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Out of the shadows: a classification of economies by the size and character of their informal sector

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Abstract

Given that 60 per cent of the global workforce is in the informal sector, this article develops a typology that classifies economies according to firstly where different countries sit on a continuum of informalization and secondly, the character of their informal sectors. This is then applied to the economies of the 27 member states of European Union (EU-27). Finding a clear divide from East-to-West and South-to-North in the EU-27 with the more informalized and wage-based informal economies on the Eastern/Southern side and the less informalized and more own-account informal economies on the Western/Nordic side, it is then revealed that formalization and more own-account informal sectors are significantly correlated with wealthier and more equal (as measured by the gini-coefficient) countries in which there is greater labour market intervention, higher levels of social protection and more effective redistribution via social transfers. The paper concludes by discussing the implications for theory and practice.

Keywords: informal sector; shadow economy; underground economy; economic development; European Union

Introduction

Until now, classificatory schemas of economies have used the character of their formal economies to differentiate countries, such as their levels of Gross Domestic Product (GDP) or Gross National Income (GNI) per capita (World Bank, 2012) or whether their formal economic systems are control, market or mixed economies (Arnold, 1996; Rohlf, 1998) or liberal or coordinated varieties of capitalism (Hall and Soskice, 2001). The starting point of this paper is that classifying economies by the character of their formal economies would be appropriate if most work globally was in the formal economy. However, this is not the case. The majority (1.8 billion) of the global workforce of three billion is in the informal sector (Jütting and Laiglesia, 2009) and the informal sector is much larger than the formal sector in many economies across the globe (Dibben and Williams, 2012). Consequently, the aim of this paper is to develop an alternative typology that classifies economies by the size and character of their informal sectors. So far as is known, this is the first attempt to do so.

To commence, the first section will highlight how the conventional depiction of the informal sector as a small and disappearing vestige of some past regime of accumulation has been transcended by an emergent recognition that the majority of the global labour force work in the informal sector and that in many global regions it is larger than the formal sector. Identifying that a classificatory schema of economies by the variable size and character of the informal sector across the globe is lacking, the second section then begins to fill this gap by developing a typology of economies according to their degree of informalization and the nature of their informal sectors. In the third section, this is then applied to understanding the economies of the 27 member states of European Union (EU-27) by evaluating not only where different member states sit on a continuum of informalization but also the diverse character of the informal sector across these nations. Revealing that informality is higher and waged

informal employment more prevalent in less equal societies and economies with lower levels of state intervention, the final section will then discuss the implications.

Before commencing, however, the informal sector needs to be defined. Reviewing the extensive literature on this subject, at least 45 different adjectives have been used to denote this endeavour, including ‘a-typical’, ‘cash-in-hand’, ‘hidden’, ‘irregular’, ‘non-visible’, ‘shadow’, ‘undeclared’, ‘underground’ and ‘unregulated’. Nearly all describe what is absent, insufficient or missing from such economic activity. Despite this array of terms, a strong consensus exists that what is missing, insufficient or absent from the informal sector is that it is remunerated activity which is not declared to the state for tax, social security and labour law purposes when it should be declared, but is legal in all other respects (European Commission, 1998, 2007b; Renooy et al., 2004; Sepulveda and Syrett, 2007; Williams and Round, 2008). Consequently, if economic activity possesses other absences or insufficiencies, such as that the good and/or service traded is illegal, or that no money changes hands, then it is not part of the informal sector but instead part of the ‘criminal’ economy or unpaid economy respectively. However, blurred edges exist to this definition such as when gifts or in-kind labour are offered in lieu of money (White, 2009). For the purposes of this paper, nevertheless, only economic activities involving monetary transactions are here included in the definition of the informal sector.

Beyond a residue: the persistence and nature of the informal sector in contemporary economies

Throughout the 20th century, a widespread belief was that the formal sector was colonising every nook and cranny of the modern world and that the informal economy was merely a remnant from some past regime of accumulation that was fading from view (Boeke, 1942; Geertz, 1963; Lewis, 1959). As such, there was little reason to pay much attention to the

informal sector. It was deemed wholly appropriate when studying and classifying economies to focus upon the apparently ever more dominant formal economy.

