly for tax and social security purposes), measurement (in GDP statistics) and regulation (mainly labour regulation). The informal sector has been defined by any combination of the above units and criteria. Thus, for instance, it has been defined as the set of all income that escapes measurement, all enterprises that escape registration, all activities that escape regulation, all income that escapes registration, all people whose work escapes registration, all enterprises that escape regulation, and so forth.

Although these concepts are related, they do not necessarily define the same thing. For instance, the ‘registration’ and ‘measurement’ criteria are often assumed to delineate the same group of observations (see for example Kaufmann and Kaliberda 1996). However, as already noted, activities that escape taxation are not necessarily activities that escape measurement of GDP. Moreover, only productive activities are included in GDP, whereas certain activities such as illegally exporting capital or concealing income on capital gains, are considered tax evasion but are not productive activities and therefore are not considered to be
‘unmeasured GDP’. Similarly, household activities such as agricultural production for own-consumption should be included in GDP, and would therefore be included in measures of the underground economy based on the measurement criterion, but are not considered part of tax evasion. In the same way, using income or productive activities as units does not necessarily measure the same thing, as certain taxable income is generated by non-productive activities such as capital gains.

None of these criteria or units of observation are preferable to the others per se. Different units and criteria may be used depending on the aim of the research. However, it is important to make a conceptual distinction between those unmeasured, (and/or unregistered and/or unregulated) activities (income, enterprises, or people) whose primary purpose is to meet basic needs, from those which are deliberately concealed to avoid taxes or regulations. This is particularly important in transition countries where, despite the focus of both policy and academic research on tax evasion, money laundering and corruption, there is increasing evidence of the existence and growth of an informal sector in the ‘developing country’ sense, as people turn to small-scale income and employment generating activities to generate livelihoods in the absence of sufficiently remunerated formal employment and social security (see Anderson 1998; Bernabè 2002; Clarke 1999a, b; Lokshin and Yemtsov 2001). By distinguishing between these two concepts, it is possible to analyse the extent to which these ‘informal’ income-generating activities provide a social-safety net, and the extent to which they undermine government revenue. 17 This information will be critical for public policy, as it will allow the benefits of an increase in government revenue to be weighed against the risk of an increase in poverty, which would result from an attempt to ‘tax’ or ‘eradicate’ some of these income-generating activities without providing any other form of social security.

The call to distinguish between the informal and the underground/hidden/unofficial sector (or economy) is not new. Thomas (1992; 1995), for instance, suggests that informal enterprises can be distinguished from irregular ones in that the latter involve the production of legal goods and services, but are illegal in the production or distribution process (because they evade taxes, social security

17 Note that to this end, on-going research by this author evaluates the extent to which the informal labour market is providing a social safety net in Georgia.
contributions, or infringe other regulations), while the former involve legal goods and services and are ‘quasi-legal’ in their production or distribution process. They are ‘quasi-legal’ in that they are undertaken ‘not to evade taxes, since their earnings are unlikely to be large enough to attract the tax collector, but because the authorities do not formally encourage such [activities]’ (Thomas 1995, p.14).

Similarly, the Organisation for Economic Cooperation and Development (OECD), the System of National Accounts (SNA) and the International Labour Office (ILO) suggest that ‘activities performed by production units of the informal sector are not necessarily performed with the deliberate intention of evading the payment of taxes or social security contributions, or infringing labour or other legislations or administrative provisions. Accordingly the concept of informal sector activities should be distinguished from the concept of activities of the hidden or underground economy’ (Eurostat, IMF, OECD, UN and World Bank 1993, (5).3; ILO 1993b, Par.5(3); OECD 1997, p.16). However, as we will see below, the argument presented here is for a distinction between informal economic activities, and underground economic activities, irrespective of the type of enterprise in which they take place, whereas the ILO and OECD distinguish between activities that take place in informal enterprises and underground activities.

The European Bank for Reconstruction and Development (EBRD) also differentiates between ‘informal work undertaken to maintain subsistence levels’ and ‘informal labour motivated by market incentives such as tax evasion or the business environment’ (EBRD 2000, p.102). It suggests that informal work has played a crucial role in the provision of employment and earnings for many people during the transition period but that the driving forces have differed across regions, with the poorer countries motivated by the lack of formal opportunities and a need to survive while in the more advanced countries the motivation has been more market-related including tax evasion and avoidance of bureaucratic delays and impediments (EBRD 2000, p.97).

Finally, it is important to note that the use of motive (or intent) to differentiate between activities is common practice in both law and economics. As Cowell (1990, p.11-12) points out, from a legal perspective the distinction between (illegal) evasion and (legal but questionable) avoidance relies on the judge’s perception of the intentions underlying the taxpayer’s actions. Motive also plays an important part in the
construction of models of economic behaviour and Cowell suggests that evasion and avoidance can be distinguished on the basis of motive and therefore also differ in economic behaviour.

3.2 The Conceptual Framework: Informal vs. Household, Underground, and Illegal Activities

Although the distinction between informal and underground activities is the subtlest, it is also important to distinguish between other forms of non-measured, non-taxed, and/or non-regulated activities. Several authors have argued that a distinction can be made between household, informal, underground, and illegal activities\(^1^8\) (Commission of the European Communities - Eurostat, et al. 1993; ILO 1993b; Thomas 1992). However, most of these conceptual frameworks have based their definition of the informal sector on that adopted by the 15\(^{th}\) International Conference of Labour Statisticians (ILO 1993b). As argued below, this enterprise-based definition is not necessarily appropriate for transition countries where there has been a growing informalisation of the labour market, which is not entirely captured by the concept of the ILO (1993b) concept of ‘informal enterprises’.

Since the informal sector is associated with unmeasured activities, it is useful to use the conceptual framework of the system of national accounts. Here we propose to build on concepts defined in the 1993 Eurostat, IMF, OECD, UN, World Bank ‘System of National Accounts’ (hereon referred to as SNA 1993). As explained above the units and criteria used to define informality\(^1^9\) are related, but not identical. The choice of units and criteria ultimately depends on the reason for which the informal sector or economy is being studied. Here we do not attempt to argue that one unit or criterion is preferred to the others, but rather to present a broad conceptual framework, which can be used to distinguish between household, informal, underground or illegal sectors regardless of the units or criteria used to define them. It is important to highlight from the outset that the framework must therefore remain quite broad and that it is impossible (and unrealistic) to define strict boundaries

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\(^1^8\) Not all have used the same terminology (e.g. Thomas distinguishes between household, informal, irregular, and criminal production), but the broad concepts are the same.

\(^1^9\) Recall that four main units of observation (enterprises, activities, income and people) and there main criteria (non-registration, non-measurement, and non-regulation) were identified.
between these sectors. The sectors overlap and for certain activities, persons, enterprises, or income, it may be difficult to determine whether they belong to one sector or another. However, this does not deprive us of an understanding of what constitutes the bulk of the sectors.

Moreover, here the use of the term ‘sector’ refers only to the grouping of similar activities, enterprises, people, or income along certain lines for the purpose of measurement and research and in no way implies that these groupings are independent of one another. In fact, as much of the research in developing countries has shown there is a continuum, not only between informal and formal activities, but also between household, informal, underground and illegal activities. However, for policy, measurement and analytical purposes it is important to distinguish between them. Finally, it is possible, if desired, to make the sectors mutually exclusive by simply starting with one sector and defining each subsequent one as including that, which is not included in the previous ones. So, for example, starting with the household sector, the informal sector could be defined as the set of activities, enterprises, income or persons, which satisfy certain characteristics, and which are, by definition, not part of the household sector, and so on.

