

# Informal and Nonstandard Employment in the United States

## *Implications for Low-Income Working Families*

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For many years, policy analysis on informal employment primarily focused on less-developed economies. Informal workers are often concentrated in agricultural, domestic service, or manual activities; they can include individuals who are self-employed in the sense that they do not work for any particular employer or firm. Whether self-employed or working for others, individuals (and their employers) who do not report earnings or income for tax purposes are part of the informal economy.

As capitalist economies mature and develop, regulatory and worker protection policies become established, and social assistance expands, informal work should decline. Yet, today, informal work remains a major part of the economies of developed as well as developing countries. Some analysts suggest that the rate of informal work may be increasing partly in response to expanding globalization. New businesses are expanding in urban areas, but costs of starting up enterprises are high, causing some entrepreneurs to operate in the informal sector and pay lower wages to minimize expenses (Schneider 2002; Williams 2011).

The literal definition for the informal sector is straightforward: economic activities that are outside tax and regulatory policies. This definition applies to both workers and the individuals or companies for which they work. In contrast, formal, or standard, employment generally refers to regular wage and work arrangements at an employer's location or under the employer's supervision or policies, where the wages and income are reported to the government as required by law.

In developed countries, including the United States, the distinction between formal and informal economic activities is not always clear. For example, informal employment is similar in some ways (e.g., operating without a regular attachment

to a particular firm, not covered by employer-sponsored benefits) to nonstandard or contingent employment (such as temporary, intermittent, part-time, day labor, and contract workers), which may operate in the formal sector. In addition, individuals often mix formal, informal, and nonstandard work—for example, working a second job or moonlighting, sometimes “off the books.”

This brief describes informal and nonstandard employment and explores the policy implications for low-skilled workers in those arrangements.<sup>1</sup> Individuals in both informal and nonstandard employment have relatively high poverty rates and low earnings, and women represent a disproportionate share of the workers. The poor, who work mainly in the informal sector, may find it even more difficult than low-wage formal workers to raise themselves and their families out of poverty through work alone because informal wages are lower and there is less chance for wage increases.

### **The Informal Market and Public Policy**

Informal employment in the United States tends to be overlooked in policy circles. When it is considered, it is often viewed in terms of black market (i.e., criminal and illegal) activities, undocumented immigrants, or white-collar tax evasion. Aside from these stereotypes, though, informal employment represents various economic arrangements. The existence of the informal market has implications for numerous policy options related to workers and their families, and to businesses (particularly entrepreneurial activity and small businesses).

For their informative book about how poor mothers live, *Making Ends Meet*, Edin and Lein (1997) interviewed 349 low-income mothers; all



but one earned some income from informal work, typically supplementing welfare payments or earnings from formal low-wage jobs. Few of these women were engaged in illegal activities such as drug dealing or prostitution; the vast majority indicated they “worked on the side,” regularly babysat, cleaned houses, did lawn and yard work, or collected cans and other recyclable items to earn money. In other words, the mothers performed legitimate work outside the formal labor market (that is, outside tax laws).

Public policies, though, strongly encourage formal employment. Workers benefit from participating in the formal sector, as shown in the left side of figure 1. American society, similar to those of other developed economies, assumes that informal employment should be discouraged; it also assumes that formal employment is at the core of human capital development and is key to achieving social welfare policy goals related to increasing individual economic self-sufficiency. Social insurance benefits are premised on work in the formal sector, and the pathways to improved earnings and occupational upward mobility value sustained formal work experience. Tax credits are designed to encourage formal businesses and formal work, and some key policy goals are achieved through the income tax system. For example, the earned income tax credit (EITC) supplements the income of workers who have earnings from formal employment. Periodic economic stimulus payments to individuals, such as those

provided in 2009 during the height of the recession, also usually work through the formal system, providing special one-time payments to those who file federal income tax returns.

Welfare reform is also premised on formal employment. Ideally, individuals move from public assistance to employment in the formal labor market, and their wages are complemented by the EITC and tax credits to workers and employers. This expected pattern was confirmed during the economic boom of the 1990s, when the strong demand for workers, along with changes in the nation’s welfare policies, contributed to substantial increases in employment among low-income parents, especially mothers.

