



Informality: The State of the Art. Nr. 1

Understanding Informality: Concepts, Determinants, and Evidence from the Literature

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State of Art / Estado del Arte / Concepts / Determinants / Theoretical Approaches

1. INTRODUCTION

Informality has become central in development studies and labour market analysis, especially since the early 1970s when it was introduced to describe economic activities outside formal regulatory frameworks. Over the decades, this concept has gained both empirical relevance and theoretical complexity, driven by the expansion of informal employment across the Global South and, increasingly, in advanced economies. According to Charmes (2012), employment in the informal economy can account for as much as 70 percent of non-agricultural employment in some regions, particularly in sub-Saharan Africa and South Asia. The rise of informality challenges traditional economic models and calls for refined policy responses to address the socioeconomic and institutional determinants that sustain it.

This review article synthesizes the main definitions, theoretical schools of thought, and determinants of informality found in recent academic literature and institutional reports. Drawing on case studies and comparative data from different world regions, the article aims to offer a grounded understanding of the informal economy's structure, persistence, and role in shaping development trajectories.

The term 'informal sector' was first coined by Keith Hart in 1973 in his study of labour markets in Ghana (Hart, 1973). Hart defined informal activities as escaping formal state regulation but providing

essential economic functions. Subsequently, the International Labour Organization (ILO) formalized this concept through its 1972 Kenya report, identifying characteristics such as ease of entry, small scale, family ownership, and labour-intensive production (ILO, 1972).

The ILO later refined its definitions. The 15th International Conference of Labour Statisticians (ICLS) in 1993 introduced the 'informal sector' as defined by enterprise characteristics. The 17th ICLS in 2003 broadened the scope with 'informal employment', which refers to the nature of employment relationships lacking social protection or labour rights, regardless of whether the job is in a formal or informal enterprise (Charmes, 2012). Masello (2020) highlights an important conceptual distinction: informal employment in modern firms due to evasion (legal non-compliance) versus informal employment in structurally precarious units due to economic incapacity, or what he terms 'structural informality'. This distinction underpins the need for policy differentiation based on the root causes of informality.

Examples of Informality and its Determinants:

- Street vendors: Buying a cheap watch or book from a street vendor is a common manifestation of informal economic activity, often overlooked but cumulatively contributing billions in unreported income (Portes & Haller, 2023, p. 1).
- Household services: Hiring a handyperson for cash or an immigrant woman for childcare and cleaning are examples of informal work that bypasses formal labour regulations and taxation (Portes & Haller, 2023, p. 1).
- Subcontracting: Formal firms often subcontract production to informal workshops or individual workers to reduce labour costs and avoid regulations, creating a strong link between the formal and informal sectors (Yusuff, 2011, p. 1).
- Informal construction or manufacturing: These sectors often employ unregistered workers, highlighting how businesses operate informally to reduce costs (Masello, 2020, p. 1).
- African informal economy: The emergence of informality in African countries is seen as a social and historical process driven by structural factors and crises rather than just a sector of last resort, distinguishing it from Latin American experiences (Yusuff, 2011, p. 1).
- Government policy and enforcement: Variations in regulatory quality and enforcement abilities significantly impact the size of the informal economy. For example, countries with better regulatory quality and effective enforcement tend to have smaller informal economies (Mee, 2020, p. 16). Conversely, high regulatory burdens, like excessive paperwork and startup costs, can drive businesses into informality (Mee, 2020, p. 9).

2. CONCEPTUALIZING INFORMALITY: DEFINITIONS AND THEORETICAL APPROACHES

The concept of informality has evolved considerably since Keith Hart's (1973) seminal study of urban labour in Ghana, which introduced the notion of the 'informal sector' as encompassing income-generating activities operating outside formal state regulation. Initially adopted by the ILO in its 1972

Kenya report, the concept focused on small, unregistered, and low-capital enterprises. Over time, however, the term expanded to capture a broader range of employment and production arrangements lacking formal protections.

According to Charmes (2012), the informal economy includes two primary components: (1) employment in the informal sector—comprising small, unincorporated units—and (2) informal employment, which refers to jobs lacking legal or social protection, even when located in formal firms. The ILO institutionalized this two-fold framework through the 15th (1993) and 17th (2003) International Conference of Labour Statisticians (ICLS), which provided statistical definitions for the 'informal sector' and 'informal employment', respectively.

