

The demise of formal employment? — A literature update on informality

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This discussion paper was prepared by Nur Thuraya Sazali and Tan Zhai Gen, researchers from the Khazanah Research Institute (KRI). The authors are grateful for the valuable comments by Abdul Razak Othman, Hawati Abdul Hamid, Nur Amirah Mohamad Fauzi, Siti Aiysyah Tumin and Wan Amirah Wan Usamah (names are in alphabetical order). Opinions expressed are those of the authors and may not necessarily represent the official views of KRI. All errors remain the authors' own.

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“While the years ahead will undoubtedly bring new changes, the dependence on work for one’s livelihood and the effect of work on a person’s overall well-being will not change”

ILO (2016, p. xxv)

PREFACE

The boundary of informal economy is expanding. Freelancers and gig workers have now become a household name and jobs are no longer what we used to know. While this creates more opportunities, the diversification of jobs has increased the growth of informal jobs beyond the low scale and low economic spheres.

Enterprises all over the world are leaning towards more agile and leaner but atypical employment schemes without the traditional employment benefits. With the demise of lifetime employment with clear employer-employee relationship, what does it mean to be a worker in the future?

This paper is the first installation of Khazanah Research Institute’s (KRI) series on the informal and non-standard employment study in Malaysia. It covers the conceptual origin of informality, its definitions, components, empirical prevalence, causes, consequences and potential policy implications.

The demise of formal employment? — A literature update on informality

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SUMMARY

- ❖ The boundary of informal economy is expanding with the majority of new employment opportunities coming from the informal economy. This, coupled with the persistent old form of informality and increasing informalisation of job, are making informality a dominant feature of both the current and future employment landscape.
- ❖ Despite academic incongruence, there is a statistical convention on the different components of informal economy. **Informal economy** is made of firm-based **informal sector** and worker-based **informal employment**. These three concepts are not substitutable (but complementary) to one another.
- ❖ Latest indicators show that the informal economy is large and growing. Informal employment accounts for almost 62% of total global employment and informal sector has contributed between 20% and 64% of the total Gross Domestic Products.
- ❖ Growth in non-standard employment is a major contributor to the growth of the informal economy employment. This includes the high growth rates of the gig-economy, online digital platform and part-time employment, signalling the expansion of informal economy.
- ❖ The informal economy is highly heterogenous. Decision to enter informality can be informed by both individual preferences (by choice) and structural incentives (by necessity).
- ❖ While informality offers greater labour flexibility, it can also exacerbate economic inefficiency and labour vulnerability.
- ❖ There are separate policy options for formalising workers and firms. In order to maximise the positive and minimise the negative, indiscriminate formalisation is ill-advised. The importance of local context in policy design is also stressed.

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1. INTRODUCTION

The boundary of informal economy is expanding with the majority of new employment opportunities coming from the informal economy¹. Coupled with the persistent traditional form of informality and increasing informalisation of jobs, this makes informality a dominant feature of both the current² and future³ employment landscape.

In the 2000s, the informal economy, defined as “all economic activities by workers or economic units that are—in law or in practice—not covered or sufficiently covered by formal arrangements” is back in the spotlight⁴. Several reasons may account for this⁵:

- One, contrary to theories, informal economy has not only persisted despite positive economic growth but has also emerged in different forms like the gig and platform economy⁶. This new form of work has been purported to alter our concept and understanding of work⁷.
- Two, informal economy does not exist only on the periphery. Instead, it has integrated with its formal counterpart and contributes to the overall economy.
- Three, given the strong association between informality and poverty, understanding informality could unlock progress in poverty reduction, income inequality and gender equality⁸. This is especially when the least advantageous groups often constitute a larger portion of the informal economy.

This discussion paper collates key and latest research findings on informality to provide the foundation for and contextualise the topic at hand. It is the first installation of Khazanah Research Institute’s series on informal and non-standard employment study in Malaysia.

The paper is organised as follows: It will first discuss the conceptual and operational framework of the informal economy along with its empirical prevalence and economic importance. This is then followed by a review of the causes and consequences of the informal economy, before a section on policy options. The paper concludes by emphasising the importance of shaping policy direction in the context of the different forms of informality.

Whilst acknowledging the breadth and depth of the informal economy, for brevity, the paper excludes the discussion on illegal, hidden or underground activities as well as unpaid care and household activities. Such activities are beyond the scope of this paper and the term informal economy henceforth excludes criminal or shadow economy as well as unpaid care or the reproductive economy.

¹ ILO (2002a) as cited in Schoukens and Barrio (2017). Refer Stone and Arthurs (2013) for a further discussion on the decline of standard employee-employment relationship.

² OECD (2009)

³ Chen (2019)

⁴ ILO (2002b, p.25)

⁵ This section derives primarily from Vanek et al. (2014), *ibid*.

⁶ For example, refer Eurofound (2015) as cited in Schoukens and Barrio (2017)

⁷ Refer Deloitte (2018) for more details of gig economy as a job disruptor. Refer ILO (2018a) for more details of job quality in the gig economy.

⁸ Chen (2012) and ILO (n.d.-a)

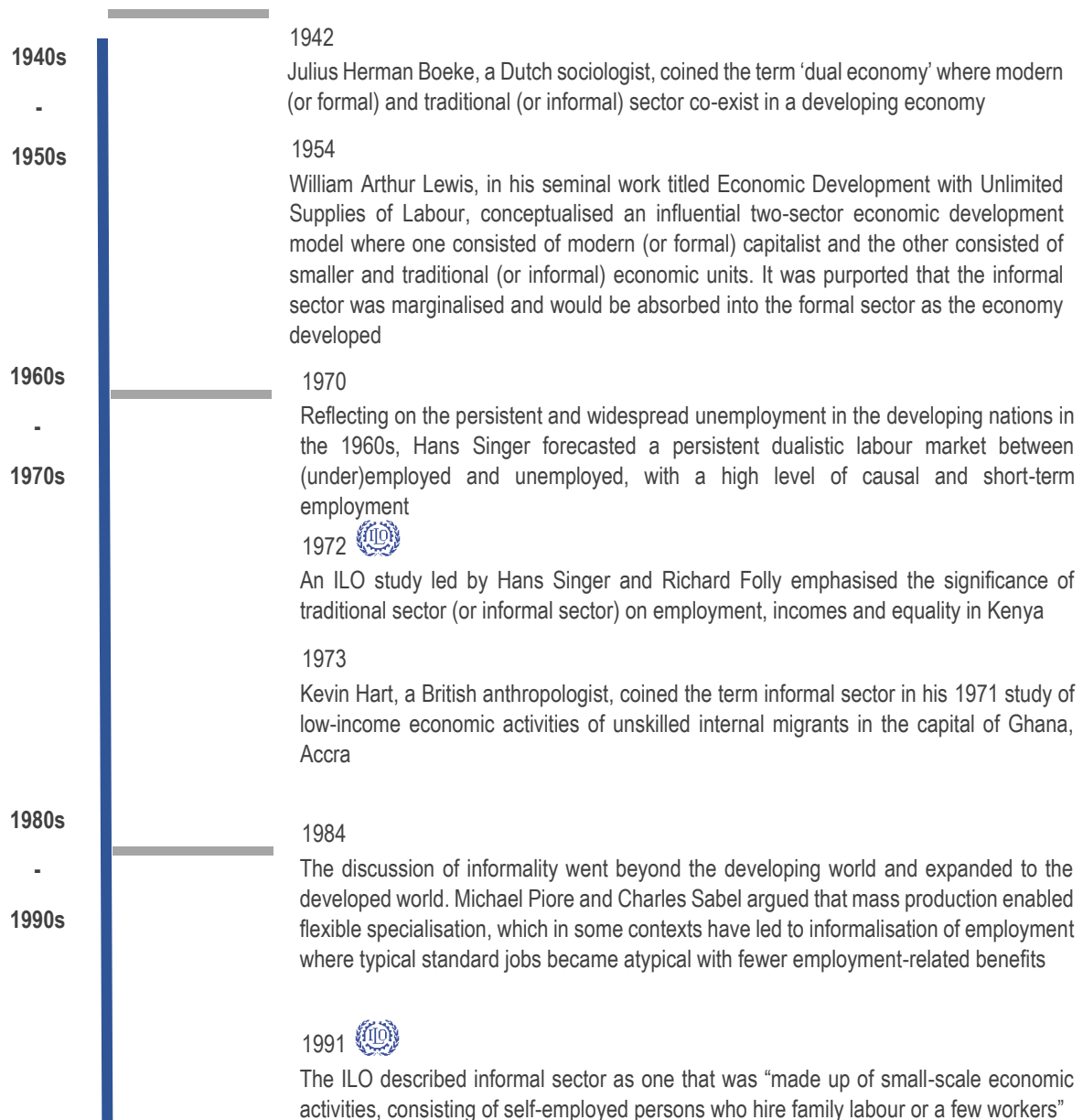
2. WHAT IS INFORMAL ECONOMY?