Over the past few decades, however, there has been recognition that the informal sector is not only widespread, persistent and even growing relative to the formal sector in many global regions (ILO, 2002b; OECD, 2002; Rodgers and Williams, 2009; Schneider et al., 2010) but also that the majority (60 percent) of the global workforce is in the informal sector (Jütting and Laiglesia, 2009). There is recognition, nevertheless, that its persistence and growth varies across global regions and cross-nationally (Buehn and Schneider, 2012; Feld and Schneider, 2010; ILO, 2002b; Schneider, 2011), locally and regionally (Herwartz et al., 2011; Pickup and White, 2003; Williams and Windebank, 1994, 2002), by gender (e.g., Brill, 2011; Leonard, 1994; Rokicka and Ruzik 2010; Williams, 2011; Windebank and Williams, 2010; Yusuff, 2011) and socio-demographic group (e.g., Enste, 2011; Krstić and Sanfey, 2011; MacDonald, 1994, 1996; Pahl, 1984; Williams, 2004). The outcome is that whilst the earlier ‘modernization’ or residue perspective depicted the informal sector as everywhere in decline and the ‘globalisation’ thesis conversely portrayed it as universally growing as a deregulated global economy takes hold (Castells and Portes, 1989; ILO, 2002a; Sassen, 1996), a more context-bound appreciation has emerged of this sphere as widespread and growing in some populations but smaller and declining in others due to how economic, environmental, social and institutional factors combine together in various ‘cocktails’ in different populations resulting in different outcomes (Renooy et al., 2004; Sepulveda and Syrett, 2007; Renooy and Williams, 2009).

Just as more context-bound understandings are emerging regarding its variable magnitude and growth, the same is occurring, albeit more slowly, with regard to its character. For many decades, a dominant view was that the informal sector was composed almost entirely of waged work, mostly conducted under ‘sweatshop-like’ conditions by marginalised

populations out of necessity (Ahmad, 2008; Geetz and O'Grady, 2002; Ghezzi, 2010). This focus upon waged work largely resulted from the literature on the informal sector being dominated by a structuralist school of thought which views informal waged employment to be growing due to the new downsizing, sub-contracting and outsourcing arrangements emerging under de-regulated global capitalism (Castells and Portes, 1989; Davis, 2006; Gallin, 2001; Sassen, 1996; Slavnic, 2010) and thus depicts informal waged employment as existing at the bottom of a hierarchy of types of employment characterised by low wages and poor working conditions (Castells and Portes, 1989; Gallin, 2001). Exemplifying how informality is becoming an inherent component of corporate strategies in late capitalism, for example, is the finding that many formal employees in East-Central Europe often receive from their formal employer not only a declared salary for their work but also an undeclared 'envelope wage' (Karpuskiene, 2007; Meriküll and Staehr, 2010; Round et al, 2008; Williams, 2007, 2009; Woolfson, 2007; Žabko and Rajevska, 2007).

It has been increasingly recognised, however, that not all work in the informal sector is waged employment. Much is undertaken on an own-account basis; 70 percent of informal workers in sub-Saharan Africa are self-employed, 62 percent in North Africa, 60 percent in Latin America and 59 percent in Asia (ILO, 2002b). This recognition first emerged in a third (majority) world context (Cross, 2000; Cross and Morales, 2007; De Soto, 1989, 2001; Neuwirth, 2011). It is now also widely accepted in relation to both post-Soviet economies (Chavdorova, 2005; Round et al., 2008; Williams et al., 2013) as well as the western world (Lazaridis and Koumandraki, 2003; OECD, 2012; Renooy et al., 2004; Small Business Council 2004; Snyder, 2004; Venkatesh, 2008; Williams and Windebank, 1998).

Indeed, it has found much support from neo-liberal commentaries that view informal workers as micro-entrepreneurs voluntarily operating in the informal sector in order to avoid the costs, time and effort of formal registration (Becker, 2004; De Soto, 1989, 2001; London

and Hart, 2004; Nwabuzor, 2005; Small Business Council, 2004). As Nwabuzor (2005: 126) asserts, 'Informality is a response to burdensome controls, and an attempt to circumvent them', or as Becker (2004: 10) puts it, 'informal work arrangements are a rational response by micro-entrepreneurs to over-regulation by government bureaucracies'. Therefore, and in contrast to structuralists who view the persistence and growth of the informal sector to result from de-regulation and see the remedy to be greater regulation (Davis, 2006; Gallin, 2001; Slavnic, 2010), this neo-liberal perspective views it to result from high taxes, over-regulation and state interference in the free market and the solution to be tax reductions, de-regulation and minimal state intervention.

Since the turn of the millennium, moreover, a third perspective has emerged on the character of the informal sector. Drawing inspiration from a wider body of critical, heterodox, post-development and post-structuralist literature that challenges the conventional 'thin' depiction of monetary exchange as universally market-like and profit-motivated and promulgates 'thicker' representations of the complex nature of monetary transactions (Bourdieu, 2001; Carrier, 1997; Zelizer, 2011), a small but important body of thought has started to rethink the social relations and motives underpinning informal monetary transactions. This has revealed that besides informal work conducted by rational economic actors under profit-motivated market-like relations, informal workers also sometimes operate as social actors and undertake own-account informal work for kin, neighbours, friends and acquaintances for reasons other than financial gain, including redistributive and familial and community solidarity rationales (Morris, 2011; Persson and Malmer, 2006; Pfau-Effinger, 2009; Slack and Jensen, 2010; White, 2009; White and Williams, 2010; Williams, 2004). How the nature of the informal sector varies across nations, however, remains so far little understood.