Four primary schools of thought attempt to explain the origins and persistence of informality:

- Dualist School: Sees the informal economy as a marginal space for the excluded poor, driven by a mismatch between population growth and formal job creation (Hart, 1973; Wilson, 2010). Informal actors are seen as involuntary participants, surviving on the fringes of economic development.
- Structuralist School: This school argues that informality is embedded within capitalist development, wherein formal firms outsource to informal units to cut labour costs. Informality is thus a functional and dependent element of formal economic structures, particularly in Latin America (Tokman, 1992; Yusuff, 2011).
- Legalist School: Emphasized by De Soto (1989), this view blames overregulation and state inefficiencies for pushing entrepreneurs into informality. Informal actors are seen as rational agents evading burdensome licensing and tax systems.
- Voluntarist School: Unlike exclusion theories, this approach (Maloney, 2004) argues that some choose informality to maximize flexibility, minimize costs, and maintain autonomy. Here, informality reflects strategic choice rather than mere survival.

Masello (2020) highlights the risks of conflating structural informality (linked to productivity constraints) with informal behavior in formal settings. A clear distinction is critical to formulating effective policies. Charmes (2012) further underscores that informality does not equate to illegality; it often represents institutional adaptation or exclusion rather than criminal activity.

In response to the conceptual diversity and measurement challenges, the ILO and United Nations have supported efforts such as the Delhi Group to refine survey tools and harmonize international definitions.

TABLE 1 – SUMMARY OF THE MAIN SCHOOLS OF THOUGHT TO EXPLAIN INFORMALITY

School of Thought	Main Argument	Key Authors
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Dualist	Informality arises from exclusion and lack of formal jobs.	Hart (1973), ILO (1972), Wilson (2010)
Structuralist	Informality is functionally linked to capitalist systems and formal sectors.	Tokman (1992), Yusuff (2011), Masello (2020)
Legalist	Burdensome regulations lead to informality as a rational response.	De Soto (1989), Marinescu & Valimăreanu (2019)
Voluntarist	Informality is a strategic, voluntary choice to avoid costs or gain flexibility.	Maloney (2004), Marinescu & Valimăreanu (2019)

The literature identifies a wide range of determinants that influence the size and characteristics of informal economies. These include structural economic conditions, institutional and legal frameworks, demographic and social dynamics, and macro-level forces like globalization.

From a structuralist viewpoint, Tokman (1992) and Masello (2020) argue that informality is a product of segmented labour markets and dualistic economies. Informal employment thrives where formal job creation is limited due to structural heterogeneity—where low-productivity sectors coexist with modern, capital-intensive sectors. Masello's (2020) work in Latin America illustrates how structural informality persists despite economic growth due to systemic inequalities in access to capital and markets.

Institutionalist and legalist approaches, for instance, by De Soto (1989), emphasize excessive regulation, taxation, and bureaucratic obstacles that deter formalization. Djankov et al. (2002) found a strong correlation between the number of procedures required to start a business and informality rates. In many developing countries, formalization entails prohibitive costs, driving entrepreneurs to remain outside regulatory systems.

Voluntarist perspectives, such as those advanced by Maloney (2004), suggest that informality may reflect rational economic choices. Workers or entrepreneurs may choose informal employment because it offers flexibility, lower tax burdens, or higher net incomes. However, Charmes (2012) warns that such arguments may obscure involuntary informality stemming from exclusion rather than choice.

The demographic dimension also plays a key role. Informality is disproportionately concentrated among women, youth, and low-skilled workers (Charmes, 2012). These groups face barriers in accessing formal employment due to discrimination, lack of credentials, or family responsibilities, particularly in contexts with weak labour protections.

Finally, globalization and labour market deregulation have expanded informal work through outsourcing, sub-contracting, and precarious gig work. Blunch et al. (2001) note that even in growing economies, informality can increase when formal firms reduce costs by shifting labour outside regulatory coverage. Thus, informality is shaped by a complex interplay of constraints, incentives, and power dynamics.

3. DETERMINANTS OF INFORMALITY: ANALYTICAL PERSPECTIVES

Various structural, institutional, social, and political forces shape the informal economy. Scholars and policymakers typically classify its determinants into four interrelated domains: economic structure, regulatory and institutional context, social-demographic dynamics, and political factors.

From a structuralist viewpoint, informality is rooted in economic dualism—the coexistence of modern, capital-intensive sectors with low-productivity, labour-intensive activities. Masello (2020) refers to this as 'structural informality,' where entire segments of the labour force are confined to subsistence-level production due to barriers to formal employment. Tokman (1992) supports this view, emphasizing that informality results not from underdevelopment but from the inherent inequalities within capitalist growth models.

Legalist interpretations, championed by De Soto (1989), argue that excessive regulatory burdens—licensing, taxation, and compliance costs—discourage formalization. Djankov et al. (2002) provided empirical evidence linking complex business regulations to high informality rates.

Voluntarist perspectives (e.g., Maloney, 2004) suggest that some actors consciously choose informality to enjoy flexibility, reduce costs, or evade rigid formal rules. Yet critics caution that this view may overestimate agency, particularly among marginalized workers (Charmes, 2012).