We adopt the term ‘hidden economy’ to refer to the output from all productive activities, enterprises, income or people which are unmeasured in GDP and/or untaxed and/or unregulated. In order to simplify the discussion we refer only to ‘productive economic activities’, but any of the other units of observations could be used. The important thing is how the sectors can be distinguished from one another. Also note that any of the criteria (measurement, registration, regulation) could be used alone or together, depending on the purpose.

Thus the hidden economy comprises a wide range of productive activities from housework to organised crime. These can be grouped into four main categories: the household sector, the informal sector, the underground sector and the illegal sector.

We define the household sector as the set of household productive economic activities that produce goods and services for own-consumption within the same household and, which are unmeasured and/or untaxed and/or unregulated because they are outside the SNA production boundary (e.g. household cleaning, maintenance and repair of dwelling occupied by the household,
preparation and serving of meals, care for the sick or elderly, transportation of household members and their goods, etc).

According to the SNA (1993) household activities producing goods for own-consumption are only included in the SNA production boundary ‘if the amount produced is believed to be quantitatively significant in relation to the total supply of that good in the country’ (SNA1993: 6.25). Thus, in developing and transition countries, activities such as agricultural production for own-consumption (which often represents a significant share of total national agricultural production) are included in the SNA. We therefore excluded these activities from our definition of the household sector and, as will be argued below, we consider them part of the informal sector. Thus here the household sector includes

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20 Productive economic activities are activities, which fall within the general production boundary, as defined by the 1993 SNA. They must satisfy two important criteria: (1) they are ‘carried out under the control and responsibility of an institutional unit that uses inputs of labour, capital, and goods and services to produce outputs of goods and services’. Thus, ‘a purely natural process without any human involvement or direction’ such as unmanaged growth of fish stocks in international waters is not included, whereas the activity of fish farming is (SNA1993: 6.15). (2) The output must be capable of being exchanged. Thus activities such as eating drinking, sleeping, taking exercise, etc. are not included as ‘it is impossible for one person to obtain another person to perform them instead’, whereas activities such as washing, preparing meals, caring for children, the sick or aged are all activities that can be provided by other units and therefore fall within the general production boundary’ (SNA 1993: 6.16).

The SNA Production Boundary, as defined by the 1993 SNA, defines those productive economic activities that should be included in GDP estimates. Regarding the production of goods and services within the household, it specifies that production of goods within the household should be included in GDP if the amount produced is believed to be quantitatively significant in relation to the total supply of that good in the country (1993 SNA:6.25). Production of services is generally excluded from GDP ‘with the exception of own-account production of housing services by own-occupier, and of domestic and personal services produced by employing paid domestic staff’ (1993SNA:6.18). Productive activities which fall within the SNA production boundary are classified in the latest revision of the UN ‘International Standard Industrial Classification of All Economic Activities (ISIC) Third Revision’ (1989). An equivalent classification is provided by Eurostat for the European Union in the ‘Statistical Classification of Economic Activities in the European Community (NACE Rev. 1) (1996).
those activities that fall within the general production boundary but not within the SNA production boundary.

Our definition of the household sector is different from that adopted by the SNA (1993) and Thomas (1992), which include all household production for own-consumption in the household sector (regardless of how quantitatively significant it may be). The main reason they do this is that both adopt the ILO (1993) concept of the informal sector, which by definition excludes household production for own-consumption (ILO 1993b, par. 14). However, as will be argued in detail below, household production for own final use should be included in the informal sector, because it is included in the SNA, and because it is a very important source of employment, income and production in many transition and developing countries. Moreover, for public policy purposes, it should be distinguished from other household activities such as cleaning and cooking, which are not included in the SNA.

Finally, some authors have argued for the inclusion of non-quantitatively significant household activities in the SNA, particularly in developing countries where they may contribute considerably to livelihoods (see for example Harrison 2000, p. 46-47). Since there are market alternatives to activities such as taking care of the old or the sick and education, then only including services that are paid for in national income means that equivalent activities, which take place within the household, are counted as costless. In developing and transition countries where social services are extremely limited and incomes are very low, household activities are an important source of income and employment for a significant share of the population. In the UK, the Office for National Statistics (ONS) is developing a so-called ‘household satellite account’ which will, for the first time, measure and value the outputs produced by households, including housing, transport, nutrition, clothing, childcare, adult care and so forth [Office for National Statistics UK, 2002 #231].

We define The informal sector as the set of productive economic activities, which fall within the SNA (1993) production boundary, and are unmeasured untaxed and/or unregulated, not because of deliberate attempts to evade the payment of taxes or infringe labour or other legislation, but because they are undertaken to meet basic needs (e.g. petty trade, household agricultural production, ambulant street vending, unregistered taxi services – with own car,
rickshaw or other means of transportation, undeclared paid domestic employment, etc).

As previously mentioned, the ILO (1993) (and thereby the SNA 1993) also argue for the need to distinguish informal sector activities from underground activities on the basis that the former are not necessarily performed with the deliberate intention of avoiding the payment of taxes, social security contributions, or complying with certain legal standards, while the latter are. However, there is a fundamental difference in the conception of the informal sector presented here and the ILO (1993) definition: The ILO (1993) definition is based on units (or enterprises), while the one presented here is based on productive activities, irrespective of the units (or enterprises) in which they are carried out.

The ILO (1993) ‘Resolution Concerning Statistics of Employment in the Informal Sector’ defines the informal sector as the set of ‘units engaged in the production of goods or services with the primary objective of generating employment and incomes to the persons concerned’ (ILO 1993b, 5(1)). Production units of the informal sector are defined as a subset of household unincorporated enterprises. Household enterprises are ‘units engaged in the production of goods or services which are not constituted as separate legal entities independently of the households or household members that own them, and for which no complete set of accounts (including balance sheets of assets and liabilities) are available which would permit a clear distinction of the production activities of the enterprises from the other activities of their owners and the identification of any flows of income and capital between the enterprise and the owners’ (ILO 1993b, 7).

The informal sector definition presented here differs from the ILO (1993b) definition in three main ways. First of all, in the ILO definition, activities undertaken in informal sector enterprises can theoretically be ‘underground’ (i.e. undertaken with the deliberate intent of evading taxes etc.) but they generally are not, because the ‘primary objective [of informal sector enterprises] is to generate income and employment to the persons concerned (ILO 1993b, 5(1)). In contrast, in the concept of the informal sector presented here, informal activities are by definition not underground, although it may at times be difficult to know which of the
two categories a given activity may belong to (see figure 1 below). Thus, defining the informal sector in terms of productive activities instead of enterprises is conceptually more consistent with the SNA (1993) concepts of underground, household and illegal productive activities, and therefore enables the conceptualisation of the hidden economy as being comprised of these four largely distinct concepts.