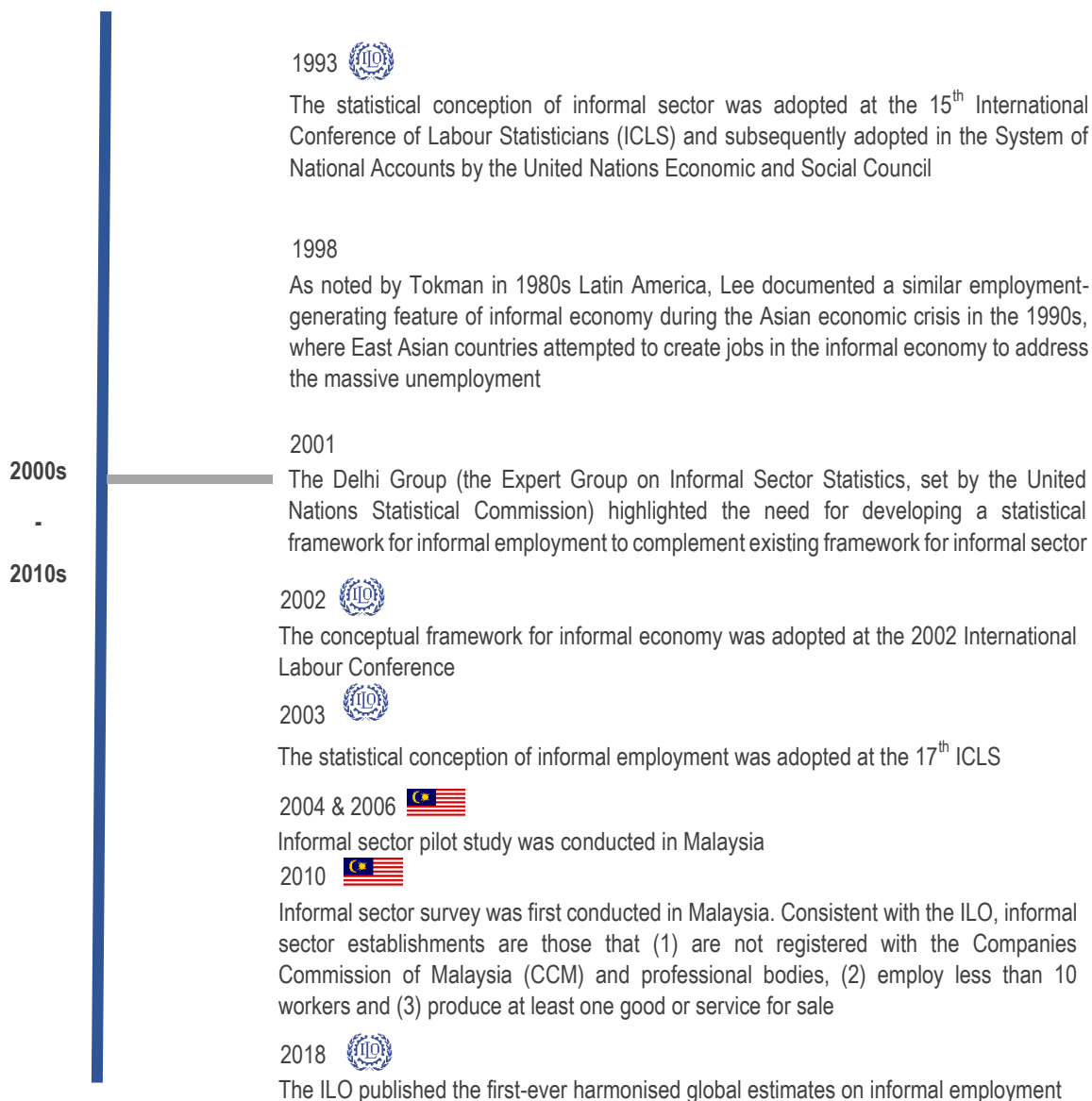
Defining informal economy is key as it can mean different things to different people. This section aims to unpack informality by describing its origin, components and ways to measure it.

2.1 Conceptual evolution

Informality is not new and the theoretical attempts to understand this concept can be traced back to as early as the 1940s. The historical timeline in Figure 1 showcases not only the conceptual reasoning to adopt informality, but also its evolution—i.e. from merely looking at the registration status of an enterprise to the workers' access to job-dependent social protection and benefits.

Figure 1: Historical timeline of informality





Source: Authors based on Chen (2012) DOS (n.d.) and Guha-Khasnobis et al. (2006)

Today, the relevance of informality reflects the persisting and growing incidence of the different forms of informality. Compared to the past, informal workers are not only referring to those in informal sector like traditional street vendors or home-based workers but now include contract workers or gig workers working for formal enterprises. This changing nature of job is reflected in the 2018 International Conference of Labour Statisticians, where a new classification has been introduced to capture the blurring lines between formally and informally employed. For example, between self-employed workers or entrepreneurs and contract workers like in the case of platform workers like e-

hailing riders⁹. Now, one's employment status matters less, what counts more now is his or her level of authority¹⁰ and economic risk¹¹.

2.1.1 Components of informal economy

Analysing informality today requires a clear understanding of which specific definition of informality is being used for the analysis to be useful. Despite academic incongruence on the conceptual and operational framework of informal economy¹², there is a statistical convention on the different components of the informal economy. The definitions as endorsed by the International Labour Organization (ILO) are:

- Informal **sector** refers to unregistered firms¹³
- Informal **employment** refers to unprotected workers¹⁴
- Informal **economy** refers to both unregistered firms and unprotected workers¹⁵

Informal economy is thereby consisting of both the informal sector (enterprise-based definition) and informal employment in the formal sector (worker-based definition). It is important to note the differences between these three official statistical terms as they are often used loosely and interchangeably¹⁶.

Focusing on employment, Figure 2 (located on the next page) provides a pictorial understanding of how these definitions relate to each other. **Employment in the informal sector**, represented (1) and (2), are both the informally employed and formally employed as long as they are employed in unregistered firms. **Informal employment**, represented by (1) and (3), are employed workers who are unprotected without legal and social protection (e.g. access retirement or pension scheme, annual leave or sick leave)¹⁷. The **informal economy** encompasses workers in both of this, which are (1), (2), (3), therefore including all workers who are either in the informal sector or informally employed, or both.

⁹ The alternative classification focuses on work relationship. Occupation is classified based the workers' level of authority (i.e. control or dependency over tasks and market access) and economic risk (i.e. remuneration risk/stability and financial risk). Source: ILO (2018c). As cited in Schoukens and Barrio (2017), refer Goldin (2006) for a detailed discussion on the murky area between employment and self-employment.

¹⁰ Level of authority here refers to individuals' control or dependency over the work that they do or their access to the market. Source ILO (2018c)

¹¹ Level of economic risk here refers to the extent to which individuals are exposed to financial loss or whether they experience reliable stream of remuneration. Source: *ibid*

¹² For debates on the formal-informal dichotomy, refer Guha-Khasnobis et al. (2006)

¹³ The complete definition is "...the production and employment that takes place in unincorporated small or unregistered enterprises." Source: ILO (1993) as cited in Chen (2012, p.8)

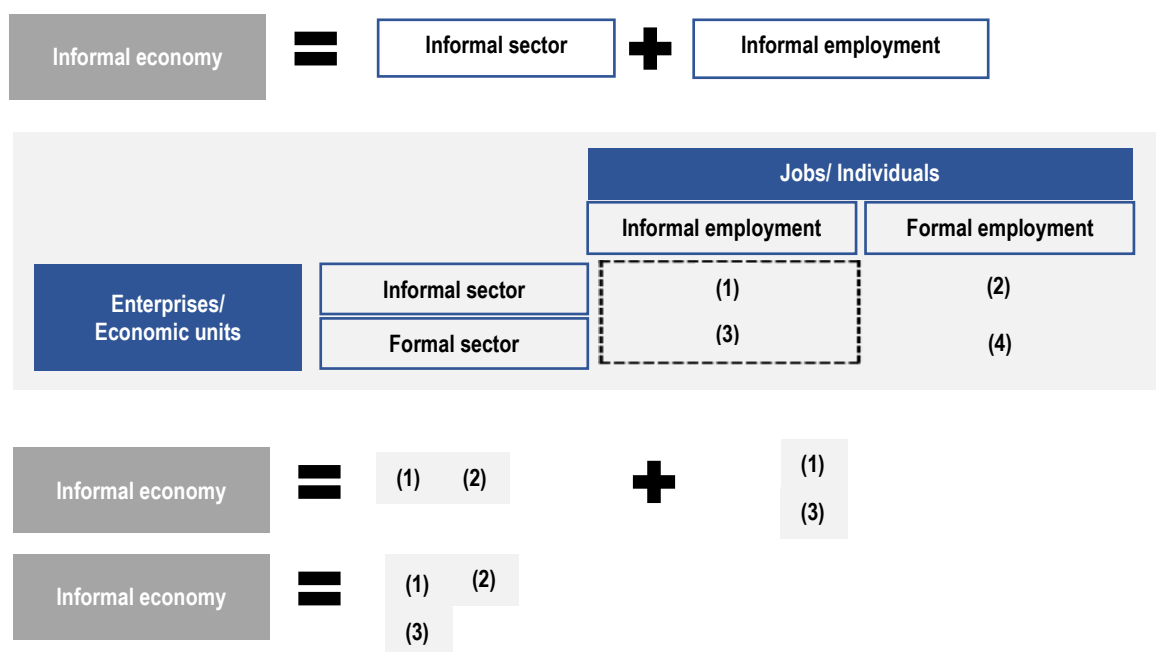
¹⁴ The complete definition is "...employment without legal and social protection – both inside and outside the informal sectors." Source: ILO (2003) as cited in *ibid*.

¹⁵ The complete definition "...all units, activities and workers so defined and the output from (informal sector and informal employment)." Source: ILO (2002a) as cited in *ibid*.

¹⁶ To avoid confusion and differentiate from informal employment, the ILO has used 'Employment Outside the Formal Sector' to refer to employment in the informal sector. Source ILOSTAT (n.d.)

¹⁷ ILO (2018b)

Figure 2: Different components of informality



Source: Adapted from Charmes (2012) and ILO (2002b)

Note: This is a simplified version of the internationally recognised conceptual framework. Refer Hussmanns (2004) and ILO (2018d) for a detailed discussion and illustration of the complete framework

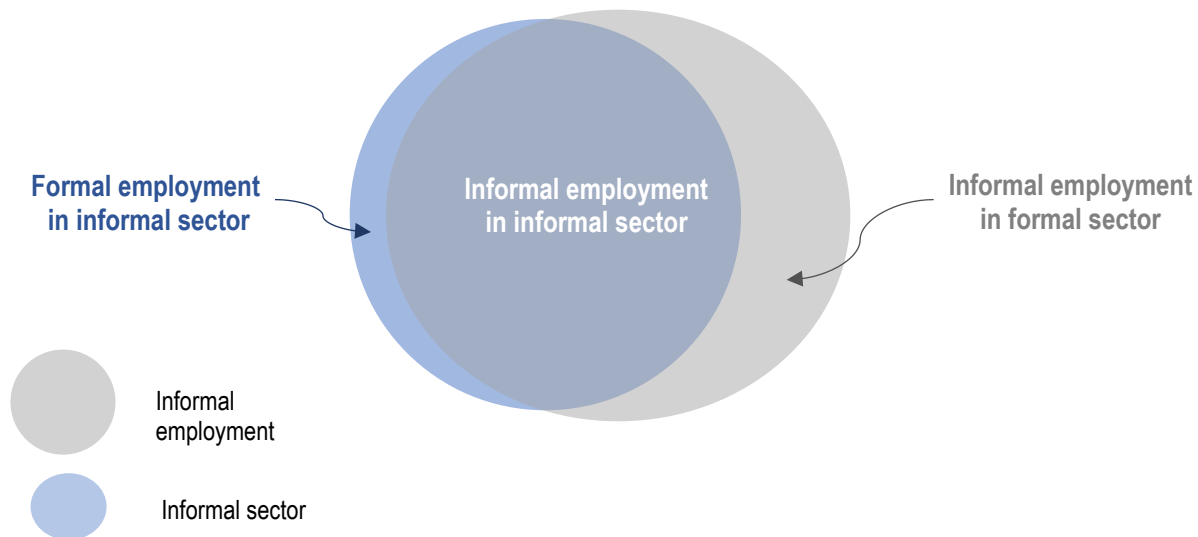
As shown in the Figure 3 (located on the next page), there is an overlap between informal sector and informal employment. This means that these two concepts are not mutually exclusive (i.e. one can be informally employed in informal enterprise)¹⁸. Therefore, workers for an unregistered food stall are **employed in the informal sector**. Conversely, workers who do not have social protection, regardless of being employed in registered or unregistered stall, are both in **informal employed**. All these workers are therefore classified in the **informal economy**.