In sum, the recognition that the majority of the global labour force are in the informal sector provides a clear rationale for developing a typology that classifies economies by the extent and nature of their informal sectors, as does the recognition that its magnitude and character varies in complex ways that are poorly understood. Here, therefore, attention turns to developing a classificatory schema of economies according to the variable size and nature of their informal sectors.

A typology of the degree and character of informalization

Any classificatory schema of economies that compares the variable size and heterogeneous character of the informal sector across the globe firstly needs to convey the extent of informalization in any economy and secondly, how the nature of the informal sector varies across economies. Figure 1 provides a simple way of classifying the extent of informalization in any economy. All economies can be situated at some point on this spectrum. However, great care needs to be taken in how this is interpreted. In the past, a temporal sequencing has been sometimes overlaid onto such a spectrum in that a natural and inevitable temporal trajectory towards the left of the continuum has been assumed, resulting in countries being placed in a hierarchical ‘development queue’ with the more formal economies of the west at the front and the more informal economies of the third (majority) world depicted as at the back (Massey, 2005) and also ‘backwards’ relative to their formal counterparts (Geertz, 1963; Lewis, 1959).

INSERT FIGURE 1 ABOUT HERE

However, the place any economy inhabits on this continuum does not necessarily represent normative superiority but rather, difference, and neither should one assume any natural and inevitable temporal trajectory in a particular direction. If any lesson is to be learned from the past few decades, it is that different economies are moving in different directions along this continuum. Privileging formalisation as a universal process not only denies the lived practices of economic development but also excludes the possibility of alternative present and future trajectories.

To capture how the character of the informal sector varies across economies, meanwhile, any typology needs to outline the different forms of informality in any economy. Figure 2 provides a simple way of classifying the nature of informalization in any economy by the proportion of all informal work that is undertaken on a waged rather than an own-account basis.

INSERT FIGURE 2 ABOUT HERE

Informal waged work and informal own-account work, however, can be further sub-divided. Firstly, two types of informal waged work can be identified, namely:

- Envelope wages – formal employment, defined as paid work that is registered by the state for tax, social security and labour law purposes, has been conventionally seen as separate from informal employment. However, the identification that formal waged employees working for formal employers are sometimes paid two wages, an official declared wage and an additional unofficial undeclared (‘envelope’) wage, displays that jobs are not either formal or informal, but sometimes concurrently both. Such envelope wages can be paid by formal employers either for overtime and/or for the regular work conducted by their formal employees; and

- Wholly informal waged employment – this is waged work that is wholly unregistered by or hidden from, the state for tax, social security and labour law purposes, and can be temporary or permanent and relatively low- or high-paid.

Informal own-account work, similarly, and reflecting the neo-liberal and post-structuralist accounts, can also be further sub-divided into two broad varieties, namely:

- Informal self-employment – this ranges from ‘false self-employment’, where a person works for one employer but is self-employed and pays no wage tax, has no rights such as dismissal protection and no vacation entitlements, through to various forms of proper self-employment conducted either by the formal self-employed conducting various portions of their trade off-the-books or by the self-employed working wholly off-the books. This own-account informal work is conducted under market-like relations for profit-motivated purposes; and
- Paid favours – this is own-account work conducted for and by kin living outside the household, friends, neighbours and acquaintances for redistributive and social rationales. In practice, however, informal self-employment and paid favours overlap since own-account work is composed of many varieties along a spectrum from purely market-like profit-motivated informal self-employment to purely solidarity-oriented paid favours. As a general rule, nevertheless, the closer the social relations, the less market-like are the transactions (White, 2009; White and Williams, 2010).

Given this division of both informal waged employment and informal own-account into two types, Table 1 displays a more nuanced classification of the nature of the informal sector in any economy according to which of these four broad types is dominant, assessed according to whether the majority (over 50 per cent) of informal work in an economy is a particular type. If the majority of informal work is waged work (i.e., envelope waged work and wholly informal waged employment), these are deemed ‘waged’ informal economies. Such economies are then further sub-divided into ‘under-declared waged’ informal economies

when envelope wages are the dominant form of waged informal work and ‘undeclared waged’ informal economies when wholly informal waged employment is the dominant form of waged informal work. Meanwhile, if the majority of informal work is own-account work (i.e., informal self-employment and paid favours), these are deemed ‘own-account’ informal economies, again sub-divided into ‘market-oriented own-account’ informal economies if the majority of own-account work is informal self-employment and ‘solidarity-oriented own-account’ informal economies if the majority of own-account work is paid favours.

INSERT TABLE 1 ABOUT HERE

With these classificatory schemas for comparing the degree and nature of informalisation in hand, attention now turns to classifying economies in a particular global region in terms of the extent and nature of their informal sectors, namely the 27 member states of the European Union (EU-27).