Secondly our definition includes all productive activities that are unregistered, unprotected by labour and other legislation, unmeasured, and generally outside the formal legal system, and not just those that take place in units with certain characteristics. Informal productive activities, can take place in informal, formal, non-informal household, or other enterprises. The type of unit in which they take place does not determine whether or not they are informal. This is important because it means that all persons engaging in such activities are considered informally employed, including casual workers in formal enterprises, unpaid family workers in other household or formal enterprises, and all other unregistered workers who are not protected by labour regulations (such as minimum wage requirements, maximum hours of work, paid holidays, protection against dismissal, etc.) and have no access to social protection (such as pensions, health and other insurances). As previously mentioned, this is particularly important in transition countries (but also in developing countries and to some extent developed countries21) where there has been a growing informalisation of the labour market with an increase in self-employment, subcontracting, and moonlighting (to supplement official wages and pensions, which are often only a fraction of the minimum subsistence level).

Indeed, since its ‘conception’ the informal sector has been of interest in developing countries because it is an important source of income and employment for the poor. It is a survival strategy in countries where

21 There is a literature on the informalisation of employment in western industrialised countries, which looks at whether the growth of ‘self-employment’ is a positive or negative phenomenon. Some have argued that it is a sign of the efficiency, flexibility and adaptability of the labour market, while others see it as an increase in precarious, unprotected employment, arguing that people become ‘independent contractors’ because they lose or cannot retain full-time wage employment with accompanying benefits (see for example Dennis 1996).
there are insufficient formal employment opportunities, where wages may be too low to cover the cost of living, and where social safety nets such as unemployment or pension benefits are either lacking or also insufficient to cover the cost of living. As such, it should include all productive activities, which generate income and employment for the poor, and not just those that take place in household enterprises with certain characteristics.

Thirdly, the ILO (1993) resolution excludes household production of goods and services for own final use. In contrast, the definition presented here includes these activities as long as they are part of the SNA production boundary. As previously mentioned, goods are included in the SNA production boundary if they are quantitatively significant in relation to the total supply of that good in the country. In practice, in transition countries this generally means the inclusion of the production of agricultural goods for the household’s final use, as many other goods produced by households, such as clothing and housing, constitute a very small fraction of the total production of these goods in these countries. For services, it includes the personal services produced by employing paid domestic staff and the own-account production of housing services by the owner-occupier.

No explanation was provided by the 1993 ‘Resolution concerning statistics of employment in the informal sector’ for the exclusion of household activities producing for own consumption. However in both transition and developing countries, household agricultural production for own consumption constitutes not only an essential source of income and employment for a large share of the population, but also an important share of total agricultural production. Moreover, primary employment in household agricultural production for own-consumption does not differ in economic behaviour from that in other informal activities, as all are undertaken to generate income to meet basic needs. Finally, small-plot agricultural production has been a significant source of ‘extra income’ for households in transition countries since the Soviet period, and as we have seen there is evidence that with the collapse in living standards, many have turned to subsistence agriculture to survive.

We use the concepts of underground and illegal production as defined in the SNA (1993).
The underground sector consists of legal productive economic activities that are part of the SNA (1993) production boundary and are unmeasured and/or untaxed and or unregulated because they are deliberately concealed from public authorities for the following kind of reasons: to avoid the payment of income, value added or other taxes; to avoid the payment of social security contributions; to avoid having to meet certain legal standards such as minimum wages, maximum hours, safety or health standards, etc.; to avoid complying with certain administrative procedures such as completing statistical questionnaires or other administrative forms (SNA1993: 6.34) (e.g. most cases of tax evasion and benefit fraud).

The illegal sector consists of productive activities that generate goods and services forbidden by law or that are unlawful when carried out by unauthorised producers. There are two types of illegal activities: those that produce goods and services whose sale, distribution or possession is forbidden by law, and activities which are usually legal, but become illegal when carried out by unauthorised producers (SNA 1993: 6.30) (e.g. production of narcotics, illegal transportation in the form of smuggling, prostitution and unlicensed medical practice). Furthermore illegal activities are included in the SNA production boundary if the transactions involved are based on mutual consent. Thus, for instance, prostitution is included but theft is not (OECD 1997, p.12).

The table below provides a convenient summary of the conceptual framework. It is important to consider that the three criteria used here to distinguish between the different sectors are not the only ones that determine whether an activity is informal, underground or other. They are just used here to help the reader recall what we have broadly conceptualised as the household, informal, underground and illegal sectors.

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22 They are legal provided that certain standards or regulations are complied with.

23 The SNA (1993) recognises that it may be difficult to determine whether there is mutual consent (e.g. does bribery involve mutual consent?).

24 For example, we have not included lack of measurement, registration and regulation as criteria. Nor have we included activities, that are illegal because they are carried out by unauthorised producers.
### Table 1: Summary of the Conceptual Framework

<table>
<thead>
<tr>
<th>Productive activities</th>
<th>Within the SNA (1993) production boundary?</th>
<th>Are goods and services legal?</th>
<th>Primary reason why activity is unmeasured/untaxed/unregulated?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Household</td>
<td>No</td>
<td>Yes</td>
<td>Irrelevant*</td>
</tr>
<tr>
<td>Informal</td>
<td>Yes</td>
<td>Yes</td>
<td>Activities undertaken to meet basic needs, not deliberately concealed.</td>
</tr>
<tr>
<td>Underground</td>
<td>Yes</td>
<td>Yes</td>
<td>Activities deliberately concealed to avoid taxes, social security contributions, legal standards, compliance with administrative procedures, etc.</td>
</tr>
<tr>
<td>Illegal</td>
<td>Yes</td>
<td>No</td>
<td>Irrelevant</td>
</tr>
</tbody>
</table>

* The primary reason why household and illegal activities are unmeasured is irrelevant to their classification in the household or illegal sector, as this is determined by whether or not they are within the SNA production boundary and whether or not they are legal.

As can very quickly be seen, the borderline between household, informal, underground and illegal sectors may not be very clear, and activities may often belong to more than one sector. The figure below illustrates how these sectors are interrelated.

![Figure 1: The relationship between informal, household, underground and illegal activities](image-url)
As can be seen, it may not be obvious whether an activity is part of the household or informal sector (area A in figure 1), for instance. Subsistence farming, for instance, may be considered part of the household sector if it is not quantitatively significant in respect to total agricultural production (as may be the case in many western industrialised countries), whereas it may be part of the informal sector if it is quantitatively significant (as is the case in many developing and some transition countries). Similarly, it may be difficult to determine whether an activity is part of the illegal, household, or informal sectors (area B). The cultivation of poppy seeds on household plots for instance, could be considered as any of the three depending on whether household production of poppy seeds is quantitatively significant with respect to the total poppy seed production in the country, whether it is undertaken to meet basic needs, and whether it is considered illegal in that particular country. The boundary is similarly difficult to define between informal and underground and between underground and illegal activities. Thus, construction activities undertaken by unregistered construction workers, for instance, may be considered informal or underground (area C), depending on whether or not they are deliberately concealed and whether they are undertaken to meet basic needs (they could of course be both). Finally, as highlighted in the SNA (1993, 6.35), production that does not comply with certain safety, health or other standards, for instance, could be described as either underground or illegal (area D).

Having said this, however, it is important to reiterate that what is important is the conceptual distinction between these activities. We do not require the sectors to be mutually exclusive in order to understand what types of activities constitute the bulk of each sector.

