

## **Chapter 24: The Informal Sector**

### **A. Introduction**

24.1. The purpose of this chapter is to present the application of a concept, the informal sector, in the context of households as producers. It is a further elaboration of the various aspects of the household sector described in chapter 23 of the 1993 SNA Rev.1, because the sub-set of household enterprises making up the informal sector plays a significant role in the economy in many developing countries and countries in transition. Especially in those countries, the informal sector represents a highly relevant grouping of household enterprises for policy analysis and formulation.

24.2. In describing the sub-set of household enterprises that make up the informal sector, this chapter presents the characterization of the informal sector used in the resolution of the 15<sup>th</sup> International Conference of Labour Statisticians (ICLS) on statistics of employment in the informal sector, namely:

*“(1) The informal sector may be broadly characterized as consisting of units engaged in the production of goods or services with the primary objective of generating employment and incomes to the persons concerned. These units typically operate at a low level of organisation, with little or no division between labour and capital as factors of production and on a small scale. Labour relations -where they exist - are based mostly on casual employment, kinship or personal and social relations rather than contractual arrangements with formal guarantees.*

*(2) Production units of the informal sector have the characteristic features of household enterprises. The fixed and other assets used do not belong to the production units as such but to their owners. The units as such cannot engage in transactions or enter into contracts with other units, nor incur liabilities, on their own behalf. The owners have to raise the necessary finance at their own risk and are personally liable, without limit, for any debts or obligations incurred in the production process. Expenditure for production is often indistinguishable from household expenditure. Similarly, capital goods such as buildings or vehicles may be used indistinguishably for business and household purposes.”*

Moreover, the chapter draws on the work accomplished by the Expert Group on Informal Sector Statistics (Delhi Group) in the application of the informal sector concept. Additionally, the chapter has benefited from several methodological publications by the International Labour Organisation (ILO), Organisation for Economic Cooperation and Development (OECD), United Nations Economic Commission for Europe (UNECE), United Nations Statistics Division (UNSD) and other international and non-governmental organizations in providing further clarification on the measurement of the informal sector.

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24.3. Section B sets the stage by describing the rationale and policy perspective of the informal sector concept. Section C presents of the scope and characteristics of the informal sector as defined and adopted by the 15<sup>th</sup> ICLS along with differences in meaning and coverage of concepts used in the SNA. This section also presents the more recently developed concept of informal employment adopted by the 17<sup>th</sup> ICLS, which does not fit within a national accounting framework as easily as the informal sector does but will be considered in some countries in devising a data collection strategy. Section D compares and contrasts the informal sector with some other related production concepts. Finally, section E presents various alternative measurement approaches in devising a data collection strategy for the informal sector, the limitation of international comparability and the informal sector's contribution to GDP as a key policy variable.

## **B. The informal sector in the SNA: rationale and policy perspective**

24.4. The informal sector as an economic phenomenon manifests itself in different ways in different countries. Its size and significance may also depend on the social structures, national and local economic policies and enforcement efforts of a given country. The motives for participation in the informal sector range from pure survival strategies to the desire for flexible work arrangements. It may encompass practically all kinds of economic activities and household enterprises with different forms of operation. A large number of informal activities are carried out without a fixed location, in homes, small shops or workshops. Informal activities range, for example, from street vending, shoe shining and other activities that require little or no capital and skills to activities that involve a certain amount of investment or level of expertise such as tailoring, car repair and professional services. Many informal sector enterprises are operated by an individual, working either alone, as self-employed entrepreneur, or with the help of unpaid family members, while other informal micro-entrepreneurs may engage paid workers.

24.5. The level of policy interest in the informal sector varies by country in close relation to the significance of the informal sector in that country's economy. Research indicates that the informal sector may be of high policy interest especially in developing and transition countries. The size, registration and other characteristics of the production units of the informal sector are key variables in determining development objectives for the informal sector like increased production, job creation and security, reduction of poverty, and empowerment of women when designing and monitoring specific social support and assistance programmes.

24.6. With the significance of the informal sector and the policy interest being different across countries, the need differs in defining, identifying and obtaining representative data on the informal sector. Moreover, the need to improve the exhaustiveness of the household sector accounts with the explicit measurement of the informal sector will depend on its share in employment and income generation in each country.