Evaluating the degree and character of informalization in the EU-27

Methodology

Measuring the size of the informal economy is difficult because this remunerated activity is by definition hidden from view. For this reason, indirect measurement methods are often adopted which measure its size using proxy indicators and/or statistical traces of such work found in data collected for other purposes. These indirect methods range from those using monetary indicators as proxies, such as the currency demand method which takes the use of cash as an indicator of informality, through those using non-monetary indicators, such as

discrepancies in the labour supply figures across different surveys, and those using discrepancies between income and expenditure either at the aggregate or household level, to measurement methods using multiple indirect indicators (GHK and Fondazione Brodolini, 2009; Ram and Williams, 2008). However, some claim that although participants hide this work from the authorities, they do not hide it from researchers and will openly discuss this matter with them (MacDonald, 1994; Pahl, 1984; Windebank and Williams, 2010). As such, informal work is directly investigated using qualitative, quantitative or mixed method surveys. These produce lower estimates of its size than indirect methods, leading proponents of indirect methods to suggest that participants do conceal their informal work from researchers. Although one has no way of knowing whether direct surveys produce underestimates or indirect methods inflated estimates of its size, the consensus across the practitioner and academic communities is to use indirect measurement methods to measure its size and survey methods to evaluate its nature (European Commission, 1998, 2007b; Joassart, 2010; OECD, 2012; Thomas, 1988, Ram and Williams, 2008; Schneider, 2008). This approach, nevertheless, is far from perfect. Error and bias remain when measuring its size and nature since indirect methods probably over-estimate its magnitude and survey participants probably more fully report those types of informal work (e.g., paid favours) deemed more socially acceptable, resulting in an over-representation of the proportion of informal work composed of these socially acceptable forms.

This paper, nevertheless, follows this consensus to evaluate its size and nature in the EU-27 by using an indirect measurement method to evaluate cross-national variations in its size and a direct survey method to evaluate its varying nature across countries. Here, the most widely used indirect method globally is selected, namely the DYMIMIC (dynamic multiple-indicators multiple-causes) method, to evaluate its variable size (for a detailed description of how this method calculates the size of the informal sector, see Schneider, 2005). Rather than

rely on one indicator to measure its size, the advantage of this method is that multiple monetary and non-monetary indicators, related to the money in circulation, level of tax morality and labour supply, are used. The further advantage is that data is available not only for the EU-27 (see Schneider et al., 2013) but for 162 countries, and this method is commonly used by agencies such as the World Bank to estimate its variable size globally (Schneider et al., 2010). Although indirect methods using single indicators could be used or direct survey methods such as head counts of the proportion of jobs that are informal (ILO, 2002), the fact that this method is widely used and that few critiques of this method exist, make it an obvious choice.

The data source used to evaluate the nature of the informal sector, meanwhile, is the extensive cross-national survey on the character of undeclared work conducted in 2007 as part of wave 67.3 of Eurobarometer (European Commission, 2007a; TNS Infratest et al, 2006). Indeed, this is the only EU-wide cross-national data-set currently available on the character of the informal sector. Replicating the sampling method of other Eurobarometer surveys, 26,659 face-to-face interviews were conducted in the 27 EU member states, ranging from some 500 interviews in smaller nations to 1,500+ interviews in larger EU countries conducted in a manner that provides a representative sample of the population in each country (European Commission, 2007a). All interviews were conducted face-to-face in people's homes with the interview schedule adopting a gradual approach to the more sensitive issues, firstly asking respondents for their opinions regarding the informal sector and having established some rapport, questions regarding their purchase of goods and services from the informal sector and reasons for doing so, followed by their engagement in envelope wage work and finally, their supply of wholly informal employment, including the proportion that is waged work, informal self-employment and paid favours. The advantage of using this cross-national survey is not only that it collects data on the various types of

informal work used in the above conceptual framework but also that any over- or under-representation of the different types of informal work are likely to be of a similar order of magnitude across countries, assuming that the relative social acceptability of different forms of informal work remains constant cross-nationally (although this requires testing in future surveys).

Below, firstly, the variable size of the informal sector in the EU-27 will be reported, secondly, its heterogeneous character, thirdly, the relationship between its size and character and fourth and finally, the relationship between the size of the informal sector in each member state and their levels of wealth, equality, social protection and state redistribution.

Findings

To evaluate the degree of informalization in the economies of the EU-27, Table 2 reports the results of the DYMIMIC method for each country, showing how the size of the informal sector as a percentage of GDP ranges from 8.1 percent in Luxembourg to 32.7 percent in Bulgaria. All EU economies are therefore located on the formal side of the continuum in Figure 1, unlike other global regions where many economies are on the informal side of the spectrum (Dibben and Williams, 2012; Schneider et al., 2010). Nevertheless, differences exist in the position EU member states occupy on the more formal side of this continuum.