3.2.1 HOW DOES THIS DEFINITION OF THE INFORMAL SECTOR RELATE TO THOSE IN THE EXISTING LITERATURE?

The table below provides a simplified summary of our conceptual framework and its relation to definitions of the informal sector in the existing literature. Once again, it is important to clarify that this table is neither a precise recapitulation of our conceptual framework and nor is it a summary of the definitions in developing, industrialised, centrally planned or transition countries. For the purpose of simplicity, the table is based on only one unit of observation (economic activities) and one criteria of informality (lack of measurement). Moreover, as in table 1, it uses only three criteria to distinguish between household, informal,
underground and illegal activities (position with respect to the SNA production boundary; legality of goods and services produced; and primary reason for which the activity is unmeasured). Finally, we only represent the ‘main’ or ‘stereotypical’ definitions in each of these regions although, as we have seen, there is great heterogeneity in informal sector definitions in all regions.

According to our conceptual framework, the informal sector is represented in table 2 by the sum of cells 2, 3 and 4 (i.e. the area with horizontal lines). The underground sector is the sum of cells 5, 6, 7, the illegal sector is the sum of cells 8, 9, 10, and the household sector is represented by cell 1 (e.g. cooking, cleaning, caring for the sick etc). Note that for OECD (1997) and Thomas (1992) the household sector would be represented by cells 1 and 3 (i.e. they include all activities aimed at producing goods and services for own-consumption, including those that are in the SNA production boundary, such as subsistence agriculture in many developing and transition countries).

Definitions in ‘developing’ countries can be illustrated by the ILO (1993) definition, which can broadly be represented in table 2 by the sum of cells 2, 5, 6 (i.e. the area with vertical lines). In this case, the informal sector is the set of informal own-account enterprises and enterprises of informal employers. As we have seen, according to this definition, activities undertaken in the informal sector can theoretically be underground or illegal (cells 5 and 8).

Note that this table is not exhaustive. Another reason why activities may be unmeasured is because of statistical error for instance. However it is not included here as it is not relevant to our distinction between household, informal, underground, and illegal activities.
Table 2: Comparing the conceptual framework to other definitions of the informal sector in the literature

| Types of Enterprises or units | Unmeasured economic activities | | | |
|-------------------------------|--------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
|                               |                               | Out of SNA production boundary | In SNA production boundary      | Legal                           | Illegal                         |
|                               |                               |                                 |                                 | Aim is to meet basic needs      | Deliberately concealed to avoid tax or regulation |
| Unincorporated                | Household                      | Informal own-account enterprises or Enterprises of informal employers | (2)                             | (5)                             | (8)                             |
|                               |                                 | Other (e.g. household enterprises producing for own-consumption) | (1)                             | (3)                             | (6)                             | (9)                             |
| Non Household (e.g. government) |                               |                                 |                                 | (4)                             | (7)                             | (10)                            |
| Other (i.e. corporations, quasi-corporations, non-profit institutions) |                               |                                 |                                 |                                 |                                 |                                 |

Notes: Cells shaded in black represent activities that, by definition, do not exist. Cells that are blank do exist, but are outside of our conceptual framework. In our conceptual framework, the household sector = (1); the informal sector = (2)+(3)+(4); the underground sector = (5)+(6)+(7) and the illegal sector = (8)+(9)+(10).
Definitions in ‘developed’ countries can broadly be represented by the sum of cells 2 to 10. This includes all activities that should be measured, taxed or regulated, because they fall within the SNA production boundary, but are not. Note that it may also include other activities such as the evasion of taxes on capital gains, which we cannot represent in our matrix because they are not productive economic activities.

As we have seen, definitions in transition countries have been extremely varied. In the literature review, we grouped studies into three categories, which can very broadly be represented in the table above. Definitions used by studies that have focused on how people survive during transition, can be represented by any combination of cells 2 and 3. Those which have focused on measuring untaxed or unmeasured GDP have defined it as any combination of cells 2 to 10 plus some other non-productive activities such as capital flight. Finally, those which have focused on the transformation of the Soviet second economy into the informal economy are even more difficult to represent in the above table as they have included all private sector activity, which could include cells 2, 3, 5, 6, 8, 9 and those parts of cells 4, 7 and 10 which are in the private sector plus other non-productive activities such as theft, bribery and capital flight.

Finally, definitions in centrally planned countries are equally difficult to illustrate in the above table and could be represented by the same cells as those of the above group that adopted second economy definitions.

3.3 Operationalising the ‘Informal Sector’
In order to measure and study the informal sector, the conceptual definition must be made operational. The way it is operationalised will depend on the measurement objectives. Thus, for example, if the aim is to measure or analyze informal employment, then labour force surveys can be used and the definition can be operationalised based on status in employment. If the aim is to measure the production of the informal economy, it may be more appropriate to use household income and expenditure surveys and to adopt an operational framework based on productive units.

The aim here is to present an example of how the conceptual definition of the informal sector discussed above can be operationalised for the purposes of measuring and studying informal employment. Indeed, as previously mentioned, from labour market, poverty and social policy
perspectives, it is critical to understand how many people work in unregistered, precarious, and unprotected employment, who they are, and what types of activities they engage in, in order to design appropriate labour market and poverty reduction policies and in order to ensure that policies aimed at increasing government revenue by tackling tax evasion do not have a detrimental impact on livelihoods.

3.3.1 A TYPOLOGY OF INFORMAL EMPLOYMENT

If we are to use existing data to attempt to get a measure of the extent of informal employment in the country, assumptions will have to be made. In particular, assumptions must be made as to what types of activities can be considered to be undertaken ‘to meet basic needs’. One way to operationalise the definition is to use status in employment as a proxy.  

We therefore assume that individuals engaging in certain types of employment can be considered to be engaging in productive activities which are unmeasured and/or untaxed and/or unregulated not because they are deliberately concealed to evade the payment of taxes or to avoid complying with certain laws and regulations, but because of a necessity to generate income and employment to meet basic needs.

Our typology of informal employment includes individuals with the following status in either their primary or secondary jobs: (1) own-account workers and employers in household enterprises27 (2) (unpaid)

26 The ILO (1993a, (4)) ‘International Classification of Status in Employment’ classifies the employed into 6 groups: employees, employers, own-account workers, members of producers co-operatives, contributing family workers, and workers not classifiable by status.

27 It is important not to confuse household enterprises with the household sector. Household enterprises are not necessarily part of the household sector as defined here (they are only part of the household sector if they produce for own consumption and the product is not quantitatively significant). As discussed above, household enterprises- or unincorporated enterprises owned by households have the following characteristics: (1) they are not constituted as separate legal entities independently of the households or household members that own them, and (2) they have no complete set of accounts (including balance sheets of assets and liabilities) available, which would permit a clear distinction of the production activities of the enterprises from the other activities of their owners and the identification of any flows of income and capital between the enterprise and the owners’ (ILO 1993b, 7). Finally, household enterprises may produce for own-consumption, sale or barter.
contributing family workers (3) non-regular employees, and (4) others employed casually, temporarily or seasonally (5) employees engaging in left-hand work (or the earning of informal income at the formal workplace).