¹⁸ Conceptually, this also implies that “...informal employment does not include the formal sector in totality.”
Source: Charmes (2012, p. 104)

Figure 3 shows the relative size of the **employed in the informal sector** and **informal employment** within the **informal economy**. More workers are in informal employment (grey circle) than being employed in the informal sector (blue circle). A large group of these workers are both in informal employment and in the informal sector (overlap between blue and grey circles). Informal employment in the formal sector is the second largest group (grey crescent-shaped), followed by those formally employed in the informal sector (blue crescent-shaped).

The distinction made between these three concepts is stressed because with the changing nature of job the focus has moved beyond who do you work for (illustrated by informal sector) to the nature of your employment (proxied by informal employment). One may work for an established registered firm but if s/he is a temporary worker, s/he will still be excluded from the typical employment-related social and legal protection. The logic behind the shift in conceptual paradigm is elaborated in Box Article 1.

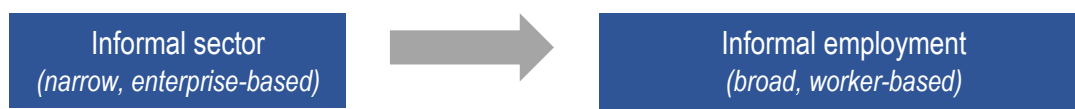
Figure 3: Venn diagram of informal sector and informal employment



Source: Authors

Note: The size of the circle is a proxy for the magnitude of workers. Empirically, the share of informal employment is higher than informal sector. The overlap between informal employment and sector is also concentrated in the informal sector, not the formal sector. Although conceptually informal sector includes both formal and informal employment, formal employment within informal enterprises is relatively rare. Source: ILO (2002b)

Box article 1: Statistical nuances: from narrow to broad



From its inception, measuring the informal sector, serves a practical purpose: to calculate informal sector contribution to the gross domestic product (GDP)¹⁹. To align with the System of National Accounts, informal sector was defined based on production unit or enterprises²⁰, not employment relations. This is also known as the productivity view²¹.

In the early 2000s, however, there was a recognition that enterprise-based definition of informal sector “would not be able—nor meant to capture—all aspects of such a trend towards an increasing ‘informalisation’ of employment”²².

Informalisation is where formally registered firms, faced with cost pressure or increasing competition, establish informal working contracts that exempt them from providing social security contribution and other typical employment benefits. To account for this, a broader job-based statistical definition of informal employment was later adopted. This is also known as the social protection view²³.

Given the different observation units (i.e. production and employment), the ILO sees both types of informality as indispensable²⁴. That is, they **are not substitutable but complimentary** to one another. This is also because policies to address unregistered firms and unprotected workers are likely to differ; thereby, requiring disaggregation of data. Operationally, as we will see, calculation for informal employment is not possible without information on the status of the firms.

Source: Hussmanns (2006) and Oviedo et al. (2009)

¹⁹ For a more detailed discussion on definition and measurement, refer Hussmanns (2006)

²⁰ Enterprises here refer to both entities that employ labour and those who do not. This implies that self-employed individuals (e.g. street vendors, home-based workers, taxi drivers, etc.) should be considered as enterprises. Underreporting may still occur especially for individuals engaging in small-scale activities or who at the borderline between wage and self-employment. Source: *ibid*.

²¹ Oviedo et al. (2009)

²² Hussmanns (2006, p.4)

²³ Oviedo et al. (2009)

²⁴ Hussmanns (2006)

2.2 Measuring informality

There are two methods in measuring the different forms of informality: directly using micro datasets from labour force surveys or indirectly using aggregated data.

2.2.1 Direct method

Depending on existing available information, informal economy employment can be derived from labour force surveys, which are regularly collected by countries to derive employment and unemployment figures. This, however, depends on the survey's questions, the granularity of collected data²⁵ and access to the micro datasets. If the collected information is not detailed enough, additional clarification questions can be added into the labour force surveys²⁶. Emphasis was placed on measuring the actual employment situation (*de facto*) than the legal entitlement (*de jure*)²⁷. As discussed in Box Article 2, this direct method cannot be utilised to estimate employment in the informal economy in Malaysia.

2.2.2 Indirect method

In the absence of direct methods, indirect methods can be used to estimate the employment in informal economy.

There are several well-documented indirect ways to estimate the informal economy like calculating the difference between aggregate income and aggregate expenditure from the National Accounts or measuring the difference between the estimated demand of money and the actual amount of money circulating in the economy²⁸. Note, however, these estimations are not without limitations.

Nevertheless, since employment is the focus of this study, we will employ an employment-related estimation method. The most straightforward way to estimate the informal employment is by calculating the difference or discrepancy between the total labour force and the formal employment, defined by workers' social security and retirement coverage. This is also known as the reductionist approach. Box Article 2 (on the next page) elaborates why the direct method cannot be employed to measure the different dimensions of informality for Malaysia.

²⁵ Granular information on the job and enterprise characteristics are key. This may include worker employment status (e.g., job permanency like permanent, temporary, seasonal, occasional etc.) and firms' legal status (e.g., type of accounts used, ownership status, etc.). Source: *ibid*.

²⁶ Experts agree that labour force surveys are the most appropriate medium to measure informality. Source: *ibid*.

²⁷ To account for national circumstances, operational specifications are determined by countries. Nevertheless, emphasis was placed on measuring the actual employment situation not the legal situation. For samples of recommended question, refer *ibid*.

²⁸ For a detailed review of other methods, refer Oviedo et al. (2009) and Medina and Schneider (2018)

Box Article 2: Data paucity and Malaysia

Paucity of data remains an issue in measuring the informal economy.

In 2018, only about 35 countries out of the 188 ILO Member States collected and released the employment data related to the informal economy¹. Malaysia is one of the non-reporting countries. While this is a drastic improvement from just two reporting countries in 2000 to 35 in 2018, the ILO was only able to publish the first harmonised estimates of informal employment in 2018 using available micro datasets from 112 countries, which again Malaysia did not provide¹. Of the eleven Southeast Asian countries, only three countries (Indonesia, Thailand and Vietnam) collected and released similar types of data.

The data paucity in Malaysia may just be a lag in adoption. In fact, it took Malaysia roughly 11 years to adopt the 1993 ICLS recommendation. Pioneered in 2004 and started in August 2009, only information of employment in the informal sector has been collected and published in Malaysia¹.

Evidently, the focus of Malaysian informal sector workforce surveys has centered around estimating the contribution of non-observed activities (informal sector included) to the Gross Domestic Product (GDP)¹. Despite this explicit purpose, statistics on the contribution of the informal sector to Malaysia's GDP has not been published.

Nevertheless, data from the informal sector workforce surveys is insufficient to show the magnitude and extent of informal employment in Malaysia. This is especially the case given the rise of formal job becoming increasingly informal. While existing general employment statistics can tell the volume of jobs, it provides limited insight into the quality and form these jobs take¹. Data on informal employment can help to fill this gap as it differentiates workers with and without the typical employment-related social security (like SOCSO¹ or EFP¹) and benefits (i.e. access to paid or annual leave).

It is not only the quantity of jobs that counts, its quality is equally important too. Considering the demise of lifetime employment and the rise of contract-based employment, data on the magnitude and conditions of those both in the informal sector and employment is key in informing better policy formulation and evaluation.

Considering that only data on informal sector is available for Malaysia, an indirect method will be used to estimate informal employment. This will hopefully allow for a more comprehensive understanding of the Malaysian informal economy.

Source: ILOSTAT (various years), ILO (2018) and DOS (various years)

3 SHOULD WE CARE?

Are there empirical evidences that can showcase the prevalence and expansion of the informal economy? This section collates information on the significance of informal economy and finds the following:

Latest indicators show that the global informal economy is large:²⁹

- By employment: 61.2 % of global employment was estimated by the ILO to be in the informal economy³⁰. The World Bank estimated 64.7% of workers in emerging countries are in the informal economy³¹
- By enterprise: Based on the World Bank's Enterprise Surveys, 54 percent of firms in all surveyed countries were reported to compete against unregistered or informal firms³²
- By share of GDP: Informal sector (including agriculture) was estimated to contribute between 20 % and 64 % of the total GDP of developing countries in 2000s³³

The global informal economy is also growing:

- The share of atypical or non-standard employment (e.g. part-time and temporary) across the world has grown in recent years
- As captured by the Online Labour Index, the online gig economy had a 26.5 percent growth from May 3rd, 2016 to September 8th, 2019³⁴. This growth in gig economy indicates a growing global appetite for specialised and temporary labour

²⁹ This section drew from Chen (2008)

³⁰ ILO (2018d)

³¹ World Bank (2019)

³² This datapoint was computed using a simple average of country-level point estimate. Source: World Bank (n.d.)

³³ Charmes (2012)

³⁴ Oxford Internet Institute (2019)

3.1 Large informal economy

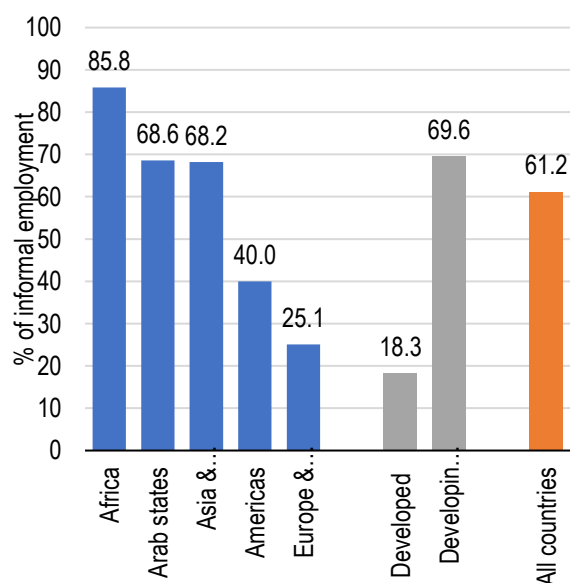
The magnitude of informal economy can be measured by its size of employment, enterprise and contribution to GDP. Across all three indicators, informal economy has been found to be empirically prevalent.