INSERT TABLE 2 ABOUT HERE

To analyse these variations, member states are here grouped into four EU regions: Western (Belgium, Germany, France, Ireland, Luxembourg, Netherlands, Austria and the UK); Eastern and Central Europe (Bulgaria, Czech Republic, Estonia, Latvia, Lithuania, Hungary,

Poland, Romania, Slovenia and Slovakia); Southern Europe (Cyprus, Greece, Spain, Italy, Malta and Portugal), and the Nordic countries (Denmark, Finland; Sweden). All Western European and Nordic economies are either ‘nearly-formal’ (i.e., the informal sector is 1-10 percent of GDP) or ‘largely formal’ (11-20 percent) economies, with the exception of Belgium, whilst all Southern and East-Central European economies are ‘semi-formal’ (31-50 percent) or ‘mostly formal’ (21-30 percent) with the exception of the Czech Republic and Slovakia. This reveals a clear divide from East-to-West and South-to-North in the EU-27 with economies on the Eastern/Southern side being more informalized than those on the Western/Nordic side, displayed by the fact that Eastern and Central European and Southern European nations are clustered in the top half of Table 2 displaying high levels of informalization and Western European and Nordic nations clustered in the bottom half of the table.

Turning to the nature of the informal sector in the EU-27, of the 8.6 percent (1 in 11) of the population reporting participation in the informal sector over the previous year in the Eurobarometer survey, Table 3 reports that nearly one-third (31.4 percent) had received envelope wages from their formal employer, 14.4 percent engaged in informal waged employment, 14.4 percent in informal self-employment and 39.7 percent in paid favours. The EU-27 as a whole can therefore be classified as an ‘own-account’ informal economy in that the majority (54.1 percent) of informal work is own account work (i.e., self-employment and paid favours) and more particularly, it is a ‘solidarity-oriented own-account’ informal economy because the majority (73.3 percent) of own-account informal work is paid favours.

INSERT TABLE 3 ABOUT HERE

Cross-national variations exist, however, in the nature of the informal sector. Table 3 reveals that while all 11 Nordic and Western European member states are ‘own-account’ informal economies, 10 of the 16 Southern and East-Central European member states are ‘waged’ informal economies, and the remaining six are own-account informal economies, although the latter all have fairly substantial waged realms compared with Nordic and Western European member states. Consequently, there is a divide from East-to-West and South-to-North in the EU-27 with economies on the Eastern/Southern side being more waged informal economies and those on the Western/Nordic side being own-account informal economies. Moreover, all waged informal economies are ‘under-declared waged’ informal economies, with the exception of Malta which is an ‘undeclared waged’ informal economy. All own-account informal economies, meanwhile, are ‘solidarity-oriented own-account’ informal economies. None are ‘market-oriented own-account’ informal economies, although Italy is fairly close with 46 per cent of own-account work conducted on a more market-oriented basis, as is Lithuania, which although a waged informal economy because 50.8 per cent of informal work is in the waged realm, has an own-account sector in which there is a 50/50 split between market-oriented and solidarity-oriented own-account work.

To analyse whether there is a relationship between the size and nature of the informal sector across the EU-27, meanwhile, Figure 3 compares the size of the informal sector with the proportion of informal work conducted as waged employment (i.e., envelope wages and informal waged employment). Using Spearman’s rank correlation coefficient (r_s) due to the non-parametric nature of the data, this displays a strong statistically significant correlation ($r_s=.709^{**}$) between the size and nature of the informal economy across the EU-27. EU member states with larger informal sectors have more ‘waged’ informal economies, whilst those with smaller informal economies have more ‘own-account’ informal economies.

INSERT FIGURE 3 ABOUT HERE

What, however, is the relationship between the extent and nature of informalisation and the formal economic systems across the EU-27? As Table 4 displays, a first finding is that there is a strong relationship between the size and nature of the informal sector and the level of wealth as measured by GDP per capita ($r_s = -.578^{**}$ and $r_s = -.513^{**}$ respectively). More affluent member states have smaller informal economies and more own-account informal economies than relatively poorer member states. Whether this remains valid when extrapolated beyond Europe could be usefully evaluated in future research.

INSERT TABLE 4 ABOUT HERE

A second finding is a significant correlation between the level of equality in a society, as measured by the gini-coefficient (European Commission, 2011), and the extent and nature of the informal sector. Equality in a society is significantly correlated with lower levels of informality ($r_s = 0.411^*$) and own-account informal economies ($r_s = 0.442^*$). However, the gini-coefficient measures only the inequalities in market income and old age benefits before tax and other transfers. As such, this correlation does not in itself imply any relationship between government interventions such as redistribution via social transfers, and the size and nature of informal economies.

Indeed, two competing views exist on this relationship. On the one hand, structuralists argue that the informal sector is a by-product of economic de-regulation and reductions in state welfare provision, and that labour market interventions and welfare provision should be therefore bolstered to tackle the informal sector (Ahmad, 2008; Ghezzi, 2010; Meagher, 2010; Slavnic, 2010). On the other hand, a neo-liberal approach argues the inverse; that the

informal sector is a direct result of high taxes, over-regulation of the economy and too much government interference in the realm of welfare provision, and that economies should therefore pursue tax reductions, de-regulation and minimal state intervention to prevent the informal sector from growing (De Soto, 1989, 2001; London and Hart, 2004; Nwabuzor, 2005).