Own-account workers and employers in household enterprises are essentially those employed in the traditional ILO ‘informal sector’, although we also include production for own-final use (such as small-plot agricultural production). These are ‘informal own-account workers’ or ‘informal employers’ as defined in ILO (1993b). Unpaid contributing family workers are also, by definition, employed in household enterprises. Both these groups can be assumed to be unregistered, unmeasured and unregulated, not because of a deliberate attempt to evade taxation but because are simply generating income and employment for the household.28

Non-regular employees are employees who do not have ‘stable contracts, for whom the employing organisation is responsible for payment of relevant taxes and social security contributions and/or where the contractual relationship is subject to national labour legislation’ (ILO 1993a, par.8, 9). In contrast to western industrialised countries, where many of those employed ‘under the table’, may be doing so to deliberately avoid the payment of taxes, in many developing and transition countries, these are often low-skilled, low-paid workers, who work under such contracts because of a necessity to meet basic needs. Both the Georgian Labour Force data and Clarke (1999c) show that non-regular paid employees, in Georgia and Russia respectively, are largely employed in low-skilled skilled jobs such as tea or bread manufacturing and petty trade. It can, of course be argued, that their employers are involved in ‘underground’ activities, because they may be deliberately avoiding the payment of taxes and social security contributions. However, evidence from the Georgia Labour Force data (1999) and from Clarke (1999c) suggests that non-regular agreements are often used in small-scale family enterprises, and often for friends, partners or relatives, not because they are ‘a means of evading the restrictions of labour legislation, but because they are appropriate in very small, informally organised businesses, particularly in the sphere of trade’

28 The EBRD (2000, p.102) also considers contributing family work as informal employment undertaken to maintain subsistence levels.
Casual, temporary and seasonal workers in transition countries can also be assumed to be informal in that it can quite safely be assumed that they do not have ‘regular contracts’ and that those who engage in such precarious employment do so to meet basic needs.

Finally, as we have discussed, research and anecdotal evidence suggests that left-hand work, which was widespread during the Soviet period, has increased since the beginning of transition. These activities should be considered informal, as they are unregistered and unaccounted for not because of a deliberate attempt to evade the payment of taxes but because of a necessity to meet basic needs. As Birdsall highlights, activities such as the overcharging of customers, the pocketing of fees for official services or the diversion of clientele from the firm are as vital to livelihood as formal wages and can constitute a significant part of worker’s earnings (Birdsall 2000, p.1). Left-hand work is regarded as a way in which people ‘get by’ in the absence of sufficient formal income; ‘their small-scale allows the practitioner to ‘tread water’ but not get ahead’ (Birdsall 2000, p.3).

This typology is distinct from the ILO operational definition in five significant ways. First, as discussed extensively above, it includes all forms of vulnerable, invisible, precarious ‘informal’ employment and not only that which takes place in ‘informal sector enterprises’. Second, it includes left-hand work, or the earning of informal income at the formal work place. Third, as we have seen, it includes employment in the production of goods and services for own consumption (in practice this means agricultural production for own-consumption and paid domestic employment). Fourth, it includes employment in agriculture. The ILO (1993:16) excluded agricultural activities from the informal sector ‘for practical reasons’. It had no objection to their inclusion from a conceptual point of view, but from an operational one it deemed that it would be inconvenient to include them in the informal sector, as agriculture represents such an important share of employment in developing countries and it would therefore be very expensive to cover agricultural activities in informal sector surveys. However, precisely because it is such an important source of (largely informal) employment in developing and in the poorer transition countries and because it has proved to be one of the main strategies employed by households to cope with the fall in living standards in many transition countries, it is argued here that agriculture should be included. Fifth, whereas the large
majority of informal sector studies using the ILO (1993) operational framework have included only the urban sector, both rural and urban employment is included here. Nevertheless, it is important to note that the ILO 1993 Resolution explicitly states that both urban and rural activities should be included. However, it recommends that given that the informal sector is so widespread in rural areas, and that it may be very expensive to carry out surveys across both urban and rural areas, countries could start by measuring the \textit{urban} informal sector (ILO 1993b,14).

3.3.2 A N EMPIRICAL EXAMPLE: THE CASE OF GEORGIA

The Georgia Labour Force Survey (1998, 1999) is a nationally representative, quarterly survey, co-designed by Georgian and ILO statisticians. It covers the entire territory of Georgia, with the exclusion of the regions of Abkhazia and Tsingvali (South Ossetia). The sample size is 5,000 households, and households stay in the sample for four quarters.

To apply the typology of informal employment to the Georgia Labour Force survey, we must use proxies for ‘household enterprises’, ‘non-regular employment’, and ‘left-hand work’. First, we use location as a proxy for ‘unincorporated household enterprises’ rather than ‘registration’ or ‘number of employees below a certain number’, as per the ILO (1993) definition.\footnote{The ILO(1993) operational definition of the informal sector consists of household enterprises that are either (1) informal ‘own-account enterprises’ or ‘enterprises of informal employers’. The first are operated by own-account workers and can employ contributing family workers and employees, however they do not employ employees on a continuous basis. The second employ one or more employees on a continuous basis. For operational purposes, all own-account workers are usually included as are employers operating enterprises, which are unregistered or employ less than a maximum number of workers (usually 4-10).} Thus own-account workers and employers in household enterprises include: (1) own-account workers or employers whose business is located at home, outside home, in a street booth, on a construction site, in a market place, at a customer’s home or in a non-fixed location (2) own-account workers or employers whose business takes place in a factory, office, establishment, shop, workshop, etc. which is independent from the home and is \textit{not registered}, and (3) own-account workers or employers working on their own or rented plot of
land, in agriculture, either in an urban area or in a non-registered rural enterprise.

Location is used as a proxy for household enterprises in the case of the Georgian Labour Force data because the question on registration is not particularly meaningful. Over 90% of own-account workers said they were ‘registered’. However, qualitative research and anecdotal evidence suggest that in some cases this may refer to the payment of some kind of local licence fee (to obtain a permit to sell in a market for instance), while in others it refers to the payment of bribes to local police, sanitary inspectors, tax inspectors, and local racketeers. However, in neither of these cases does the ILO ‘registration criterion’ apply, since it refers to registration under national legislation, such as under ‘factory or commercial acts, tax or social security laws, professional groups regulatory acts, or similar acts, laws or regulations established by national legislative bodies’ (ILO 1993b, :8.(3)). The OECD (1997) also argues that it is inappropriate to define the informal sector in transition countries according to legal status or to the relation with public authorities since most of these countries lack business laws and regulations and the means to enforce them.

Similarly, identifying informal enterprises by the number of employees (less than 4 - which is generally the lowest number used in such cases) is also inappropriate, as over 97% of own-account workers and employers work in enterprises with less than 4 people (including owners, employees, unpaid workers and casual workers). It would therefore amount to including all own-account workers and employers and it could be argued that it would also include professionals (doctors, lawyers, accountants) etc. who could have relatively high incomes and intentionally conceal their activities to avoid the payment of taxes. The most appropriate proxy for household enterprises in the Georgia Labour Force Survey is therefore location.

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30 As an example of these ‘unofficial’ taxes, Dudwick (1999, p.29) relates: ‘to sell Khachapuri, a cheese pastry, in the market, Gayane pays the tax inspector 50 Lari (US$25) and the director of the market 120 Lari (US$60) each month.