3.1.1 By employment

As shown in Figure 4, informal employment (inclusive of agriculture) accounted for more than half of the total global employment (61.2%). The ILO's estimation for developing and emerging countries (69.6%) is similar to the World Bank's estimation of the informal employment workforce in the emerging countries (64.7%)³⁵.

As informal employment is closely associated with poverty and low productivity, it is not surprising to see a substantial gap between the developed (18.3%) and less developed countries (69.6%). However, the World Bank has also documented that informality in most developing countries “has remained remarkably stable notwithstanding economic growth or the changing nature of work”³⁶. As illustrated in Figure 5, informal employment remains substantial high across different income groups for developing countries. This highlights the persistence of informal employment despite the economic status.

Figure 4: Share of informal employment including agriculture (percentage)



Source: ILO (2018d)

Figure 5: Share of informal employment in emerging countries, latest years (percentage)

Low income	%
Nepal	98
Senegal	89
Chad (mean)	81
Togo	63
Ethiopia	36
Lower middle income	
Côte d'Ivoire	91
Vietnam	75
Pakistan (mean)	68
Kyrgyz Republic	57
Kosovo	40
Upper middle income	
Paraguay	71
Mexico	57
Turkey (mean)	46
Brazil	36
Bulgaria	19

Source: World Bank (2019)

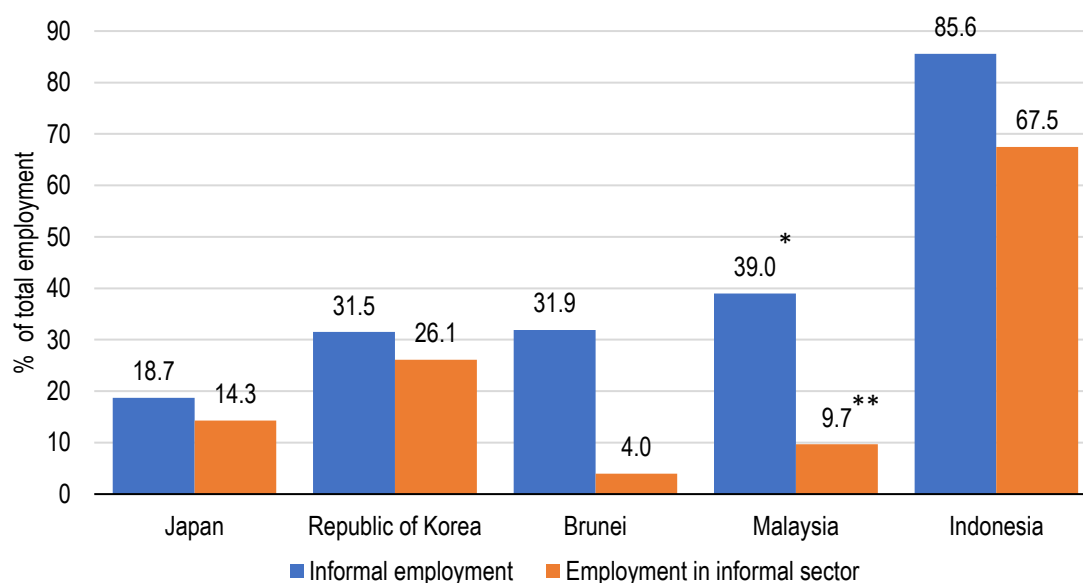
³⁵ World Bank (2019, p. 7)

³⁶ Ibid. By contrast, Loayza (2018) found an inverse relationship between informality and economic growth and structural reforms. That is, between 2005 and 2015, developing countries with positive economic growth and strong reforms have seen decrease in informal sector and informal employment.

As mentioned earlier, Malaysia only publishes official statistics on employment in the informal sector (9.4% in 2017³⁷), which is theoretically much smaller than informal employment. Nevertheless, as shown in Figure 6, Malaysian informal employment has been estimated to account for 39% of the total employment³⁸.

Like Brunei, a much higher percentage of informal employment in Malaysia indicates than there are more informal employment workers (without social protection) in the formal than workers working with unregistered firms in the informal sector. Put it simply, 39% of all Malaysians workers are in informal employment, indicating a substantial share of workers in Malaysia is unprotected by existing social protection structure.

Figure 6: Share of workers in informal employment and employment in the informal sector, selected countries, latest years (percentage)



Source: DOS (2018) ILO (2018d) and Schmillen et al. (2019)

Note: * This estimated datapoint is from Schmillen et al. (2019)

** This official datapoint is from DOS (2018)

Informal employment refers to workers without typical social protection

Employment in informal sector refers to workers in informal or unregistered firms

³⁷ DOS (2018)

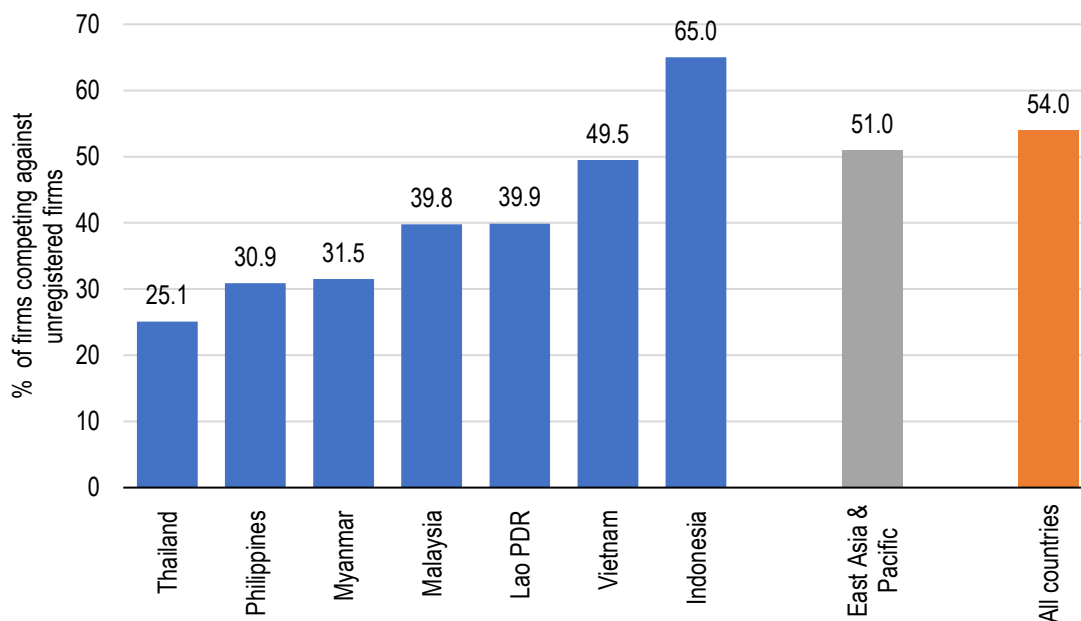
³⁸ Schmillen et al. (2019)

3.1.2 By enterprise

Informal enterprises are often deemed as an unfair competition as unlike other formal firms, they can escape the taxation and regulatory burden. Since an international comparison for unregistered firms is not easily available, the World Bank Enterprise Surveys can be a proxy for the prevalence of informal enterprises.

Latest data from the World Bank Enterprise Survey show that 54% of firms in all surveyed countries reported that they compete against unregistered or informal firms (Figure 7). Consistent with the shares of informal employment, this informality indicator is much higher in developing countries like Sub-Saharan Africa (66.7 %) than in developed countries like Europe and Central Asia (37.7%). At 39.8%³⁹, Malaysia occupies the lower end of the range, while Indonesia occupies the top at 65.0%. While this indicator does not capture the actual number of informal firms, it still indicates a substantial prevalence of informal enterprises.

Figure 7: Proxy for informal enterprises: share of firms competing against unregistered or informal firms, selected countries (percentage)



Source: World Bank (n.d.)

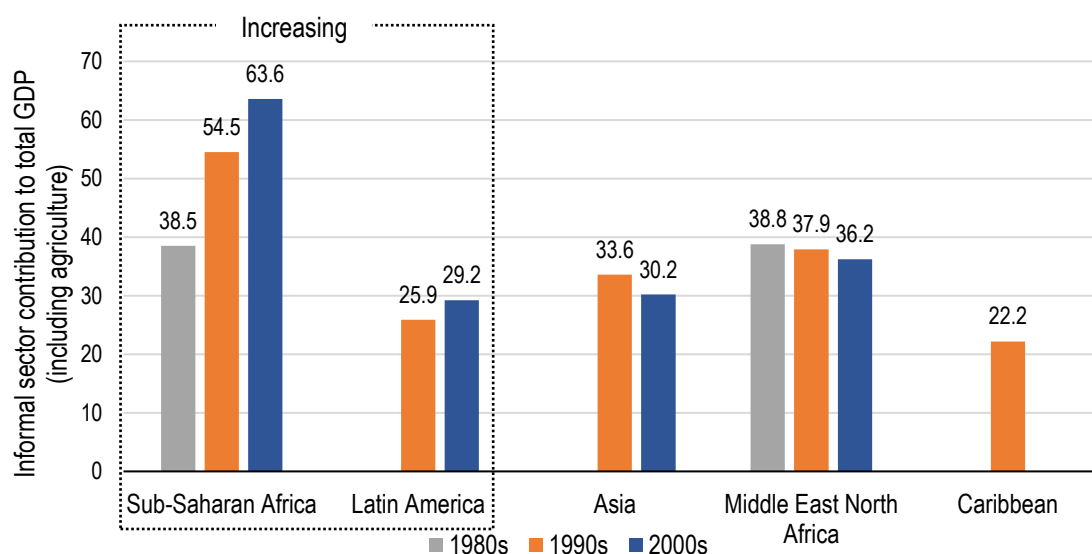
Note: Last accessed 10th September 2019

³⁹ This lower percentage is also consistent with Malaysian low share of informal sector workforce of 9.4 % in 2017. Source: DOS (2018)

3.1.3 By share of GDP

Latest estimates, however imperfect, indicate that informal sector contribution to total GDP can range between 20% in transition countries⁴⁰ like Armenia and 64% in Sub-Saharan Africa, where employment in informal sector in agriculture is dominant (Figure 8). The trends in GDP contribution (in time series) are rather ambiguous with increasing share in Sub-Saharan Africa and Latin America, while decreasing for others. Nevertheless, another estimate published by the World Bank in 2018 found that in developing countries, informality typically contributes around 30% to the total GDP and hires about 70% of the total labour force.⁴¹ These figures in totality highlights a substantial economic contribution of the informal sector.