To start to evaluate these competing discourses regarding whether informalisation is associated with under- or over-regulation in the economy, firstly, the correlation between the size and nature of informal sectors and the varying levels of public intervention in the labour market aimed at correcting disequilibria can be evaluated. To do this, government expenditure on the labour market is evaluated, either in the form of actual disbursements or of foregone revenue (reductions in taxes, social contributions or other charges normally payable), explicitly targeted at groups of people with difficulties in the labour market, including the unemployed, people in employment but at risk of involuntary job loss, and inactive persons who are currently not part of the labour force but who would like to enter the labour market and are disadvantaged in some way (European Commission, 2011). The finding is that a statistically significant correlation exists between such labour market expenditure and both the degree ($r_s = -.594^{**}$) and nature ($r_s = -.430^{**}$) of informalisation. Higher levels of labour market intervention expenditure are significantly correlated with lower levels of informality and own-account informal economies.

This correlation between state intervention and smaller (rather than larger) informal sectors is further reinforced when the relationship between the informal sector and the proportion of GDP spent on social protection benefits (excluding old age benefits) is analysed. A substitutive effect is identified but not in the direction suggested by neo-liberal discourse. Member states where a higher proportion of GDP is spent on social protection have smaller informal sectors and these again tend to be own-account informal economies.

This critique of the neo-liberal discourse that informal economies are a result of over-regulation and state interference is further reinforced when the redistributive impacts of state intervention are evaluated. Analysing the reduction in percentage points of poverty before and after social transfers, with poverty defined as the proportion of people with an income below 60 percent of the national median income (European Commission, 2011), member states where social transfers have a greater impact on reducing poverty have smaller informal sectors, not larger one's as suggested by neo-liberals, and these tend to be more own-account informal sectors.

Conclusions

This article has provided a typology of economies that positions them on a continuum in terms of the extent and nature of their informal sectors. Analysing the EU-27 using this classificatory schema, all 27 member states are shown to be on the formal side of the continuum in terms of the extent of their formalisation, although economies on the Eastern/Southern side are more informalized than those on the Western/Nordic side. It also reveals that although the EU-27 as a whole is a 'solidarity-oriented own-account' informal economy, there is again a regional divide with economies on the Eastern/Southern side being more 'waged' informal economies and those on the Western/Nordic side being 'own-account' informal economies. Moreover, all 'waged' informal economies are 'under-declared waged' informal economies, with the exception of Malta which is an 'undeclared waged' informal economy. All own-account informal economies, meanwhile, are 'solidarity-oriented own-account' informal economies. None are 'market-oriented own-account' informal economies, although Italy and Lithuania come close to being so. The outcome is a clear statistically significant relationship between the size and nature of the informal sector.

Member states with larger informal sectors in the EU-27 tend to be ‘waged’ informal economies whilst member states with smaller informal economies have more ‘own-account’ informal economies.

Examining the relationship between the degree and nature of informality and formal work and welfare systems, meanwhile, a close association is identified. Formal economic systems which are wealthier and more equal (as measured by the gini-coefficient) and where there is greater labour market intervention, higher levels of social protection and more effective redistribution via social transfers, are significantly correlated with lower levels of informalisation and own-account informal economies. Indeed, this explains the higher levels of informality and waged-oriented informal economies of East-Central European economies which generally have lower levels of labour market intervention, social protection, effective state redistribution via social transfers and greater inequality, and the lower levels of informality and own-account informal economies in Nordic and West European nations where there is higher levels of labour market intervention, social protection, effective state redistribution via social transfers and equality.

These findings have clear policy implications. Conventionally, debates on how to tackle the informal economy have narrowly revolved around whether punitive measures should be used or whether to provide incentives to enable formalisation (Renooy and Williams, 2009). This article transcends these debates and reveals that the structure of the broader work and welfare regimes are strongly correlated with the extent and nature of the informal sector. Analysing the type of work and welfare regimes required, this article refutes the neo-liberal advocacy of less state intervention and reveals in the EU-27 that pursuing greater expenditure on labour market interventions, social protection and social transfers so as to construct more equal societies is correlated with smaller, not larger, informal sectors and own-account rather than waged informal economies. What now remains to be seen is whether

similar correlations are identified when this typology of economies that classifies them according to the extent and nature of their informal sectors is more broadly applied across the global economic landscape. If this article therefore stimulates both the wider application of this typology in other global regions as well as further critical evaluation of neo-liberal policy prescriptions as the way forward, then it will have fulfilled its intentions.