31 However, as can be seen in the operational framework below, the registration criterion is used for employers and own-account workers working in ‘non-household’ locations such as offices, factories, establishments, etc. (although they only represent 0.03% of total employment). Registration is also used to identify informal rural agricultural own-account workers and employers. This
Second, we use ‘employees with an oral agreement’ as a proxy for ‘non-regular employees’. In many transition countries, including Georgia and Russia, oral employment agreements are illegal. Although in most western industrialised countries the law regards oral employment contracts as legally binding and therefore offers employees hired on the basis of oral agreements the same protection as those hired under written agreements, in most CIS countries (including Russia and Georgia), oral agreements have no legal force and those employed under such agreements have no protection under the labour code (Clarke 1999c, p.8). Moreover, employment based on an oral agreement is unregistered and therefore employers will not pay any of the taxes and social security payments required by the law.

Finally, we are obliged to omit left-hand work, as it is problematic to operationalise. Not only are there no questions in the Georgia Labour Force Survey that would permit us to identify individuals engaging in informal income-earning activities at the formal work place, but also even if there were such questions responses may not be reliable, as individuals are likely to be reluctant to disclose such information. One possible way of analysing such activities would be to use the existing literature to identify occupations that typically give rise to opportunities for left-hand work and to analyse the income-consumption gap of individuals employed in these occupations. This could be tried in future research. However, left-hand work is perhaps best studied by qualitative means.

The operational framework presented below provides a detailed, step-by-step flowchart of how the informally employed are identified in the Georgia Labour Force Survey (1999). For the purposes of analysis and presentation, the informally employed are grouped into five major categories: (1) informal self-employed: own-account workers and
employers working in household enterprises (categories P1a to P1d + P2a to P2d), (2) unpaid contributing family workers (P3), (3) informal employees: employees with oral agreements, and employees employed casually or temporarily (P4+P5) (4) other informals: others (including members of producers co-operatives) working either casually, temporarily or in typically informal activities (P6+P7a+P7b), and (5) informal secondary jobholders: workers with formal primary jobs and informal secondary jobs (S1 to S7b).

In the framework below P and S refer to Primary and Secondary employment. We consider all those with an informal primary job or with a formal primary job and an informal secondary job to be informally employed. Primary employment is checked first. If primary employment is not informal, then secondary employment is checked, thereby avoiding any double counting.

---
32 We merge own-account workers with employers because employers accounted for only 1.5% of total employment and ‘informal’ employers accounted for only 0.7% of total employment in 1999.

33 Members of producer’s co-operatives and those with unidentified status in employment are not asked about the location of their work. We therefore use casual/temporary/seasonal employment as a criteria and check whether they are involved in activities or occupations for which more than 50% of workers are informal. This group represents a very small share of total employment. Overall, others informally employed’ account for only 0.8% of total employment.
3.3.3 Results
The Application of our typology to the Georgia Labour Force Survey data (1999) yields the following results.

Table 3: Informal employment by personal characteristics and type of informal employment

<table>
<thead>
<tr>
<th>% of Total employment within a given group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Employed</td>
</tr>
<tr>
<td>52%</td>
</tr>
<tr>
<td>Informally employed</td>
</tr>
<tr>
<td>8.9%</td>
</tr>
<tr>
<td>Informal self-employed</td>
</tr>
<tr>
<td>30.6%</td>
</tr>
<tr>
<td>Contributing family workers</td>
</tr>
<tr>
<td>7.5%</td>
</tr>
<tr>
<td>Informal employees</td>
</tr>
<tr>
<td>0.8%</td>
</tr>
<tr>
<td>Other informals</td>
</tr>
<tr>
<td>4.2%</td>
</tr>
<tr>
<td>Not informally employed</td>
</tr>
<tr>
<td>48%</td>
</tr>
</tbody>
</table>

Gender

<table>
<thead>
<tr>
<th></th>
<th>Total informally employed</th>
<th>Informal self-employed</th>
<th>Contributing family workers</th>
<th>Informal employees</th>
<th>Other informals</th>
<th>Informal secondary job holders*</th>
<th>Not informally employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>females</td>
<td>57%</td>
<td>6.1%</td>
<td>40.2%</td>
<td>5.4%</td>
<td>0.8%</td>
<td>4.1%</td>
<td>43%</td>
</tr>
<tr>
<td>males</td>
<td>48%</td>
<td>11.7%</td>
<td>21.5%</td>
<td>9.6%</td>
<td>1.0%</td>
<td>4.1%</td>
<td>52%</td>
</tr>
</tbody>
</table>

Urban/Rural

<table>
<thead>
<tr>
<th></th>
<th>Total informally employed</th>
<th>Informal self-employed</th>
<th>Contributing family workers</th>
<th>Informal employees</th>
<th>Other informals</th>
<th>Informal secondary job holders*</th>
<th>Not informally employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>urban</td>
<td>38%</td>
<td>13.9%</td>
<td>7.9%</td>
<td>12.4%</td>
<td>1.4%</td>
<td>2.0%</td>
<td>62%</td>
</tr>
<tr>
<td>rural</td>
<td>62%</td>
<td>5.6%</td>
<td>46.0%</td>
<td>4.2%</td>
<td>0.5%</td>
<td>5.6%</td>
<td>38%</td>
</tr>
</tbody>
</table>

Age Group

<table>
<thead>
<tr>
<th></th>
<th>Total informally employed</th>
<th>Informal self-employed</th>
<th>Contributing family workers</th>
<th>Informal employees</th>
<th>Other informals</th>
<th>Informal secondary job holders*</th>
<th>Not informally employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>15-25</td>
<td>76%</td>
<td>3.8%</td>
<td>61.1%</td>
<td>9.0%</td>
<td>0.8%</td>
<td>1.0%</td>
<td>24%</td>
</tr>
<tr>
<td>26-35</td>
<td>54%</td>
<td>7.4%</td>
<td>33.4%</td>
<td>8.9%</td>
<td>1.0%</td>
<td>3.7%</td>
<td>46%</td>
</tr>
<tr>
<td>36-45</td>
<td>50%</td>
<td>10.6%</td>
<td>22.8%</td>
<td>10.0%</td>
<td>1.3%</td>
<td>5.1%</td>
<td>50%</td>
</tr>
<tr>
<td>46-55</td>
<td>47%</td>
<td>9.5%</td>
<td>21.2%</td>
<td>8.9%</td>
<td>0.8%</td>
<td>6.7%</td>
<td>53%</td>
</tr>
<tr>
<td>56-65</td>
<td>49%</td>
<td>9.7%</td>
<td>28.7%</td>
<td>5.4%</td>
<td>0.7%</td>
<td>4.2%</td>
<td>51%</td>
</tr>
<tr>
<td>66+</td>
<td>48%</td>
<td>9.7%</td>
<td>34.9%</td>
<td>1.6%</td>
<td>0.2%</td>
<td>1.7%</td>
<td>52%</td>
</tr>
</tbody>
</table>