Figure 8: Estimated⁴² informal sector contribution to GDP in developing countries (percentage)



Source: Adapted from Charmes (2012)

⁴⁰ Countries that are listed as Transition include Armenia, Azerbaijan, Kyrgyzstan, Macedonia, Moldova, Romania, Russia, Serbia, Slovakia and Ukraine. Source: Charmes (2012)

⁴¹ Despite the cited averages, there is a wide disparity within and between region. Source: Loayza (2018)

⁴² Estimating informal sector contribution to economy is riddled with obstacles. Refer Charmes (2012) for a discussion of the limitations of his computations.

3.2 Increasing share of employment in the informal economy

As jobs without standard employment protection is the defining feature of informal employment, the rise of atypical employment contracts that are synonymous with job insecurity and lack of protection implies that the boundary of the informal economy, specifically informal employment is expanding.

3.2.1 Increasing share of ‘non-standard’⁴³ employment

The rise of atypical, non-standard employment especially in developed countries have rejuvenated debates on what non-standard employment implies. Non-standard employment are jobs which go beyond a secure employment framework⁴⁴. This, therefore, makes understanding what standard employment means crucial. While there is no official definition for ‘standard’ employment, historical movements and changes in the economic structure have roughly alluded to the conditions expected from ‘standard’ employment (Table 1).

Table 1: General outcome of stable employment provided by open-ended employment arrangements

Conditions for standard employment	
Income & employment security	• Legally defined minimum work hours, collective bargaining, minimum wage, decent compensation and wellbeing of family • Regulating unfair dismissals
Safety & health of workers	• Standards to ensure the safety and health of workers at the workplace
Enhancing productivity	• Due to firm competition, workers are provided skills training and better tools to improve productivity
Stable economy	• An outcome of stable employment provided by open-ended employment arrangements
Voice	• Available avenues to organize and provide collective voice
Fair treatment	• Formally recognised employer-employee relationship, with proper dispute resolution systems
Equality of access	• Laws and regulations that prohibit discrimination by employers, who serve as gatekeepers of employment
Social protection	• Social protection in terms of paid leaves, sick leaves, pensions and equivalent as part of employment

Source: Adapted from Rubery (2015)

⁴³ Employment schemes that deviate from full-time permanent employment are known as non-standard employment. In the 2018 ICLS, two primary categories of non-standard forms of employment have been recommended to be reported. These are fixed-term or contract workers and short-term or casual workers. Source: ILO (2018c)

⁴⁴ Source: ILO (2016)

The conditions for ‘standard’ employment are formed to ultimately define the relationship between workers and employers, with the state acting as a third party safeguarding this relationship. Standard employment means that workers trade managerial prerogative to employers, in return for stability and continuity of work. The state acts as the third party to ensure this contractual relationship is honoured, while channelling off the risk of economic insecurity as a whole. Therefore, workers under ‘standard’ employment are entitled to have a secured consistent work and income, in a safe working environment, be treated fairly without discrimination, and able to voice out their concerns. The workers can also expect social protection provided, thus also access to training and eventually a stable economy.

Therefore, non-standard employment is a condition where workers who contribute their labour do not consistently have access to the above conditions. This does not mean all of them are informal or vulnerable – it depends on the relationship between the employer and worker, and the conditions they are working under. The vulnerability and informality of non-standard employment need to be understood in different categories and context.

Non-standard employment encompasses a larger group of workers than those in the informal economy and in specific informal employment, but also overlaps with these workers in important ways. For example, some in the standard employment are in the informal sector if the employment arrangement fulfils the conditions for standard employment, while both formal or informal temporary contracts are non-standard given the non-continuous frequency of work. On the other hand, genuine self-employment is not part of non-standard employment as there is no employment relationship and they independently produce and sell goods and services to the market.

3.2.2 Different segments of non-standard employment

The ILO⁴⁵ observes non-standard employment in four major areas: temporary employment, part-time and on-call work, multi-party employment relationship, and disguised employment or dependent self-employment.

Temporary employment covers workers are employed for a specific period either by fixed term or by task-based work. This also includes casual workers, where they are informally employed outside of employment regulation for a short period of time. Digital micro-task and online work can also be part of the temporary employment.

Part-time employment covers those who work fewer hours than legislated, where employers tend to commit fewer obligations. Zero-hour contract and marginal part-time are also popular, where working hours are unpredictable, and the firm is contractually obliged to pay only when particular work is done. On-call workers are also a part of this, where work may be given at any time by the employer, but without a guaranteed minimum amount of wages and work. However, some workers enjoy more flexible working hours, with newer practices such as job-sharing, progressive retirement and part-time parental leave becoming popular.

⁴⁵ Ibid.

Multi-party employment relationship covers workers who are recruited by employment agencies and matched to firms that hire the agencies to manage their workforce. This employment relationship is often triangular—agencies pay and arrange workers, employers pay and deal with agencies. The direct relationship between the employer and worker may not be clear, leading to possible abuse such as flaunting the requirements for occupational health and safety as these workers are technically not employed by the employer. Another common practice is where the workers are managed directly by the sub-contracted companies.

Finally, **disguised employment/dependent self-employment** is employment which, on paper, are standard (both as formal workers or self-employed) but when scrutinized do not meet the standards of standard employment. Online crowd-work and work on demand in the online platform economy may be part of this, where the ‘self-employed’ through online platforms are still subjected to managerial control by firms that procure the services online.

Many of these non-standard workers work in multiple types of non-standard work, including a mix of standard and non-standard work.

3.2.3 Global estimates of non-standard employment

Globally, temporary employees in registered private sector firms are on average 11% of all employees in the firms, while women make up of 57% of part-time employees⁴⁶. The aggregated non-standard employment rates across most European countries have also increased between 1998 and 2008⁴⁷.

Note however that the proportions of non-standard employment vary across countries with different development levels. For instance, the percentage of temporary workers across the countries in the world ranges from 0.1% in Qatar up to nearly 65% in Vietnam in 2013⁴⁸.

The levels of part-time workers also vary across countries, where nearly 45% of waged employment in Netherlands work less than 35 hours per week compared to nearly none in Tunisia in 2014⁴⁹. The percentage of temporary agency workers also doubled between 1990 to 2000 in the US⁵⁰. Dependent self-employment in Europe ranged up to 3% of private sector employment (excluding agriculture) in some countries⁵¹.

⁴⁶ Ibid.

⁴⁷ Schmid (2010)

⁴⁸ ILO (2016)

⁴⁹ Ibid.

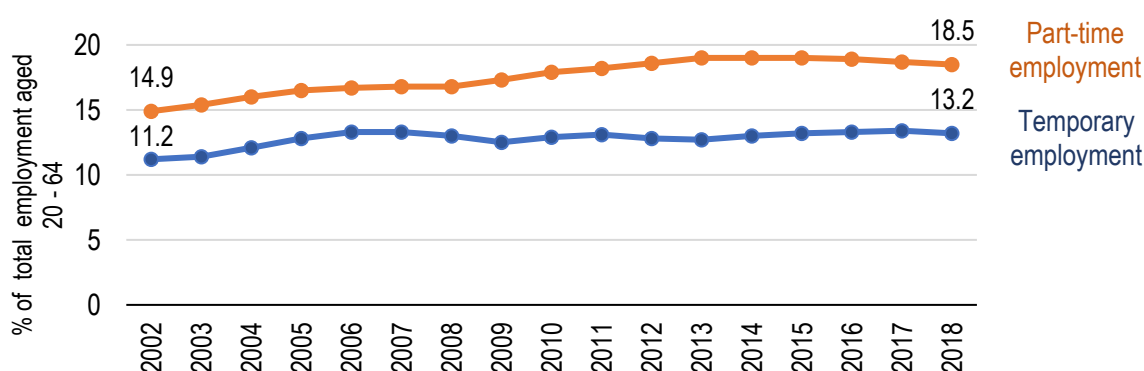
⁵⁰ Ibid.

⁵¹ Ibid.

Part-time and temporary employment (both are non-standard work) have also risen in the European Union⁵². As shown in Figure 9, the share of temporary employment⁵³ has increased from 11.2% in 2002 to 13.2% in 2018. The same goes to part-time employment⁵⁴ where it has increased from 14.9% in 2002 to 18.5% in 2018. Both of these trends imply a declining possibility of finding permanent jobs with typical employment benefits in the EU.

The rapid change in the structure of the economy has also led to the increasing instances of non-standard employment. The rise of alternative work arrangements in the US has also increased sharply between 2005 and 2015, with the fall of self-employment correlated with the rise in temporary contract workers⁵⁵. Counter-intuitively, the rise was the sharpest for older and prime-aged workers, instead of 16 to 24-year old workers.

Figure 9: Share of part-time and temporary employment, EU28⁵⁶, 2002 – 2018



Source: Eurostat (2018)

3.2.4 Issues in non-standard employment—beyond informality

Non-standard employment shares many of the benefits and concerns of the informal economy, especially in terms of the level of social protection that is afforded to these workers. The cost and benefit of ‘non-standard-ness’ of work, however, goes beyond this.

In terms of income and employment security, non-standard employment is frequently seen as a ‘peripheral’ workforce compared to the ‘core’ workforce that is more likely to be part of standard

⁵² It was also reported that part-time employment only marginally declined when the labour market improved, implying that not all part-time employment in the European Union is voluntary. Source: Eurofound (2018)

⁵³ Temporary employment refers to employment contract with a fixed end-date. Source: Eurostat (n.d.)

⁵⁴ Part-time employment refers to workers who work less than the typical working hours, which typically translated to less than 30 hours per week. Source: Eurofound (2007)

⁵⁵ Katz and Krueger (2016)

⁵⁶ As of September 2019, EU28 consists of Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the UK.

employment. This implies that non-standard workers have weaker wage bargaining power and firms are more likely to pay them lower. However, the insecurity of employment may be seen by the unemployed as a stepping stone for standard employment, although this was not seen in Spain and Japan⁵⁷. In terms of training, while other forms of non-standard employment do not provide training to these workers, US temporary employment agencies do provide certain training in order to better match their firm's needs⁵⁸.