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Biography

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Figure 1. Typology of economies: by size of informal sector as % of GDP

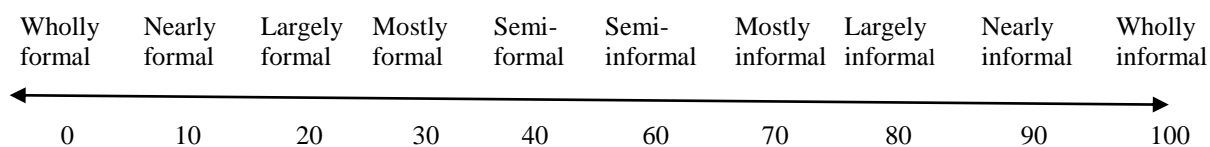


Figure 2. Typology of the nature of the informal sector: % conducted as waged work

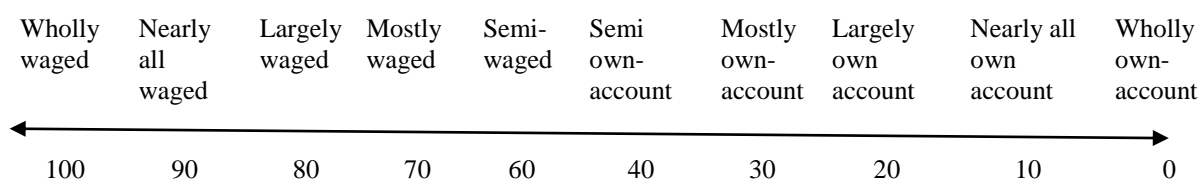


Table 1 Detailed typology of the nature of the informal sector in economies

Nature of Informalisation	Sub-types of informalisation
Waged (>50% of informal work is in the waged realm)	‘Under-declared wage-oriented’ (>50% of waged work is envelope wages)
	‘Undeclared wage-oriented’ (>50% of waged work is wholly undeclared waged work)
Own-account (>50% of informal work is in the own-account realm)	‘Market-oriented own-account’ (>50% of own-account work is undeclared self-employment)
	‘Solidarity-oriented own-account’ (>50% of own-account work is paid favours)

Table 2 Informal sector as % of GDP, EU-27

Country	Informal sector as % of GDP, 2007	European region	Type of economy
Bulgaria	32.7	East-Central	Semi-formal
Romania	30.2	East-Central	Semi-formal
Lithuania	29.7	East-Central	Mostly formal
Estonia	29.5	East-Central	Mostly formal
Latvia	27.2	East-Central	Mostly formal
Italy	26.8	Southern	Mostly formal
Greece	26.5	Southern	Mostly formal
Malta	26.5	Southern	Mostly formal
Cyprus	26.5	Southern	Mostly formal
Poland	26.0	East-Central	Mostly formal
Slovenia	24.7	East-Central	Mostly formal
Hungary	23.7	East-Central	Mostly formal
Portugal	23.0	Southern	Mostly formal
Spain	22.2	Southern	Mostly formal
Belgium	21.3	Western	Mostly formal
Sweden	17.9	Nordic	Largely formal
Czech Republic	17.0	East-Central	Largely formal
Finland	17.0	Nordic	Largely formal
Denmark	16.9	Nordic	Largely formal
Slovakia	16.8	East-Central	Largely formal
Ireland	15.4	Western	Largely formal
Germany	15.3	Western	Largely formal
France	14.7	Western	Largely formal
Netherlands	13.2	Western	Largely formal
UK	12.2	Western	Largely formal
Austria	9.5	Western	Nearly formal
Luxembourg	8.1	Western	Nearly formal

Source: Schneider (2011a)

Table 3 Character of the informal sector in the EU-27: by % of all reported informal work

Country	Informal waged		Informal own-account		Nature of the informal sector
	Envelope wages	Informal waged work	Informal self-employment	Paid favours	
EU27	31.4	14.4	14.4	39.7	Solidarity-oriented own-account
Nordic nations	11.0	13.0	11.3	64.7	Solidarity-oriented own-account
Finland	24.9	6.7	1.7	66.7	Solidarity-oriented own-account
Denmark	4.4	15.6	12.8	67.2	Solidarity-oriented own-account
Sweden	14.1	12.3	14.0	59.6	Solidarity-oriented own-account
Continental Europe	17.0	15.1	13.3	54.6	Solidarity-oriented own-account
Belgium	30.9	16.7	11.9	40.5	Solidarity-oriented own-account
UK	20.6	23.5	8.8	47.1	Solidarity-oriented own-account
Austria	26.3	12.7	13.9	48.1	Solidarity-oriented own-account
Germany	18.6	16.3	11.6	53.5	Solidarity-oriented own-account
Ireland	17.1	14.3	22.9	45.7	Solidarity-oriented own-account
Netherlands	7.4	17.6	14.7	60.3	Solidarity-oriented own-account
France	9.8	12.7	11.3	66.2	Solidarity-oriented own-account
Luxembourg	11.5	7.7	15.4	65.4	Solidarity-oriented own-account
East-Central Europe	41.2	13.7	16.9	28.2	Under-declared waged
Romania	73.5	3.7	5.9	16.9	Under-declared waged
Bulgaria	55.4	22.3	12.5	9.8	Under-declared waged
Poland	46.3	15.9	18.3	19.5	Under-declared waged
Hungary	31.7	23.1	16.8	28.4	Under-declared waged
Latvia	38.5	11.9	21.7	27.9	Under-declared waged
Lithuania	42.3	8.5	24.6	24.6	Under-declared waged
Slovakia	36.9	10.5	17.9	34.7	Solidarity-oriented own-account
Czech Republic	21.2	20.0	2.5	56.3	Solidarity-oriented own-account
Estonia	25.2	15.8	27.3	31.7	Solidarity-oriented own-account
Slovenia	27.4	11.3	9.7	51.6	Solidarity-oriented own-account
Southern Europe	35.6	18.0	20.1	26.3	Under-declared waged
Malta	22.2	66.7	11.1	0.0	Undeclared waged
Cyprus	72.7	0.0	9.1	18.2	Under-declared waged
Spain	40.5	17.0	17.0	25.5	Under-declared waged
Portugal	32.5	24.3	18.9	24.3	Under-declared waged
Italy	42.5	6.4	23.4	27.7	Solidarity-oriented own-account
Greece	18.6	20.9	25.6	34.9	Solidarity-oriented own-account