Key economic determinants include:

- High unemployment and underemployment (Wilson, 2010; Blunch et al., 2001)
- Poverty and income inequality (Amoah, 2024; Marinescu & Valimăreanu, 2019)
- Economic downturns and crises (Yusuff, 2011)
- High costs of formality (Henley et al., 2006; Mee, 2020)
- Low productivity in formal jobs (Mee, 2020)

Institutional and regulatory factors:

- Burdensome licensing and tax procedures (Marinescu & Valimăreanu, 2019; Salinas et al., 2023)
- Weak rule of law and ineffective enforcement (Portes & Haller, 2023; Mee, 2020)
- Lack of access to credit and services (Mee, 2020)

Social and demographic drivers:

- Education and skill mismatches (Charmes, 2012)
- Gender inequalities and childcare burdens (Yusuff, 2011)
- Urbanization and migration (Wilson, 2010)
- Informal networks and cultural norms (Portes & Haller, 2023)

Political determinants:

- Political instability and weak states (Mee, 2020)
- Policy inconsistencies and misdiagnoses (Masello, 2020)
- Elite capture and lack of reform incentives (Mee, 2020)

Ultimately, informality must be understood as the outcome of overlapping constraints, institutional voids, and rational adaptation strategies. Addressing it requires nuanced, multi-dimensional, and context-sensitive approaches.

TABLE 2 – SUMMARY OF THE MAIN DETERMINANTS OF INFORMALITY

Category	Key Determinants	Main References
Structural & Economic	- Unemployment, underemployment - Poverty & inequality - Cost of formality - Productivity gaps	Masello (2020); Tokman (1992); Amoah (2024); Mee (2020)
Institutional & Legal	- Bureaucracy & regulation - Weak enforcement - Poor tax systems - Lack of formal credit access	De Soto (1989); Marinescu & Valimăreanu (2019); Portes & Haller (2023)
Social & Demographic	- Gender, youth, migrants - Education & skill mismatches - Cultural norms - Informal networks	Charmes (2012); Yusuff (2011); Wilson (2010)
Political & Governance	- Weak states & poor regulation - Elite capture - Policy inconsistency - Misdiagnosis of informality types	Mee (2020); Masello (2020); Maloney (2004)

The prevalence and characteristics of informality vary significantly across regions, reflecting diverse historical, economic, and institutional contexts. According to Charmes (2012), informal employment represents over 80% of non-agricultural employment in sub-Saharan Africa and South Asia, 50–70% in Latin America, and about 20–30% in transition economies.

In sub-Saharan Africa, the informal sector is the dominant source of employment, particularly for women. Most micro-scale enterprises operate in retail trade, food preparation, and craft production. Charmes (2012) estimates that informal employment accounts for 64.9% of total non-agricultural jobs, with women constituting the majority in some countries. Informality is essentially a response to insufficient formal job creation and rapid urbanization.

Masello (2020) describes a persistent dual economy in Latin America, where high-productivity formal sectors coexist with stagnant informal enterprises. Structural informality is widespread, especially in Bolivia, Peru, and Honduras. According to Blunch et al. (2001), informal employment in the region averaged 57.7% in the late 2000s. However, the region also shows signs of voluntary informality among educated youth seeking entrepreneurial opportunities.

In South and Southeast Asia, informality is similarly entrenched. In India and Nepal, over 80% of non-agricultural workers are informal. While micro-enterprises dominate, recent growth in platform-

based work (e.g., ride-sharing) reshapes informal labour structures. Despite economic growth, formal job creation remains insufficient to absorb new labour market entrants.

Transition economies such as Russia, Ukraine, and Romania show lower levels of informality (10–30%) but exhibit upward trends post-1990s as formal job security declined. Informality often manifests through undeclared work in formal firms or hybrid forms of employment (Blunch et al., 2001).

These regional trends highlight the diverse origins, persistence, and expressions of informality. Policy interventions must account for contextual factors, including labour market structures, social norms, and institutional capacities.

4. REGIONAL VARIATIONS AND EMPIRICAL EVIDENCE

The characteristics, magnitude, and dynamics of informality exhibit considerable regional variation. These differences reflect the interplay between economic development levels, institutional structures, labour market conditions, and cultural contexts.

In sub-Saharan Africa, informality is a dominant feature of labour markets. According to Charmes (2012), informal employment accounts for over 80% of non-agricultural employment in many countries. Informal sector activities are typically concentrated in retail trade, street vending, artisanal crafts, and small-scale manufacturing. The sector also exhibits high levels of gender segmentation, with women focused mainly on low-income, unprotected occupations. For instance, in countries like Benin, Kenya, and South Africa, over 60% of female employment is informal (Charmes, 2012).

In Latin America, the informal economy is shaped by structural heterogeneity and labour market segmentation. Masello (2020) emphasizes that many informal workers are trapped in low-productivity microenterprises due to insufficient formal job creation. Countries such as Bolivia, Honduras, and Peru report informal employment rates above 70%. However, informality in the region also includes voluntary self-employment, especially among youth and educated workers seeking autonomy or higher net incomes (Blunch et al., 2001).