The benefits from the flexibility in non-standard work may also be nuanced. Non-standard work has provided flexibility of work: the flexibility in employment relationship, flexibility in scheduling work, and flexibility of when the work is to be completed⁵⁹. It was found that non-standard workers may work longer hours with multiple number of jobs, with higher work intensity. The irregular and unpredictable hours have been found to have negative impact on lives⁶⁰. Survey on temporary contract workers have also found that the majority of these workers prefer regular, standard hours⁶¹. Flexibility may also increase job insecurity. For example, when one is hired illegally as a temporary worker, s/he will be less likely to engage in litigation when they are fired or treated unfairly⁶².

3.2.5 Growth in gig economy – the rise of the platform

A key reason for the rise of informal employment is the rapid increase of workers in the online gig economy, “in which organisations contract with independent workers for short-term arrangements”⁶³. These workers perform a series of one-off tasks (‘gigs’) without an ongoing relationship with a single employer, hence also described as the gig economy⁶⁴. Although these jobs have always been available before the digital age, digital tools such as online platforms and greater internet connectivity have allowed workers to quickly access these work⁶⁵. Workers and firms have more flexibility in work organization and choice, higher work efficiency partly due to the disintermediation of job tasks, and vast number of new work opportunities at a global level⁶⁶. The online gig economy also provides new job and earning opportunities for the unemployed and those whose skills are not in demand in their present location⁶⁷.

Improvements in digital technologies have lowered the cost of moving ideas and face-to-face interaction globally, unbundling the transmission of ideas and talent needed to run businesses and industries beyond the location they operate in⁶⁸. Online platforms gather and match firms' needs and

⁵⁷ ILO (2016)

⁵⁸ Autor (2004)

⁵⁹ Spreitzer et al. (2017)

⁶⁰ Ibid.

⁶¹ ILO (2016)

⁶² Ibid.

⁶³ World Bank (2019, p. 23)

⁶⁴ Dokko et al. (2015)

⁶⁵ KRI (2017)

⁶⁶ Freelancers Union and Upwork (2017)

⁶⁷ Kässi and Ledonvirta (2018)

⁶⁸ Baldwin (2016)

the workers who can fulfil these needs from anywhere to anywhere in the world. These online platforms match independent workers to supply their on-demand and short-term services to the firms that need them, in addition to also serving as transmission channels of pay and nodes of trust for both workers and firms⁶⁹.

Globally, an estimated 48 million people are registered for online microtask work, with only 10% being active on the platform⁷⁰. In fact, the online gig economy has grown 26.5% from May 3rd, 2016 to September 8th, 2019⁷¹. It is important to note that this statistic only refers to jobs conducted remotely via digital platforms that require specialised skills like programming, and therefore, excludes jobs facilitated by apps such as driving and delivery services. Despite the volatility (which could signal seasonality) of the data, the upward trend indicates a growing global appetite for specialised and temporary labour. As mentioned previously, this growth in gig economy is not necessarily a bad thing as it can offer greater autonomy and flexibility to workers. Also note that depending on the nature of job, freelancers who are able to negotiate pay and have access to the market are not necessarily the most vulnerable group of workers.

The number of online platform workers has also increased rapidly in the last decade or so. 52% of the work posted are from the United States, followed by the UK and India⁷². A global survey of online gig workers involved in microtasks⁷³ shows that the number of workers is increasing at 14% per annum⁷⁴. More than 40% of all US workers earned parts of their incomes from online platforms in 2017⁷⁵, translating to around 57.3 million people and growing three times faster than the general US workforce⁷⁶.

While data of Malaysians on online platform workers are not readily available, some analysis in a KRI's report "An Uneven Future" revealed some of these trends. The rise of the ride-sharing platform Grab in Malaysia has been rapid, where within less than five years since their introduction in 2012, 50,000 to 60,000 Grab and Uber drivers in Klang Valley are currently available compared to 37,000 taxi drivers⁷⁷. E-commerce activities have also increased, where the value-add growth of the economy has grown by 12.7% per annum between 2010 to 2015 compared to 7.1% growth of the overall nominal GDP in the same period (Figure 10).

⁶⁹ Dokko et al. (2015), International Monetary Fund (2018)

⁷⁰ Kuek et al. (2015)

⁷¹ Oxford Internet Institute (2019)

⁷² Kässi and Ledonvirta (2018)

⁷³ Microtasks are tasks which are quick to do and do not require many instruction, but requires human judgements.

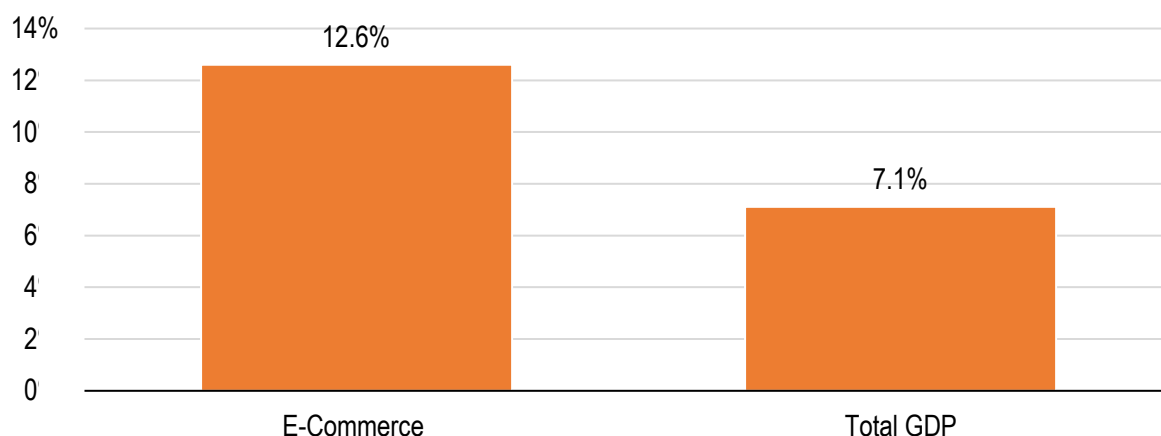
⁷⁴ Kässi and Ledonvirta (2018)

⁷⁵ Freelancers Union and Upwork (2017)

⁷⁶ Ibid.

⁷⁷ KRI (2017). Note that as of 12 October 2019 and in respond to a tighter licensing regulation, actual number of Grab drivers could be much lower compared to the cited figures.

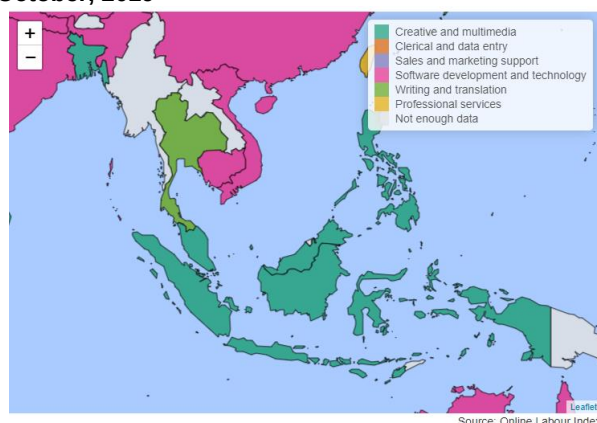
Figure 10: Value-add growth of e-commerce Malaysia in current terms, CAGR, 2010 – 2015



Source: DOS, adapted from KRI (2017)

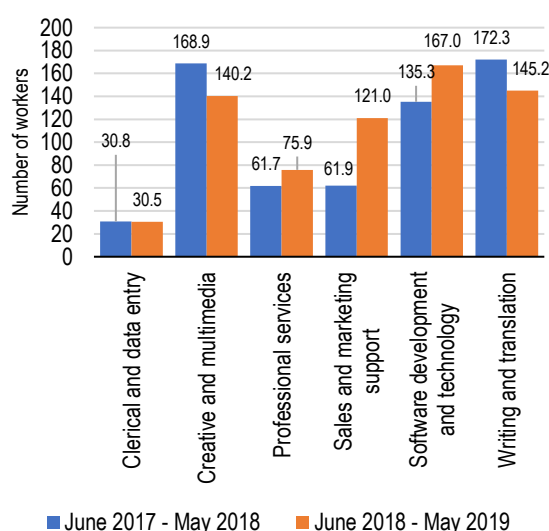
In 2019, most Malaysians offered creative and multimedia services on various microtask platforms (Figure 11). While the number of workers changes each month, on average the number of workers has increased by 7.8% between June 2017 and May 2018 from the equivalent period a year before between June 2018 to May 2019 (Figure 12). The average number of workers, while small, was the highest in June 2018 and May 2019. These workers mainly work in creative and multimedia, writing and translation, and software development technology. Percentage-wise, software development and technology workers occupy 24.6% of all workers, followed by writing and translation at 21.4%, and creative and multimedia at 20.6%. These trends indicate that online platform work and the gig work will increasingly be an important source of work for Malaysians.

Figure 11: Top services by Malaysians as of 14th October, 2019



Source: Oxford Internet Institute (2019)

Figure 12: Number of workers on labour services platforms, 2017 - 2019



Source: Oxford Internet Institute (2019)

3.3 Conclusion: convergence of narrative and trend

Consistent with the previously mentioned empirical trends, the narrative of informal economy and its overlapping non-standard employment has also changed. Table 2 captures the changes in the views of informal economy: from when it was only seen to be a temporary phase confined to developing countries to a persistent economic feature in all countries.

Table 2: Old versus new view of informal economy

The old view	The new view
It is a traditional economy that will cease with modern, industrial growth	It expands with modern, industrial growth
It is marginally productive	It is a major employment provider and contributes to the overall economy
It exists in the periphery and does not interact or link to the formal economy	It receives and produces good and services from and for the formal economy
It represents labour surplus	Much of the recent rise represents informalisation of previously formal jobs
It comprises mostly of micro-scale enterprises like street traders	It is heterogenous and comprises both resilient old forms of self-employment and new emerging forms of employment
It consists mostly of unregistered enterprises and workers that seek to evade tax and regulation	It consists mostly of enterprises and workers who are not seeking to evade tax and regulation
It comprises mostly of survival activities; therefore, not subject to economic policies	Informal economy is multidimensional. All its forms are affected by most, if not all, economic policies

Source: Adapted from Chen (2007)

4. WHAT DRIVES INFORMAL ECONOMY?

Discourses on factors driving informal economy can be essentially divided into two: by choice or by necessity. This theory is also known as the exit-exclusion taxonomy⁷⁸:

- Exit (by choice) is explained via a utility maximisation perspective, where informality is driven mainly by opportunistic behaviours
- Exclusion (by necessity) sees informality as a symptom of large structural issues, where one is forced into informality

As synthesised in Table 3, this taxonomy will be elaborated in the following two segments.