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## **C. The informal sector: scope and characteristics**

### **1. Household enterprises of the informal sector**

24.7. The conceptual basis for identifying household enterprises in the national accounts framework is that they have distinguishable characteristics. With the national accounts perspective in mind, the sub-set of household enterprises belonging to the informal sector have economic objectives, behaviour and a form of organization that sets them apart from other household production units.

24.8. More specifically, the informal sector is defined by the ICLS according to the types of production units of which it is composed. It consists of a sub-set of household unincorporated enterprises with at least some production for sale or barter and they operate within the production boundary of the SNA. Apart from excluding household enterprises producing exclusively for own final use, countries should extend the definition with additional criteria for the household enterprises to further restrict the scope of the informal sector. These additional criteria will be described in paragraph 24.10. Although different options for defining the scope of the informal sector enterprise exist, the informal sector is always a sub-set of household unincorporated enterprises, which operate within the limits of the households sector among the institutional sectors of the SNA.

24.9. Therefore, as household production units, these enterprises do not constitute separate legal entity independently of the household members who own them. Fixed and other capital used does not belong to the enterprise as such but to the household members. As expenditure for production is often indistinguishable from household expenditure and capital equipment such as buildings or vehicles may be used indistinguishably for business and household purposes, these enterprises do not keep complete set of accounts, thus can not be treated as quasi-corporations and delegated to the corporate sector.

24.10. Apart from household enterprises with units producing at least some goods and services for sale or barter, the ICLS definition of informal sector contains additional enterprise-based criteria about the size of employment, the non-registration of the enterprise and/or its employees of which their application may vary depending on national considerations and circumstances. These additional criteria are applied to restrict the scope of household enterprises to the following two sub-sets of enterprises in the informal sector:

- a) *Own-account enterprises*: either all own-account enterprises may be considered informal, or only those not registered under specific forms of national legislation (such as commercial laws, tax and social security laws and regulatory laws).
- b) *Enterprises of employers*: enterprises may be considered informal if they meet one or more of the following: (1) small size of the enterprise in terms

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of employment, (2) non-registration of the enterprise, and (3) non-registration of its employees.

24.11. With these additional criteria, the production unit in the informal sector is defined as **a household enterprise with at least some production for sale or barter for which one or more of the criteria of a limited size of employment, the non-registration of the enterprise and/or its employees are met.**

24.12. Apart from defining the informal sector, the 15<sup>th</sup> ICLS recommended the following additional considerations about the scope of informal sector and its statistical treatment.

- a) In principle, all goods and services producing activities are within the scope, which might be aggregated according to the alternate aggregation recommended for the activities of the informal sector in the International Standard Industrial Classification (ISIC) Rev. 4. This alternative presentation takes into account that some economic activities like public administration and defence (ISIC 84) do not qualify as informal sector activities as they are undertaken by units in general government. Moreover, the ICLS recommends that:
  - agricultural activities (section A) are measured separately from other economic activities to ensure international comparability and the selection and application of appropriate statistical data collection tools and sample design.
  - activities of households as employers of domestic personnel (ISIC 97) with households being producers for own final use are outside the scope of the informal sector.
- b) Geographical coverage includes both urban and rural areas even if preference may be given initially to informal enterprises operating in urban areas.
- c) Outworkers are included if the production units they constitute as self-employed persons or for which they work as employees meet the enterprise-based criteria.

## 2. Terminology

24.13. By elaborating on the concept of informal sector in this chapter, it is recognized that the term has been widely used and accepted in different subject areas such as labour and development economics, sociology, as well as adopted in statistical methodology advanced by various organizations. However, it is important to point out the differences in meaning and coverage of concepts as used in the SNA and elsewhere. Table 24.1 below provides such clarification.