Educational Attainment

<table>
<thead>
<tr>
<th></th>
<th>Total informally employed</th>
<th>Informal self-employed</th>
<th>Contributing family workers</th>
<th>Informal employees</th>
<th>Other informals</th>
<th>Informal secondary job holders*</th>
<th>Not informally employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>elementary</td>
<td>48%</td>
<td>8.6%</td>
<td>34.6%</td>
<td>2.7%</td>
<td>0.4%</td>
<td>1.5%</td>
<td>52%</td>
</tr>
<tr>
<td>incomplete secondary</td>
<td>61%</td>
<td>8.6%</td>
<td>44.3%</td>
<td>5.2%</td>
<td>0.5%</td>
<td>2.5%</td>
<td>39%</td>
</tr>
<tr>
<td>secondary</td>
<td>66%</td>
<td>10.0%</td>
<td>43.3%</td>
<td>9.2%</td>
<td>1.2%</td>
<td>2.0%</td>
<td>34%</td>
</tr>
<tr>
<td>vocational, technical</td>
<td>56%</td>
<td>10.3%</td>
<td>27.1%</td>
<td>11.7%</td>
<td>1.0%</td>
<td>5.5%</td>
<td>44%</td>
</tr>
<tr>
<td>special secondary</td>
<td>51%</td>
<td>9.3%</td>
<td>26.1%</td>
<td>8.1%</td>
<td>1.0%</td>
<td>6.4%</td>
<td>49%</td>
</tr>
<tr>
<td>higher</td>
<td>29%</td>
<td>6.3%</td>
<td>10.4%</td>
<td>5.0%</td>
<td>0.4%</td>
<td>6.4%</td>
<td>71%</td>
</tr>
</tbody>
</table>

Region

<table>
<thead>
<tr>
<th></th>
<th>Total informally employed</th>
<th>Informal self-employed</th>
<th>Contributing family workers</th>
<th>Informal employees</th>
<th>Other informals</th>
<th>Informal secondary job holders*</th>
<th>Not informally employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kakheti</td>
<td>57%</td>
<td>9.3%</td>
<td>33.2%</td>
<td>6.8%</td>
<td>0.0%</td>
<td>7.1%</td>
<td>43%</td>
</tr>
<tr>
<td>Tblisi</td>
<td>22%</td>
<td>9.8%</td>
<td>0.6%</td>
<td>10.2%</td>
<td>1.1%</td>
<td>0.7%</td>
<td>78%</td>
</tr>
<tr>
<td>Shida Kartli</td>
<td>52%</td>
<td>10.9%</td>
<td>32.1%</td>
<td>5.8%</td>
<td>0.9%</td>
<td>2.2%</td>
<td>48%</td>
</tr>
<tr>
<td>Region</td>
<td>18%</td>
<td>0.8%</td>
<td>0.2%</td>
<td>5.4%</td>
<td>0.3%</td>
<td>10.9%</td>
<td>82%</td>
</tr>
<tr>
<td>-----------------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
</tr>
<tr>
<td>Kvemo Kartli</td>
<td>55%</td>
<td>8.3%</td>
<td>34.3%</td>
<td>5.2%</td>
<td>0.6%</td>
<td>6.9%</td>
<td>45%</td>
</tr>
<tr>
<td>Samtsxe-Javakheti</td>
<td>61%</td>
<td>7.8%</td>
<td>36.6%</td>
<td>3.4%</td>
<td>0.1%</td>
<td>13.6%</td>
<td>39%</td>
</tr>
<tr>
<td>Adjara</td>
<td>52%</td>
<td>7.0%</td>
<td>27.1%</td>
<td>16.1%</td>
<td>0.5%</td>
<td>1.3%</td>
<td>48%</td>
</tr>
<tr>
<td>Guria</td>
<td>66%</td>
<td>5.4%</td>
<td>42.4%</td>
<td>5.7%</td>
<td>1.0%</td>
<td>11.1%</td>
<td>34%</td>
</tr>
<tr>
<td>Samegrelo</td>
<td>70%</td>
<td>12.5%</td>
<td>44.1%</td>
<td>8.6%</td>
<td>2.2%</td>
<td>3.0%</td>
<td>30%</td>
</tr>
<tr>
<td>Imereti</td>
<td>59%</td>
<td>7.4%</td>
<td>42.8%</td>
<td>5.1%</td>
<td>0.8%</td>
<td>2.5%</td>
<td>41%</td>
</tr>
<tr>
<td><strong>Sector</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>state sector</td>
<td>18%</td>
<td>0.8%</td>
<td>0.2%</td>
<td>5.4%</td>
<td>0.3%</td>
<td>10.9%</td>
<td>82%</td>
</tr>
<tr>
<td>private sector</td>
<td>69%</td>
<td>13.0%</td>
<td>46.7%</td>
<td>7.7%</td>
<td>1.0%</td>
<td>0.9%</td>
<td>31%</td>
</tr>
<tr>
<td><strong>Category of Economic Activity</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>agriculture, hunting, forestry, fishing (A+B)</td>
<td>69%</td>
<td>7.5%</td>
<td>57.9%</td>
<td>2.0%</td>
<td>0.1%</td>
<td>1.2%</td>
<td>31%</td>
</tr>
<tr>
<td>manufacturing (D)</td>
<td>38%</td>
<td>7.1%</td>
<td>1.4%</td>
<td>24.6%</td>
<td>0.3%</td>
<td>4.5%</td>
<td>62%</td>
</tr>
<tr>
<td>electricity, gas and water supply (E)</td>
<td>16%</td>
<td>0.3%</td>
<td>0.0%</td>
<td>6.5%</td>
<td>0.0%</td>
<td>9.1%</td>
<td>84%</td>
</tr>
<tr>
<td>construction (F)</td>
<td>52%</td>
<td>12.6%</td>
<td>0.9%</td>
<td>33.0%</td>
<td>0.6%</td>
<td>4.4%</td>
<td>48%</td>
</tr>
<tr>
<td>wholesale and retail trade (G)</td>
<td>74%</td>
<td>37.5%</td>
<td>2.4%</td>
<td>26.3%</td>
<td>6.7%</td>
<td>1.4%</td>
<td>26%</td>
</tr>
<tr>
<td>hotels and restaurants (H)</td>
<td>50%</td>
<td>9.9%</td>
<td>1.3%</td>
<td>34.2%</td>
<td>0.0%</td>
<td>4.9%</td>
<td>50%</td>
</tr>
<tr>
<td>transport and communication (I)</td>
<td>35%</td>
<td>14.7%</td>
<td>0.7%</td>
<td>11.0%</td>
<td>1.1%</td>
<td>7.0%</td>
<td>65%</td>
</tr>
<tr>
<td>financial intermediation, real estate, other business activities (J+K)</td>
<td>19%</td>
<td>4.2%</td>
<td>0.2%</td>
<td>6.4%</td>
<td>2.0%</td>
<td>5.9%</td>
<td>81%</td>
</tr>
<tr>
<td>public administration and defence (L)</td>
<td>12%</td>
<td>0.1%</td>
<td>0.1%</td>
<td>3.2%</td>
<td>0.1%</td>
<td>8.2%</td>
<td>88%</td>
</tr>
<tr>
<td>education (M)</td>
<td>20%</td>
<td>0.8%</td>
<td>0.1%</td>
<td>2.9%</td>
<td>0.1%</td>
<td>15.9%</td>
<td>80%</td>
</tr>
<tr>
<td>health and social work (N)</td>
<td>13%</td>
<td>0.4%</td>
<td>0.1%</td>
<td>2.6%</td>
<td>0.0%</td>
<td>10.0%</td>
<td>87%</td>
</tr>
<tr>
<td>other community, personal service activities (O)</td>
<td>19%</td>
<td>3.3%</td>
<td>0.6%</td>
<td>7.4%</td>
<td>0.1%</td>
<td>8.2%</td>
<td>81%</td>
</tr>
<tr>
<td>private households with employed persons (P)</td>
<td>99%</td>
<td>17.5%</td>
<td>3.5%</td>
<td>69.5%</td>
<td>7.3%</td>
<td>1.0%</td>
<td>1%</td>
</tr>
<tr>
<td>other (C+O)</td>
<td>29%</td>
<td>4.3%</td>
<td>5.6%</td>
<td>10.4%</td>
<td>0.6%</td>
<td>8.4%</td>
<td>71%</td>
</tr>
</tbody>
</table>
Notes to Table 3: “Secondary job holders have a formal primary job and informal secondary job. They are considered informally employed. The sector and category of economic activity refers to their primary job.