However, as Edin and Lein explain, informal, off-the-books work, which has always existed in the United States as in other countries, continued even during the booming 1990s. And informal work has some positive aspects, as shown in the right side of figure 1. The informal sector is a first entrée into work. Young people, for example, often babysit, mow lawns, and do other informal work that provides them with income and introduces them to the world of work and the responsibilities and expectations of that world. The informal labor market has fewer barriers to entry than the formal market, and hours of work may be more flexible. Financially, workers who do not report their earnings avoid taxes, thus increasing their disposable income. And many adults who work more than one job at a time, either full

FIGURE 1. *Benefits of Formal and Informal Employment for Workers*

Formal Employment	Informal Employment
<ul style="list-style-type: none"> <li>■ <i>Recognized work experience.</i> Acquiring work experience recognized in the labor market that could lead to occupational mobility.</li> <li>■ <i>Health insurance.</i> Access to employer-sponsored health insurance.</li> <li>■ <i>Retirement.</i> Accumulation of Social Security and other pension credits, along with employer contributions.</li> <li>■ <i>Unemployment insurance.</i> Accumulation of necessary work history to qualify for unemployment insurance.</li> <li>■ <i>Worker protections.</i> Minimum wages, safe work conditions, workers compensation, antidiscrimination laws.</li> <li>■ <i>Tax credits.</i> Qualification for employment-related tax credits and transfers (e.g., EITC).</li> </ul>	<ul style="list-style-type: none"> <li>■ <i>Tax avoidance.</i> Earnings and payments not reported to the government.</li> <li>■ <i>Detection avoidance.</i> With no reported earnings, one might avoid being detected and being required to fulfill other financial responsibilities (e.g., debt repayment, child support obligations).</li> <li>■ <i>Flexibility.</i> Increased possibility of arranging flexible hours of work; seasonal options.</li> <li>■ <i>Independence.</i> Increased possibility of self-directed individual work arrangement; creative endeavors.</li> <li>■ <i>Ease of entry.</i> No background checks or references required; fewer education credentials needed.</li> </ul>

time or part time, view the informal sector as a viable supplement to formal work. Some may combine formal and informal work, complementing regular pay with work done on the side.

Thus, formal employment reinforces some important national policy goals, such as improving working conditions and compensation, creating jobs, and strengthening the formal economy. It also reinforces the social value of work and self-sufficiency.

## How Is Informal Work Defined?

There is no clear consensus across nations on what constitutes informal employment. At the most basic level, informal employment means employment that occurs outside the tax and regulatory systems. Informal employment is understood to include “all remunerative work—both self-employment and wage employment—that is not recognized, regulated, or protected by existing legal or regulatory frameworks and non-remunerative work undertaken in an income-producing enterprise,” including people who work through subcontracting arrangements made by or entered into by employment agents (International Labour Office 2002, 11). That is, the term informal employment typically incorporates all economic activities that operate outside government rules, taxes, regulations, and monitoring (Feige 1977; Hart 1973). Portes (1981), for example, defines informal employment as work performed in income-producing endeavors that operate without formal wage arrangements.

Moving beyond this general definition, the concept becomes more complex. In the broadest sense, informal employment includes both legitimate (not criminal) activities for which one receives payment, such as babysitting or construction work, and illegitimate or criminal activities, such as drug dealing, smuggling, prostitution, human trafficking, or dealing stolen goods. In terms of social acceptability, few argue that such black-market criminal activities should be characterized as legitimate economic activity. The discussion of informal employment below excludes such criminal endeavors.

Other labor arrangements that violate laws only because they occur outside the tax and regulatory system are viewed differently than criminal activity. The term “shadow economy,” for example, often refers to actions individuals take to evade taxes or compliance with labor and wage regulations in otherwise legitimate activities or in illegal activities (Fleming, Roman, and Farrell 2000). Work in the informal economy is also often defined differently depending on the stage of economic development in a particular country.

