



“Summary of article by Manuel Castells and Alejandro Portes: World Underneath: The Origins, Dynamics, and Effects of the Informal Economy” in Frontier Issues in Economic Thought, Volume 4: The Changing Nature of Work. Island Press: Washington DC, 1998. pp. 199-202

Social Science Library: Frontier Thinking in Sustainable Development and Human Well-being

“Summary of article by Manuel Castells and Alejandro Portes: World Underneath: The Origins, Dynamics, and Effects of the Informal Economy”

“History is full of surprises.”[11] The informal economy, long considered incompatible with advanced, institutionally rich capitalist economies, is making a comeback in developed and less developed regions. In fact, informalization appears to be characteristic of recent economic trends: horizontal networks rather than vertical bureaucracies; subcontracting rather than union contracts; and the expansion of entrepreneurship, cash economies, barter transactions, and casual labor markets. This article explores the nature of the informal economy, its causes and effects, and its integral relationship to the formal economy.

WHAT IS THE INFORMAL ECONOMY?

The informal economy is a common-sense notion with moving social boundaries that is best understood as a process, rather than an object. It is both flexible and exploitative, productive and abusive, “above all, there is disenfranchisement of the institutionalized power conquered by labor in a two-century-old struggle”[11] Although most people in the informal sector are poor, some informal entrepreneurs achieve high incomes. Despite images in the collective consciousness, the informal economy is not the survival activity of destitute, marginal people, rather “[i]t is a specific form of relationships of production, while poverty is an attribute linked to the process of distribution.”[12] Either a street seller in Latin America or a Silicon Valley moonlighter can manifest its central characteristic, “*it is unregulated by the institutions of society, in a legal and social environment in which similar activities are regulated.*”[12]

The informal economy only exists in relation to an institutional framework; in a perfect market economy, all activity would be informal. What is new is the growth of the informal sector at the expense of formal work relationships. Informal activity does not rein back economic development, it constitutes a novel social trend. Sweatshops may be an old form, but their reappearance after a long period of institutional control marks a new form redefined in the context of prior institutional regulation. The disregard for regulation may affect the status of labor (evading social benefits or minimum wages), conditions of work (neglect of health and safety), form of management (fraudulent activity or unrecorded cash payments), or criminality of the product or service itself (involvement in the drug trade). This paper is concerned with the unregulated production of otherwise licit goods and services.

THE REALITY AND STRUCTURE OF THE INFORMAL ECONOMY

The informal economy is universal, that is, it is found at different levels of economic development. It is heterogeneous in form and has apparently grown in recent years. There are serious measurement problems involved in trying to define and analyze informal economic activity since it often takes place below the threshold of government recording requirements or is deliberately clandestine to avoid regulatory burdens. However, researchers using a variety of methods and data from both aggregate statistics and field studies have found an increase in conditions favorable to informal activity or their persistence in the face of economic development.

Although the informal economy is heterogeneous in form, three common aspects merit attention. First there is the *systemic connection to the formal economy*. “The specialized networks formed by unregulated enterprises free large firms from the constraints imposed upon them by social control and institutional norms.”[26] Often there is a two tier economy in which boundaries vary with political winds and changes in social unrest. “There are actually two intertwined processes at work: the decentralization of large corporations into semiautonomous units and the informalization of as many of these units as possible, so that to the benefits of flexibility are added the advantages of unregulated activities in a regulated environment.” (26)

Secondly, there are *characteristics of labor*. Labor tends to be downgraded, receiving less in wages and benefits or to working under worse conditions than formal sector workers. The downgrading of labor is not random, but depends on circumstances (e.g., immigration status, minority group membership) that allow companies to enforce their demands. Here too boundaries can shift – if structural unemployment rises, a formerly well paid union worker may end up as a pirate cab driver, while immigrant workers can move to the forefront of labor militancy. “The informal economy evolves along the borders of social struggles, incorporating those too weak to defend themselves, rejecting those who become too conflictive, and propelling those with stamina and resources into surrogate entrepreneurship.”[27]

Third is the role of *government attitudes*. Governments generally tolerate or even encourage the informal economy as a vehicle to absorb social conflict, reduce unemployment, or provide economic incentives. Informalization “is often the expression of a new form of control characterized by the disenfranchisement of a large sector of the working class.”[27]

CAUSES AND EFFECTS OF INFORMALIZATION

Precise causes of informalization differ with each society, but field researchers have identified several common themes. The first is a reaction to the power of unions, most often on the part of business, but in some cases by workers who feel that unions defend their own interests at the expense of the unorganized. Businesses also use informalization to avoid state regulation, taxes, and social legislation. International competition particularly affects labor-intensive industries and moving work underground is one strategy for reducing labor costs.

In many developing countries, industrialization occurs under conditions that preclude enforcement of state sponsored regulations. Industries like those in the Mexican *maquiladora* zone would be likely to go elsewhere if standards were upheld. And, in many countries, the economic crisis of the mid-1970s left millions of people in such harsh living conditions they

were willing to accept whatever avenues out of misery they could find. While many arrangements are marginal, flexible, and ad hoc, “[t]he small scale and face-to-face features of these activities make living through the crisis a more manageable experience than waiting in line for relief from impersonal bureaucracies.”[29]

Informalization also contributes to a decentralized model of economic organization. The national, vertically structured corporation is no longer the final stage of industrial evolution. Networks are the emergent form, and, while not all networked firms are informal, networks are a congenial form of organization for informal relationships.

The effect of informal organization on productivity is contradictory. Because a substantial part of the informal economy is in services and because its manufacturing technology is less advanced, labor productivity tends to be lower. But the reduction of bureaucratic overhead means that the productivity of capital may become higher. The best known effects are the reduction of labor costs (particularly the indirect costs of social benefits), payments to the state, and constraints on hiring and firing.

Besides these economic effects, there are social effects caused by the disintegration of collective processes surrounding work. Organized labor loses ground politically and becomes defensive about its position in the formal economy since it is split off from workers outside of it. Workers’ consciousness fragments along age, ethnic, and gender lines. Heterogeneity of work and social conditions becomes the norm, blurring the class structure. “Thus, the woman sewing at home for a ‘friend of the family’ who is a middleman selling to a commercial intermediary of a large department store, cannot be socially equated, nor does she equate herself, with a garment factory worker.”[31]

The boundaries of the informal economy vary with different contexts and historical circumstances, but the general trend is sustained by powerful forces. However, this is not the whole story. Some production and distribution processes require stability and long-range planning. Social forces in unions and official bureaucracies resist informalization. New generations of workers may mobilize to control the economy, or the state may see fit to intervene. Whether or not a new social contract will emerge is unclear, but “a return to the vertical, centralized, assembly-line model of production is unlikely in the medium term.”[33] The question remains whether informalization and decentralization will proceed uncontrolled or will be brought under regulation.