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Table 24.1. Comparison between the SNA and ICLS/ILO Use of Terms

Term (1)	SNA usage (2)	ICLS/ ILO usage (3)	Comment (4)
Sector	Institutional sectors that group together similar institutional units. (1993 SNA, paragraphs 4.6 and 4.17-20)	Group of production units. (ILO Policy Integration Department Working Paper No. 53, page 3)	SNA uses “sector” for the five institutional sectors defined in para. 4.20., except for the informal sector concept with a different meaning not as an institutional sector.
Market producers	Producer who sell or barter most or all of their output. (1993 SNA, paragraph 6.52)	Producers who sell or barter some or all of their output. (15 <sup>th</sup> ICLS resolution, paragraph 14). Thus informal sector units may not be market producers as defined by the SNA.	The ICLS chose a wider concept of market producers because units engaged solely in production for own use differ in their behaviour and objectives from those producing for the market.
Formal sector	Not defined in the 1993 SNA.	Comprises corporations (including quasi-corporations), government units, non-profit institutions, unincorporated household enterprises producing goods and services for sale or barter not included in the informal sector (ILO Policy Integration Department Working Paper No. 53, page 4)	The SNA does not use formal/informal dichotomy in terms of sectors or production.
Households	Households have various functions as defined in chapters 4 and 23 as producers, as providers of labour and as consumers of goods and services. Households engaged in production for own use, sale or barter are considered	Households as providers of labour and households producing goods and services exclusively for own final use.	The term “households” has a broader meaning in the SNA including household production for own final use not engaging labour like housing services from owner-occupied

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Term (1)	SNA usage (2)	ICLS/ ILO usage (3)	Comment (4)
	unincorporated enterprises.		dwellings.
Enterprise	An institutional unit in its capacity as a producer. (1993 SNA, paragraph 5.1)	Any unit engaged in the production of goods and services for sale or barter. (ILO Policy Integration Department Working Paper No. 53, page 4)	The ILO definition includes only production units with employment separating production units in enterprises and "households".

### 3. The informal sector as part of a broader conceptual framework

24.14. As noted in paragraph 24.11, the ICLS definition of the informal sector is in terms of enterprises. The definition was couched in these terms in part as a bridge to national accounts. For a number of reasons, the Delhi Group concluded that the definition and measurement of employment in the informal sector needed to be complemented with a definition of informal employment. However, the two concepts needed to be defined and measured in a coherent way. Employment in the informal sector, defined in terms of enterprises, and informal employment, defined in terms of jobs, can be seen as fitting together in the matrix shown in table 24.2.

Table 24.2. Employment: Production Units and Jobs Cross-classified by Type

Production units by type	Jobs by status in employment								
	Own-account workers		Employers		Contributing family workers	Employees		Members of producers' cooperatives	
	Informal	Formal	Informal	Formal		Informal	Formal	Informal	Formal
Formal sector enterprises					1	2			
Informal sector enterprises <sup>(a)</sup>	3		4		5	6	7	8	
Households <sup>(b)</sup>	9					10			

(a) As defined by the 15<sup>th</sup> ICLS (excluding households employing paid domestic workers).

(b) Household producing goods exclusively for own final use and households employing paid domestic workers.

Note: Informal employment cells 1 to 6, 8 to 10  
 Employment in the informal sector cells 3 to 8  
 Informal employment outside the informal sector: cells 1, 2, 9, 10

Source: Adapted from : 17<sup>th</sup> ICLS (2003): Guidelines concerning a statistical definition of informal employment.

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24.15. The matrix shows, across the columns, jobs by status in employment. They are further classified by their formal or informal nature. Down the rows, the table shows production by type of unit: formal sector enterprises, informal sector enterprises, and households. Informal sector enterprises are as defined by the 15<sup>th</sup> ICLS (as modified by the 17<sup>th</sup> ICLS to exclude households employing paid domestic workers). Households, as identified in the footnote to the table, are those producing goods exclusively for own final use and producing domestic services by employing paid domestic workers. (This footnote has been a source of concern. It should not be interpreted as a general-purpose definition of “households” but rather to identify in the context of this table specific kinds of production units within households.)

24.16. There are three different kinds of cells in the table.

- a) Dark gray: jobs that do not by definition exist in the specified type of production unit.
- b) Light gray: formal jobs
- c) Unshaded: informal jobs. These comprise jobs in the informal sector (cells 3 through 8), informal jobs in the formal sector (cells 1 and 2), and informal jobs in households (cells 9 and 10).

The major new element is the definition of informal jobs of employees. Employees are considered to have informal jobs if their employment relationship is not subject to national labour legislation, income taxation, social protection, or entitlement to certain employment benefits. Such jobs may occur in all kinds of production units.