Table 3: Different forms of exit and exclusion

Different forms of exit	Different forms of exclusion
Opportunistic evasion <i>Costs of formalising outweigh its benefits</i>	Labour market segmentation <i>Two-tier labour market prevents workers from formally employed</i>
Defensive evasion <i>Weak state or low institutional capacity limits the benefits of formalising</i>	Burdensome regulations <i>High entry barriers de-incentivised micro firms from formalising</i>
Passive evasion <i>With no intention and potential for growth, informal actors find no need to engage with the state</i>	Hiring practices of firms <i>Firms' hiring practices are shaped by heavy tax and regulatory burdens</i>

Source: Adapted from Chen (2012)

4.1 Is informal economy driven by choice?

The causal theory views participation into the informal economy as an active and calculative decision of individuals, resulting from weighing of the costs and benefits of formalising or in-formalising. Also known as the Exit theory, informal actors are viewed to make voluntary choices in exiting the formal economy. WIEGO (Women in Informal Employment: Globalizing and Organizing)⁷⁹ subdivides the Exit theory into three reasons: opportunistic, defensive and passive evasion⁸⁰.

⁷⁸ Perry et al. (2007) as cited in Oviedo et al. (2009)

⁷⁹ Since the Delhi Group in 2001, WIEGO has been a key statistical partner to ILO in measuring and monitoring informal employment worldwide.

⁸⁰ Chen (2012)

Opportunistic evasion applies to workers and firms that specifically exit informal economy to evade tax- and employment-related obligations. This may also apply to enterprises and workers with sufficiently low human capital and productivity, where the costs of formalising outweigh its potential benefits.

Defensive evasion, on the other hand, arises from the informal actors' view that benefits of informality could not be realised due to low institutional quality or state inefficiency⁸¹. The regulatory system might be too burdensome, the system might be corrupt, or the state might be inept to carry out the regulations. For these actors, evading tax or regulation might be viewed as justifiable if the state is deemed unable to realise the benefits from the tax collection or regulatory implementation⁸².

Lastly, passive evasion may apply to microenterprises with rudimentary economic activities such that their interaction with the state is mostly irrelevant.

4.2 Necessity driven informal economy

In contrast to the Exit paradigm, proponents of Exclusion argue that informal actors are excluded from the formal economy not by choice but by necessity. WIEGO outlines three different forms of exclusion: labour market segmentation, burdensome entry regulations and firms' hiring practices.

Some have argued that labour market segmentation⁸³ where labour is divided into core and periphery workforce is preventing workers from holding formal jobs. Fostered by the developments in employment deregulation and the rise of non-standard employment, those considered as core workers enjoy long-term contracts with the typical benefits, while periphery workers are driven out of the formal workforce with their short-term contracts without the typical benefits⁸⁴.

Next, burdensome entry regulations can deter micro firms from formalising. While countries with heavier regulatory burden tend to have higher rates of informality (here referring to the informal sector), in countries with strong governance, the higher regulatory burden has resulted in lower (not higher) informality⁸⁵. This suggests that strong states often lead to stronger enforcement, which in turns make regulations more likely to be beneficial. Nevertheless, for micro-firms, excessive regulations increase barriers to entry, which makes it less likely for them to formalise.

Lastly, firms may change their hiring practices in response to excessive tax and regulatory burden, where traditional employment package is offered to some but not all workers.

⁸¹ de Soto (1988) as cited in Loayza (2018)

⁸² Oviedo et al. (2009) includes a discussion on tax morale (i.e. social perception of taxation and public spending) and its association with the size of informal sector. According to the Edelman Trust Barometer, Malaysian general population trust in the government has increased from 37% in 2017 to 46% in 2018. Source: Edelman (2018)

⁸³ Labour market segmentation means "the division of the labour market into separate submarkets or segments, distinguished by different characteristics and behavioural rules." Source: ILO (n.d.-b)

⁸⁴ Barbanchon and Malherbet (2013)

⁸⁵ Loayza et al. (2006) as cited in Oviedo et al. (2009)

4.3 Either, neither or both: nuances in the informal economy

Subdividing the cause of participation into the informal economy between participation by choice or by consequence might help to frame one's thinking, but experts have argued that the reality is far more complex than that.

Evidence from microdata analysis of developing countries suggests that participation into the informal economy arises from both exclusion and exit, and one enforces the other⁸⁶. For instance, due to the labour market structure (exclusion), workers without the human capital that are in demand (exclusion) may choose to be informally employed (exit) in order to be employed at all.

Other scholars have argued that both taxonomies can only explain parts, not the whole, of informality⁸⁷. This reflects the heterogenous feature of the informal economy. While some might be forced into the informal economy, others might do it on purpose such as to achieve a higher degree of work flexibility and autonomy.

To others⁸⁸, informality is both the cause and consequence of a combination of lack of economic development (by necessity) and poor governance (by choice). The former paints the picture of individuals forced into the informality due to lack of productivity by both workers and firms, while the latter sees informality as individuals' reaction towards poor governance.

Nevertheless, there appears to be a consensus in the literature that participation into the informal economy is not the case of either or neither of the two schools of thought, rather a mix of both. That is, empirically, it is usually the case of both school of thoughts.

5. WHAT ARE THE OUTCOMES?

While informality and the informal economy might carry a negative connotation, it is not necessarily a good or bad phenomenon. This section explores both the benefits and drawbacks of informality from the perspectives of both firms and workers.

5.1 The benefits of informality

One key benefit of participation into the informal economy is that it facilitates labour mobility and flexibility. This can be beneficial to both enterprises and workers.

To enterprises, a higher labour mobility and flexibility enables them to respond better to demand, which in turn makes them more efficient and competitive⁸⁹. During an economic downturn, informal employment arrangements allow firms to reduce labour costs while retaining their talent. Offering existing full-time employees, a part-time arrangement in recession can also minimise the firms' hiring

⁸⁶ Oviedo et al. (2009)

⁸⁷ Refer Chen (2012)

⁸⁸ Refer Loayza (2018)

⁸⁹ Refer Webb et al. (2013)

cost when the economy finally recovers⁹⁰. For example, during the Argentina's 1999-2002 economic crisis, the share of informal employment expanded from 48% to 52%⁹¹.

To individuals, the informal economy can be beneficial too. As with firms, informal employment offers job opportunities during periods of economic contraction. Even during times of economic prosperity, the informal sphere provides opportunities for workers and sole proprietors (i.e. self-employed or entrepreneurs) to provide services and goods to both national and international firms. In this respect, informality loosens the barrier to entry for individuals who may not have the typically expected qualifications or resources.

Other non-financial incentives like working flexibility and autonomy have also been stressed as beneficial to workers. For individuals with heavier care burden such as mothers with young children or/and adults with aging parents, flexible working arrangements allow them to work and care for their dependents. Outside the typical hierarchical structure and employee status, individuals may also enjoy greater work autonomy as they can choose projects that better match their interests and skills.

5.2 The costs of informality

There are two main costs for participating in the informal economy: economic inefficiency for enterprises and increasing vulnerabilities for workers.

For enterprises, it has been argued that without formalisation (which provides bigger access to credit and capital), informal enterprises with the potential to grow might never be able to reach their full potential⁹². They might not even be able to reach an efficient scale of production. This hindrance to higher productivity is an economic inefficiency. Other studies have also found informal enterprises to have cost advantages from evading tax and labour regulations⁹³. This creates an uneven playing field in the market, putting formal firms at a disadvantage for complying with laws.

It has also been argued that the informal economy creates a free rider problem, where one benefits from a certain resource without contributing to its provision⁹⁴. While informal actors are not contributing to tax incomes, they are not exempted from using publicly available services funded by tax. This further aggravates the adverse effects of the informal economy on economic efficiency.

The prevalence and persistence of informality can further erode the public confidence in the country's institutions and negatively impact economic actors' willingness to contribute to these institutions. An extension of the tax morale argument (high public confidence in public institutions encourages tax compliance), the rampant informality may de-incentivise other actors from abiding the laws. Evidently, poor governance has been found to be positively correlated to the size of informal sector⁹⁵. This potential loss of tax revenue may undermine the government's capacity to provide public goods and

⁹⁰ MOM (2019)

⁹¹ OECD (2009)

⁹² de Soto (1988) as cited in Oviedo et al. (2009)

⁹³ Farrell (2004)

⁹⁴ Loayza (2007) as cited in Oviedo et al. (2009)

⁹⁵ Perry et al. (2007)

services. This ‘undercounting’ may also paint an incomplete economic picture, further restricting policy makers from formulating effective policies.

In general, informal economy workers earn less and they have a much more tenuous employment-related rights. It was estimated in 2009 that over 700 million informal workers⁹⁶ live in extreme poverty, earning less than \$1.25 daily⁹⁷. Lack of protection from illness, unsafe working conditions and earning loss from sudden dismissal make informal workers more susceptible to poverty. This is especially the case as labour is often the workers most significant, if not the only, asset.

More worrying, a persistent informal employment could lead to a long-lasting social exclusion, where individuals lose hope of ever climbing the social ladder. For workers who continue to work ‘at the margin’ or being excluded from the formal economy, they may be more likely to be less hopeful of brighter future prospects for them and their children. The relationship between hopelessness, informality and social mobility can be observed through schooling elasticity, where a higher value indicates a lower social mobility. Countries with higher persistence of informality like Brazil and Colombia also have higher schooling elasticity (0.7)⁹⁸. By contrast, countries with lower persistence of informality like the United States and the United Kingdom have much lower schooling elasticity (0.26 for the US and 0.19 for the UK)⁹⁹. Seeing the limited return to education, parents in countries with high informality might feel discourage to invest in the children’s education, further perpetuating the cycle of economic disadvantages.