Source: 2007 Eurobarometer survey on undeclared work

Figure 3 Relationship between size and nature of the informal s

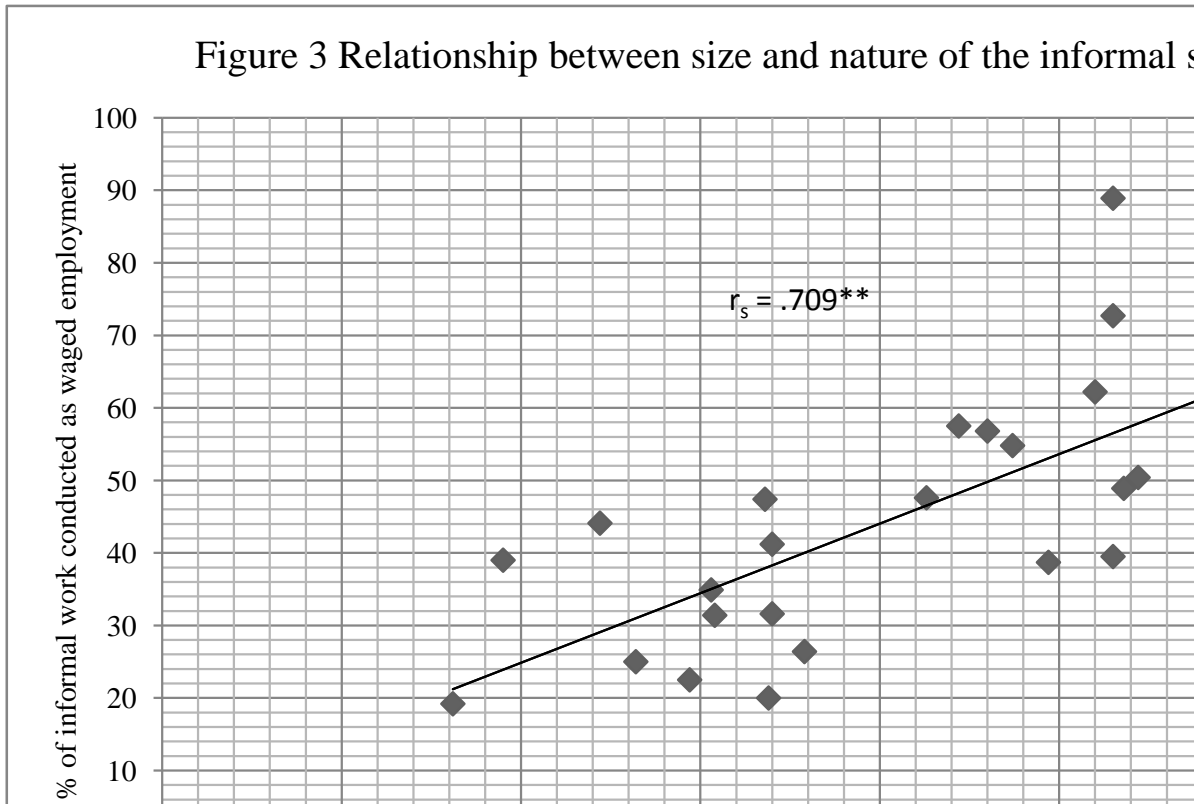


Table 4 Relationship between informalisation and nature of formal economies: bivariate analyses using Spearman's rank correlation coefficient (r_s)

	Degree of Informalisation	Nature of Informality
GDP per capita	-.578**	-.513**
Inequalities (gini-coefficient)	.411*	.442*
Labour market expenditure	-.594**	-.430*
Social protection expenditure	-.613**	-.577**
Impact of state redistribution via social transfers	-.596**	-.554**

Note: ** Correlation is significant at the 0.01 level (2-tailed), * correlation is significant at the 0.05 level (2-tailed)