#### **D. Other related production concepts**

24.17. Having set out the definition of the informal sector, it is important to distinguish informal sector production from several other related production concepts. This clarification is expected to prevent confusion with these related concepts. In case of pursuing measurement of the production of the informal sector, the distinctions create awareness of the borderline issues and some possible overlaps. In case of pursuing compilation of exhaustive GDP, of which the production of the informal sector may be a part, distinctions must be drawn to achieve coverage without double counting.

24.18. Illegal production, as described in chapter 6, is of two kinds: production of goods and services whose sale, distribution or possession is forbidden by law, and production activities that are usually legal but become illegal when carried out by unauthorized producers. Drug trafficking is an example of the first, and services of unlicensed medical practitioners of the second. In general, most of the informal sector provides goods and services whose production and distribution are legal.

24.19. “Underground production” denotes production resulting from activities that are described in paragraph 6.40, although the term is not used in the SNA. These

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activities may fall within the production boundary of the System and be quite legal, but are deliberately concealed from public authorities for various reasons. In contrast, informal sector production is not necessarily performed with the deliberate intention of evading taxes or social security contributions, or infringing labour legislation. For example, small-scale or new enterprises may not be aware of the full responsibilities with respect to taxes, contributions, and hours and wage legislations. Although informal sector production and “underground production” may partly overlap, the two can not be equated.

24.20. Household production for own final use, as described in chapter 23, comprises production of goods and services consumed or used in capital formation by the households that produce them. As noted earlier, production of the household exclusively for its own use is excluded from the informal sector. This kind of household production includes production of crops and livestock for own final use, production of other goods exclusively for own final use, construction of own houses and other own-account fixed capital formation, services of owner-occupied houses, and services of domestic personnel employed by households.

24.21. Non-observed production, as described in chapter 6 with reference to *Measurement of the non-Observed Economy: A Handbook* is broader than informal sector production, as it includes also illegal production, “underground production”, household production for own final use and production missed due to deficiencies in statistical programs. The last-mentioned deficiencies might result, for example, from undercoverage of enterprises, non-response of enterprise, or underreporting by enterprises.

## **E. Topics related to the measurement of the informal sector**

### **1. Measurement approaches**

24.22. As the informal sector manifests itself in different ways, the choice of the appropriate method for its measurement depends upon the measurement objectives. Three main measurement approaches are considered here of which the choice depends upon data requirements, the organization of statistical systems, and the resources available.

24.23. **Household surveys.** A household survey may be constructively used to complement the measure of production by household enterprises not covered in list frames. Moreover, it is useful instrument to collect data on informal sector employment. For both purposes, additional data items on household production and characteristics of informal sector employment are added to an existing labour force or similar household survey. The additional questions could be addressed to all employed persons in the sampled households during the reference period of the survey, irrespective of their status in employment and in respect of their main and secondary jobs as in many countries a large number of informal sector activities are undertaken as secondary jobs. Special probes may be required for unpaid work in small family enterprises, activities undertaken by women and children on their own account at or away from home, undeclared

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activities, and informal sector businesses conducted as secondary jobs. In designing the survey sample, care should be taken to include representative geographical areas where household activities take place and informal sector workers live.

24.24. The additional cost of the measurement of household production and informal sector employment is relatively low when using an existing household survey. However, the tool should be used judiciously and the sample design should ensure appropriate coverage of household members engaged in household production or employed in the informal sector to remedy potential shortcomings such as:

- The application of the informal sector definition may pose problems in the case informal sector data are collected from employees, contributing family workers and proxy respondents. They may be engaged in household and informal sector enterprises but have limited knowledge of the operations of the enterprises in question, including the characteristics relating to the definition of the informal sector; and
- The representative measurement of the household production and informal sector by economic activity and other characteristics may not be assured because the distribution of households does not necessarily reflect the distribution of household enterprises and informal sector units if additional information for stratification of the sample design is not available.

24.25. **Establishment surveys.** An establishment survey is used if the purpose is to collect detailed production-related information on household establishments including those in the informal sector. For using the establishment survey approach, the availability of an updated sampling frame of household establishments is a prerequisite. However, such frames in countries with large informal sectors are often not available or well maintained in the form of a limited business register complemented by an area frame. Even in countries where business registers exist, these list frames usually do not cover household enterprises. Thus, in most cases, the establishment survey that covers household establishments can be conducted only following an economic or establishment census of which the list of establishments from the economic or establishment census is used as a sampling frame if the household establishment survey is conducted immediately after the census. If this establishment survey is to be conducted later, data from the last economic or establishment census can still be used to construct an area sampling frame for the selection of sample areas.