5.3 Balancing the costs and benefits

Considering the employment-generating ability of the informal economy and the positive effect of higher labour flexibility, the informal economy is not inherently bad. At the same time, the costs of economic inefficiency and labour vulnerability should not be dismissed. Is it possible then to minimise the negative and maximise the positive? The following section discusses some of the available policy instruments in the pursuit of balancing the good and the bad.

6. WHAT ARE THE POLICY PARADIGMS?

The many forms of the informal economy have been purported as the norm¹⁰⁰ and the future is expected to be dominated by informal jobs¹⁰¹. As described in Section 3, this future projection is based on four recent labour trends:

- Persistent trend of informal employment, notwithstanding sectoral employment shifts

⁹⁶ Out of estimated 1.8 billion of informal worker. Source: OECD (2009)

⁹⁷ Ibid.

⁹⁸ IDB (2007) as cited in Oviedo et al. (2009)

⁹⁹ IDB (2007) as cited in Oviedo et al. (2009)

¹⁰⁰ Jütting and Laiglesia (2009) as cited in Kanbur (2014)

¹⁰¹ These projected trends can be offset by a substantial increase of new formal jobs, stronger or new labour regulations and/or greater opportunities to upskill and reskill. Source: Chen (2019)

- Jobs are becoming informal and there is a greater push for labour deregulation
- Emerging new forms of informal jobs, amid the growth of outsourcing, offshoring and digital economy
- Rise of self-employment in the informal economy from being displaced by trade and technology

Considering this future of work and given the perils and promises of the informal economy, what options do policymakers have? More importantly, can policymakers maximise the benefits while minimising potential costs?

Formalising or reducing the informal economy is the most commonly cited policy response to circumvent the costs of the informal economy, especially with regard to maximising the state's tax revenue and reducing workers' vulnerabilities. However, the means towards reducing informal economy may differ from one case to another, depending on the policy target. The following section includes a discussion of frequently cited policy instruments along with the limitations. Note that an in-depth overview of Malaysian policies and programmes, whilst key, is not included in this particular paper.

6.1 Formalising informal firms?¹⁰²

The most common way to formalise a firm is to either deter informality or encourage formality. The former can be done by taxing them, while the latter can be achieved by reducing regulatory burden.

However, there is a consensus that formalisation should be done at all costs. In the case of taxing informal firms, scholars have warned against taxing firms indiscriminately¹⁰³. To Kanbur and Keen (2015), applying a one-size-fits-all approach to informality reduction is problematic because informal firms are heterogenous with different reasons for not paying tax.

For example, enforcing taxation on micro firms with low productivity and profitability cannot deter them from exiting the market or guarantee tax collection can be raised¹⁰⁴. Without understanding the compositions of local informal sector along with the embedded incentive structure, policy actions are less likely to be effective. Box Article 3 outlines how a value chain analysis could potentially uncover the incentive structure.

Another oft-cited example of encouraging formalisation is by reducing regulatory costs, where the regulatory burden is making formalisation too costly for some. This inverse relationship between regulation and informality, however, has been challenged.

To Kanbur (2014), regulation offers a weak explanation for the persistent of informality, especially amid the economic growth in the last quarter of the 20th century where regulatory burden has decreased during the same period. Similarly, Loayza et al (2006) found positive impacts of regulation

¹⁰² The segment primarily drew from Martha Chen's presentation in Kuala Lumpur, January 2019. Source: *ibid*.

¹⁰³ Refer Chen (2012) and Loayza (2018)

¹⁰⁴ Porta and Shleifer (2004) as cited in Loayza (2018)

when the state can enforce the regulation and deliver the promised benefits. The World Bank (2007) has also argued that reduction in regulatory burden is insufficient without increased awareness of and access to the benefits of formalisation. Again, depending on the local context, the issue might be the enforcement or governance, not the regulation itself.

Again, not all informal firms should or will formalize. Depending on the local context, forced formalisation can lead to unintended consequences such as an increase in unemployment and poverty rate.¹⁰⁵ Local context is key. A lack of understanding of local context may lead to misguided formalising efforts.

6.2 Formalising informal economy workers?

In anticipation of more informal jobs in the future, there have been two distinct policy directions offered in the literature. One is to detach existing employment protection and benefits from firms, while the other seeks to expand existing protection and benefit package beyond the formal workers.

The former position argues that given the demise of traditional employee-employer relationship, the current benefits and protection system should be reformed and subsequently be provided by both the firms and the state¹⁰⁶. This is part of the flexicurity system where higher labour flexibility (i.e. less restrictions in hiring and firing) is balanced with a wider safety net provided to individuals, regardless of employment status. One of the key tenets is people, not job, are the ones that should be protected. Since the informal economy has been and will continue the norm, this system has been argued to be more inclusive as it protects all workers, regardless of their employment status¹⁰⁷. When the labour market as whole is made highly flexible, the argument goes that firms will also have less incentives to hire workers informally.¹⁰⁸ In reverse, when the burden of hiring workers such as the benefits and protection is lessened, firms will have more incentive to hire workers as formal workers instead of subcontracting the demanded services.

By contrast, the latter position argues that the existing tripartite relationship between the state, firms and workers should be strengthened and honoured¹⁰⁹. Proponents of this position are of the opinion that the current funding system should be maintained and further expanded to cover informal workers. This includes those without a clear straightforward employer¹¹⁰.

While a state-funded social protection independent of firms sounds appealing, sceptics have raised concerns over its sustainability and the firms' role as the main beneficiary of human capital or labour.

¹⁰⁵ Fernandez et al. (2017) as cited in Loayza (2018)

¹⁰⁶ Refer OECD (2013) Loayza (2018) and World Bank (2019)

¹⁰⁷ See *ibid.* Question remains whether higher labour flexibility will lead to worsening of working conditions, which can render better access to social protection remains meaningless.

¹⁰⁸ Refer OECD (2014) as cited in Schoukens and Barrio (2017)

¹⁰⁹ Refer Alferys (2018) and ILO (2002a)

¹¹⁰ For examples of contributory-based protection for informal workers refer Alferys (2018).

Considering the key trends on taxes (i.e. drop in corporate tax rates and income tax losses),¹¹¹ general taxation will have to rely heavier on indirect taxes on consumption. This in turn implies a greater tax burden on individuals and lesser on capital owners, whom profited from labour. More importantly, the bleak outlook of taxes raises a concern whether there is enough fiscal space to finance meaningful social protections. Proponents of this flexicurity solution, however, have argued that this is still possible through a fiscal reform through introduction of new taxes (e.g. carbon or digital tax) and reduction of fiscal incentives (e.g. subsidies)¹¹².

As jobs are expected to be more informal than formal in the future, the provision of appropriate and ample social protection is increasingly pertinent. Lessons gathered from the literature point to the importance of understanding a country's fiscal sphere along its limitations. This highlights the importance of conducting a national fiscal study to inform and complement KRI's research on informal and non-standard employment in Malaysia.

Box Article 3: A qualitative value chain analysis on informality

Information on informal actors can be gained from the top down (quantitative) and the bottom up (qualitative). One way of obtaining qualitative data is through a value chain analysis.

As mentioned in previous sections, informal enterprises and workers are now understood to interact with the formal economy. Instead of operating *in silo*, actors of informal economy source from or supply goods and services to their formal counterparts. This can take place directly (i.e. direct individual transactions) or indirectly (i.e. through intermediaries or a value chain of subcontracted relationships).

The nature of the production system that links both formal and informal actors is key in understanding the incentive structure of different parties. For instance, types of engagement typically dictate the power dynamics. This, in turn, signals the level of independence and economic risks experienced by informal actors.

For some informal actors, like owners of mom-and-pop stores or low-grade contractors¹¹³, although they assume all production risks, they have authority or control over their production. Furthermore, their access to the market is not dependent on a single entity or buyer.

By contrast, informal actors like e-hailing riders depend on the firms behind the apps and its pricing decision. Another example is the garment makers for international brands who supply their goods and services to or through a lead firm that dictates the quantity and quality of their production. These firms may also be the market gatekeeper, without whom the informal actors cannot provide their goods or services.

¹¹¹ See *ibid.* and OECD (2016)

¹¹² Refer World Bank (2019)

¹¹³ They are considered informal actors since while business owners might register their businesses or enterprise, many of them may not protect themselves by contributing to the pension system and employment injury scheme. This makes them informally employed in the formal sectors.

Additionally, despite the low authority, these actors also assume much of the risks and costs of production (e.g. equipment, electricity, workspace, etc.).

As noted by Piore and Sabel (1984)¹¹⁴, formal firms have started to favour flexible employment relationships since the 1980s. This is because it allows for a flexible specialised production process where labour could be easily expanded in peak seasons and contracted in slack seasons. Porter's 1985 value chain also showcases how the firms' activities and workforce can be organised into a core-periphery framework, where workers with core or vital tasks can be employed permanently, while workers with periphery tasks can be employed by necessity. This shift in firm organisation inevitably shapes how firms employ their workers.

As also argued by Piore and Sabel, contrary to popular beliefs, this shift in employment preference may be more of a response to changes or incentives embedded in the value chain rather than increase in labour costs. A value chain study may then uncover these incentives along with the contours of power and leverage points, where small shifts can lead to big impacts.

Source: Chen (2012) and McCormickSchmitz (2001)

7. CONCLUSION: CONTEXT MATTERS

This paper started with a discussion on the conceptual differences between firm-based informal sector and worker-based informal employment. Informal economy composes both the informal sector and informal employment. As noted, these two concepts are not substitutable, but complementary to one another.

The paper then offered updated figures to show the prevalence and persistence of informal economy in terms of its share of employment, share of production and economic contribution. Recent trends of the rising non-standard jobs inside and outside the gig economy were included to highlight that the future of work will be increasingly informal.

Two main schools of thoughts on the causes of informality—by choice and by necessity—were introduced before concluding that neither one can explain informality in its totality. This was followed by a discussion on the outcomes of informality, where it is found that informality offers both perils (i.e. economic inefficiency and labour vulnerabilities) and promises (i.e. higher labour mobility and flexibility).

Some of the highly-cited policy directions were included in the last section, with the literature stressing the importance of local contexts and on-the-ground knowledge in formulating policy. In-depth understanding of existing informal actors and its ecosystem is therefore indispensable in formulating effective policy actions.

Using the literature as the backdrop, the next instalment aims to deepen our understanding the size and composition of Malaysian informal sector workforce. Using publicly available data, the next

¹¹⁴ As cited in Chen (2012)

working paper will provide a quantitative or top-down overview of the informal sector workforce in Malaysia.

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