A few examples highlight the definitional complexities.

- *Self-employed entrepreneurs.* Many international reports of the informal sector likely include black-market and illegal activity as well as small-scale personal service or production, which might also be referred to as self-employment. In the United States, entrepreneurs who do not report their income are considered informal (or illegal) workers; those who do pay taxes may be considered nonstandard workers if they have an arrangement with an employer and both report their compensation, or they may be considered small businesses if they report business income for tax purposes.
- *Manufacturing production.* Activities related to manufacturing and dealing counterfeit manufactured items and electronic material, which are illegal (at least under U.S. law), involve otherwise legitimate labor activities (production, assembly, marketing, sales, etc.). An analyst might have to decide whether workers in such activities are to be considered in the informal (but legitimate) sector or in the illegitimate sector not generally considered part of the informal sector.
- *Bartering.* Individuals at all skill levels may trade or barter their skills, services, or production with others. At higher ends of the economic scale, professionals may make informal payment arrangements for services and may not include such compensation in their accounting for tax purposes.
- *Undocumented immigrants.* Some workers at all income levels may be performing legitimate activities, but their work is outside the tax and regulatory system because the individuals are not legally authorized to work in the United States. Some perform the same work alongside legal, and therefore formal, workers.

Figure 2 categorizes the various complex arrangements workers may have in the formal and informal sectors, excluding those engaged in criminal activities. The shaded area represents arrangements that include informal employment. On the far right side of the figure are undocumented immigrants who are not legally authorized to work. Many of them, of course, do work, but they are all working informally since they cannot legitimately participate in the tax or regulatory system. All other workers can work in the formal sector, but not all do. Moving from right to left, some workers work only in the informal sector, some mix formal

FIGURE 2. Range of Informal and Formal Employment Options for Workers

<b>Type of worker:</b>	<b>Documented or authorized to work</b>			<b>Undocumented or not authorized to work</b>
<b>Nature of work:</b>	<i>Formal work only</i>		<i>Some formal work and some informal work</i>	<i>Informal work only</i>
	<ul style="list-style-type: none"> <li>■ Standard arrangement (regular employee)</li> <li>■ Nonstandard arrangement (e.g., contingent, on-call, part-time, temporary, contractor)</li> </ul>			
<b>Type of work:</b>	<b>Formal</b> (within tax and regulations)	<b>Informal</b> (outside tax and regulations)		

and informal work, and some work only in the formal labor market.

The formal and informal sectors overlap, and delineation by worker or nature of the job is not always possible. Not all workers are exclusively either in the formal sector or in the informal sector. And, an employment arrangement is informal if either the worker or the employer fails to report earnings; in other words, the worker does not always determine whether he or she works informally or formally.

### How Much Informal Employment Is There?

Given the lack of uniformity in the definition of informal work and problems with measurement, it is not surprising that it is also difficult to know the extent of informal economic activity in the United States and in other countries. Informal employment is not captured by official government statistics and reports because individuals and employers involved in the informal sector are not likely to report all economic activity (Kalleberg et al. 1997). Estimating the size of the informal economic sector is difficult, and cross-national estimates are particularly challenging if one attempts to distinguish between licit and illicit activities.

To analyze the informal sector, the International Conference of Labor Statisticians (ICLS), a consortium of statisticians under the aegis of the International Labour Organization (ILO), adopted an international definition in an effort to reconcile competing definitions and create a consistent framework for statistical analysis. This definition of the informal economic sector includes “all unregistered or unincorporated enterprises” (ILO 2002, 11) below a certain threshold determined by national circumstances and regulations. Although the definition has not

yet been fully put into practice, several surveys have recently adopted some ICLS concepts.

The ILO has synthesized the results of surveys in 70 developing and 30 developed countries (table 1). It concludes that there is more informal employment in developing countries, such as Southeast Asia and sub-Saharan Africa, than in developed countries, and that most informal work in all countries represents what is commonly referred to as self-employment. In developing economies, the ILO notes that “informal employment (outside of agriculture) represents nearly half or more of total non-agricultural employment” (ILO 2002, 17).