South and Southeast Asia also experience high levels of informal employment. More than 80% of non-agricultural workers in India and Nepal operate informally (Charmes, 2012). Informal activities include petty trade, home-based work, and informal manufacturing. In Bangladesh and Pakistan, garment and textile industries heavily depend on informal subcontracting chains. The growth of digital labour platforms in the region is giving rise to a new form of informality—digitally mediated, often unregulated, and highly individualized.

Transition economies, such as Russia, Ukraine, and Romania, exhibit lower levels of informality (10–30%) but show upward trends due to economic liberalization and weakened labour institutions post-1990s (Blunch et al., 2001). Informality in these countries often forms undeclared employment within formal firms or hybrid arrangements, reflecting enforcement gaps rather than economic marginality.

Comparative studies underscore that informality's drivers and manifestations are region-specific. Sub-Saharan Africa and South Asia are characterized by survivalist informality rooted in structural exclusion. In contrast, parts of Latin America and Southeast Asia demonstrate mixed patterns, including exclusion and voluntary entry. Transition economies show informality shaped by institutional voids and weak enforcement.

These variations reinforce the need for context-sensitive analysis and tailored policy approaches. Uniform definitions and measurement frameworks, such as those promoted by the ILO, are critical for enabling comparative insights while respecting national specificities.

5. POLICY IMPLICATIONS AND RECOMMENDATIONS

The persistent and multidimensional nature of informality necessitates comprehensive and context-specific policy interventions. Rather than treating informality as a uniformly negative phenomenon to be eradicated, contemporary approaches increasingly advocate for its recognition, integration, and gradual formalization through supportive rather than punitive measures.

From the structuralist perspective, reducing informality requires addressing the segmentation of labour markets and the dualistic nature of economic systems. This involves fostering structural transformation by enhancing productivity in low-income sectors. Targeted investments in infrastructure, technology transfer, and access to finance for micro and small enterprises are crucial. Masello (2020) argues that failure to account for structural heterogeneity leads to policy misdiagnosis and ineffective formalization strategies.

Legalist and institutionalist approaches emphasize simplifying registration procedures, reducing bureaucratic hurdles, and improving legal access to land, credit, and social protection. De Soto (1989) and Djankov et al. (2002) demonstrate that streamlining regulatory processes can incentivize formalization. However, formalization must be accompanied by tangible benefits to outweigh compliance costs. This includes legal recognition, property rights, access to training, and inclusion in public procurement systems.

Voluntarist interpretations imply that some degree of informality is rational and desirable. For these actors, policy should focus on increasing the attractiveness of formality. Maloney (2004) recommends aligning tax burdens and administrative obligations with the capacity of small firms alongside voluntary schemes for social security enrollment and retirement savings.

Universalizing social protection is increasingly seen as a central pillar of inclusion strategies. The ILO (2002, 2003) recommends extending health insurance, unemployment benefits, and maternity protections to informal workers regardless of employment status. Initiatives such as contributory schemes for self-employed workers or tax-financed safety nets are viable, particularly in middle-income countries.

Education and skill development programs must also address informality's intergenerational persistence. Blunch et al. (2001) emphasize that lack of human capital exacerbates workers'

vulnerability and limits mobility. Non-formal training, apprenticeships, and community-based learning initiatives can help bridge gaps.

Lastly, effective labour inspection and enforcement remain critical. However, punitive approaches alone are insufficient. A shift toward cooperative compliance models, where inspectors play an advisory role, has shown promise in several Latin American countries (Masello, 2020).

Policy interventions must be comprehensive, combining legal reforms, social protection, labour rights, and economic development strategies. They must also be flexible, recognizing the heterogeneity of informal actors—from vulnerable street vendors to voluntary micro-entrepreneurs. International coordination and data sharing, as encouraged by the ILO and WIEGO networks, can further support coherent and inclusive policy design.

6. CONCLUSION

The informal economy is a complex and heterogeneous phenomenon shaped by structural, institutional, and individual-level factors. Its persistence across regions and development levels reflects economic exclusion, adaptive strategies, and systemic gaps in labour regulation, social protection, and productive capacity. This review has demonstrated that understanding informality requires a nuanced approach that distinguishes between structural constraints and voluntary informality and appreciates the interdependence between formal and informal sectors.

Policy responses must move beyond the dichotomy of formal versus informal to embrace comprehensive strategies that integrate legal reform, institutional support, skill development, and universal social protection. As countries differ in the structure and dynamics of informality, interventions must be tailored to specific regional, sectoral, and demographic contexts. Only through such holistic and inclusive approaches can the informal economy be transformed into a driver of equitable and sustainable development.

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