Some very preliminary observations can be made on the basis of these figures, however more in depth research is needed to understand the characteristics and causes of informal employment in Georgia.

- *The majority of employment in Georgia is informal:* 52% of the employed were informally employed in 1999. More than half are unpaid contributing family workers, mostly on family farms.

- If we apply the ILO (1993b) definition and include only those employed in informal sector enterprises, we find that about one fifth of employment is in informal sector enterprises. The difference is made up of unpaid contributing family workers, informal employees, casual, temporary and seasonal workers in non-informal enterprises.

- *The majority of informal employment is in agriculture.* Small-scale urban agriculture and unregistered rural plots account for 69% of total informal employment.

- *Females work more informally than males:* 57% of employed females vs. 48% of employed males worked informally in 1999. A higher proportion of females are unpaid contributing family workers.

- *Informal employment is more rural than urban:* 38% of urban employment is informal whereas 62% of rural employment is informal. This is not surprising given the share of informal employment in agriculture.

- The State sector is largely formal, however 18% of state employees work informally. Most have formal primary jobs with informal secondary jobs (moonlighting). *The majority of private sector employment is informal:* 69% of those working in the private sector are informally employed. Most are contributing family workers, self-employed and informal employees.

- *Youth and pensioners are more informally employed.* More than three-quarters of employed 15-24 year olds work informally (these

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34 We include all household enterprises in the informal sector because the data does not allow us to separate household enterprises producing exclusively for own-consumption from those producing for sale or barter.
are youth whose main occupation is employment and not education). Over 65 year-olds also have surprisingly high rates of informal employment, with 48% of the employed working informally. This is worrying given that almost half of over 65 year-olds are employed.

- **Lower education seems to be associated with informal employment** (66% of those with secondary education work informally), while higher education is associated with formal employment (only 29% of those with higher education work informally).
- **Some regions have especially high shares of informal employment:** in particular Samegrelo, Guria and Samtske Javakheti, which are amongst Georgia’s poorest regions.
- **Informal employment seems to be associated with certain activities,** including paid domestic services, agriculture, trade, and construction.

4. **Conclusions**

4.1 **Summary**

This paper has presented a conceptual framework for the analysis of the informal sector in countries in transition. A review of the literature in developing, western industrialised, centrally planned and transition countries reveals that there is no consensus worldwide over what constitutes the informal sector. However, in **transition countries**, not only has the term been interpreted differently, but also there has been no real discussion on what constitutes the informal sector; each individual piece of research has simply used the term to define its own area of interest. Thus the ‘informal’ (‘underground’, ‘unofficial’, or ‘shadow’, etc.) economy has included an extremely wide spectrum of activities such as tax evasion, corruption, money laundering, organised crime, bribery, subsistence farming, barter, petty trade, and the stealing of state property.

We argued that although there is no need for a unique definition of the informal economy **per se**, for policy purposes it is important to distinguish small-scale income and employment-generating activities, which are undertaken to meet basic needs in the absence of formal employment opportunities and social protection, from those which are deliberately concealed from the authorities for the purpose of evading
taxes or not complying with certain regulations. Building on the 1993 System of National Accounts (SNA), we developed a new conceptual framework for the ‘hidden economy’ that distinguishes between four types of unregistered, unmeasured and/or unregulated activities: (1) ‘informal’ activities, which are undertaken ‘to meet basic needs’ and are within the SNA production boundary; (2) ‘underground’ activities, which are deliberately concealed from public authorities to avoid either the payment of taxes or compliance with certain regulations; (3) illegal activities, which generate goods and services forbidden by the law or which are unlawful when carried out by unauthorised producers; and (4) household activities, which produce goods and services for own-consumption and are outside the SNA production boundary.

Given the importance of informal employment from labour market, poverty and social policy perspectives, we operationalised the above definition of the informal sector and applied it to the Georgia Labour Force Survey (1999) data to analyse informal employment in Georgia. Our typology of informal employment included individuals with the following status in either their primary or secondary jobs: (1) own-account workers and employers in household enterprises (2) (unpaid) contributing family workers (3) non-regular employees (i.e. employees without stable contracts that ensure that the employing organization pays taxes and social security contributions), (4) others employed casually, temporarily or seasonally and (5) employees engaging in left-hand work (or the earning of informal income at the formal workplace).

Our results show that, excluding left-hand work, in 1999 52% of Georgia’s employed worked informally either in their primary or secondary job, with females having slightly higher informal employment rates than males. Private sector employment was mainly informal, with 69% of workers informally employed, many working in rural agriculture. Many state employees also worked informally, with 18% holding informal secondary jobs. We also found that almost half of over 65 year olds, who already have high employment rates compared to their EU counterparts, worked informally. Finally, the results suggest that lower education and poverty may be associated with informal employment; two thirds of those with secondary education worked informally, while less than 30% of those with higher education did so, and Georgia’s poorest regions had particularly high rates of informal employment compared to the rest of the country. However more in-depth analysis is required to determine whether such relationships exist.
4.2 Policy issues and questions for further research

The hidden economy lies at the heart of the issues of poverty and economic crisis in the countries in transition. However, it is far from clear whether it is the cause or the solution to these problems. On the one hand, hidden activities undermine government revenue and thereby its ability to provide social services, contributing, amongst other things, to the informalisation of payments for social services. They also undermine government authority and the respect for the rule of law. On the other hand, they provide a very important source of income and social security in the absence of formal social protection, and they may be an important source of economic growth, particularly in situations where heavy government bureaucracy, regulation and corruption may stifle formal private entrepreneurial activity.

This paper contributes to analysing the extent to which the hidden economy is cause or solution to the economic and social problems in the region, by providing a conceptual framework with which to analyse distinct types of ‘hidden’ activities, which are likely to have different implications for livelihoods, public finance and economic growth. Some of these activities may indeed be causes of poverty and economic crisis, while others may be solutions.

Having established a framework for analysis, further research is now needed to assess the welfare and income-generating potential of household, informal, underground and illegal activities. This will help to determine which of these ‘hidden’ activities should be ‘formalised’, eradicated, permitted, or even encouraged. The most ambiguous of these questions will be how to address informal activities. The answer will largely depend on the extent to which they are found to provide a social safety net and undermine government revenue. It will also depend on their potential for growth and on whether they contribute to a loss of human capital by deskillling what is a relatively skilled and educated labour force. Answering these questions will assist the formulation of policies that effectively stimulate growth, reduce poverty and strengthen public finance and the rule of law.
References


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