24.26. When using the establishment surveys for measuring household production units including those of the informal sector, the following considerations should address known limitations:

- Production units without a fixed location or with unrecognizable business premises are easily omitted in the collection;

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- Double counting of household production may occur in cases where the collections by economic activity are undertaken consecutively over time rather than simultaneously in an integrated design. For example, the manufacturing activity of a household producing goods in a small workshop or at home may be included in the first data collection round while the retail sale activity undertaken by the same family of those produced goods is measured in a subsequent collection round.

24.27. **Mixed household - enterprise surveys.** If the aim of the survey is to collect data on household enterprises *per se* in addition to the measurement of employment-related and other household-related data, the mixed household - enterprise survey is a suitable data collection approach. The survey could cover all household entrepreneurs of the sampled household including informal sector entrepreneurs (including units operating without fixed premises – mobile units) and their activities, irrespective of the size of the enterprises, the kind of activity and the type of workplace used, and irrespective of whether the activities are undertaken as main or secondary jobs. A mixed household - enterprise survey is generally designed with enterprise modules attached to existing labour force or other household modules.

24.28. More specifically, the basic principle of the mixed household - enterprise survey is to construct a sample frame of enterprises through a household survey operation, prior to the enterprise survey itself. In a mixed household-enterprise survey, a sample of households is selected and each household is asked whether any of its members is an *entrepreneur*, *i.e.*, the sole proprietor of, or a partner in, an unincorporated enterprise as part of household survey component. Data for all the enterprises thereby identified (or for a sub-sample of them) are then collected – either immediately from the respondent reporting on behalf of the enterprise or in a subsequent stage of data collection (enterprise survey component). The advantage of a mixed household-enterprise survey is that it is possible to cover small enterprises that are not included in list based enterprise surveys.

24.29. When the mixed household - enterprise survey is chosen as the preferred method, the following design and field operational aspects have to be considered:

- Representative collection of household enterprises should take into account the geographical distribution of economic activities of household production, either in the design or post-stratification stage;
- Provisions should be made to handle enterprises with production units in more than one location;
- Duplication of coverage should be prevented for enterprises that are operated under partnerships because the same enterprise may be reported by each of its partners who may belong to different households.

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## **2. Limitations of international comparability**

24.30. Users of data on the informal sector should be aware of the limitations of their international comparability. Reviews of country practices show considerable differences in the data sources, differences in geographical coverage of surveys, differences in kind of activity covered, differences in the criteria used to identify household unincorporated enterprises, and differences in the criteria used to identify informal enterprises within household unincorporated enterprises.

24.31. In an attempt to enhance the international comparability of informal sector statistics, the third meeting of the Delhi Group (1999) has identified a sub-set of the informal sector which can be defined uniformly, though this sub-set presently covers only a relatively small part of the informal sector. The recommendation was that all countries use the criteria of household enterprises with at least some production for sale or barter, that have fewer than five paid employees, are not registered, and are undertaking non-agricultural activities. While it may not be feasible to expect considerable improvement in comparability of the informal sector in its entirety in the short run, to allow coherent interpretation of data over time, it is recommended that countries provide details about their national definitions with separate figures for agricultural enterprises, enterprises in rural areas, and services of domestic personnel employed by households, if they were included.

## **3. Informal sector's contribution to GDP**

24.32. Some variant of informal sector production as a share of GDP is likely to be a key variable in measure of performance of the informal sector. Therefore, the improved exhaustiveness and accuracy of the measurement of informal sector production would strengthen the quality of national accounts and service user needs in countries with a large number of household enterprises.

24.33. Although the present national estimates of informal sector production as a share of GDP or non-agricultural GDP suffer from the problems of comparability with respect to measurement of the informal sector (and, of course, those in the GDP estimates) continuing interest by countries with a significant number of household enterprises should improve the situation. It is expected that the preparation of reliable and, in the longer run, comparable measures of the informal sector will result progressively in the reliable measurement of the household production and generation of income account.

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