TABLE 1. *Approximate Share of the Economy and the Labor Force That Is Informal, Selected Countries, Mid-1990s*

	<b>Informal % of GDP</b>
Greece, Italy, Portugal, Spain	20–30%
Germany, Great Britain, Ireland	10–18%
Latin America	25–60%
Asia	15–50%
Africa	30–60%
United States	5–10%
	<b>Informal % of labor force</b>
Italy	30–48%
Spain	11–32%
Germany	12–22%
France	3–12%
United States	3–40%

Sources: ILO (2002); Gunn (2004); Schneider (2002).

The size of the informal sector in developed countries is more uncertain. For example, reviews suggest a very large range of estimated informal employment in the United States, from 3 to 40 percent of the total workforce (Gunn 2004). Using 12 different categories of nonstandard work and Bureau of Labor Statistics data, Polivka and Sorrentino (2008) estimate nonstandard workers represented between 11 and 20 percent of all U.S. workers in the late 1990s and early 2000s. Some research also suggests that nonstandard work has increased significantly in the United States beginning in the 1980s because of a growing immigrant population reliant on nonstandard work, usually informal arrangements (Tanzi 1999), and an increasingly decentralized labor movement (Houseman and Osawa 2003).

The scale of informal economic activity in monetary terms is even harder to estimate. Despite a body of literature linking informal and nonstandard work with a prospering and even vibrant underground economy (de Soto 1989; Thomas 1992) and research indicating a trend among middle-class Americans to pursue contingent labor as a supplement to standard work (Mattera 1985), in reality, informal and nonstandard work is concentrated at the lower end of the wage scale and represents a disproportionate share of female, black, and Hispanic workers (Horowitz 2000, 394).

## Policy Implications and Options

This brief review of concepts and definitions helps clarify the complexity of issues related to informal employment. A few general points can be summarized.

*The distinction between formal and informal work, and standard and nonstandard work, is ambiguous.* The distinctions may be particularly ambiguous in developed countries, like the United States, because more workers may combine informal and formal employment. Any examination of the informal sector, therefore, requires also examining the formal sector, paying particular attention to the interaction between the two and between informal employment and nonstandard employment. Some individuals work in both the formal and informal sectors.

*Estimates of the scale of informal employment are incomplete, but the United States has at least several million informal workers.* There are no precise estimates of the size of the informal employment sector in the United States, but it could range from 3 to 40 percent of the total non-agricultural workforce, depending on how informal is defined. Even at the low end, that means there are nearly 4 million informal workers.

*Informal employment exists at all socioeconomic levels but is concentrated among the poor.* Most informal and nonstandard employment is concentrated in the lower end of the workforce. Especially in developed countries, however, it also includes some middle-class or professional workers.

*Current policies provide both incentives and disincentives to participating in formal employment.* Welfare policies under TANF are built around a number of financial incentive formulas designed to make work pay more than welfare. Work in the welfare sense means work in the formal sector. And, many work-related benefits accrue to workers through the formal sector. Income tax credits, like the EITC, require that individuals formally report income (i.e., engage in the formal economy).

Low-income workers without children and those not eligible for TANF (e.g., those who have reached their welfare time limit and noncustodial parents) have fewer incentives to work formally, and in fact may have more disincentives to engage in the formal economy. Some may choose not to file if they learn or suspect that they will “owe the IRS.” Contract workers and other casual employees, for example, who would be required to file income taxes as self-employed would be subject to self-employment taxes (such as the employer’s share of FICA) even if their earnings are so low they would not owe income taxes; not reporting income means avoiding the tax. Noncustodial parents who are delinquent in their child support payments risk having their formal wages garnished; working informally avoids this risk.

Tax credits are also available to businesses for hiring welfare recipients or other targeted populations if the firm follows federal wage, hour, and tax policies (i.e., operates in the formal economy). But some employers may choose to operate informally because the costs of formalizing are considered too high (such as paying Social Security taxes for household workers). Others may use nonstandard work arrangements to avoid some expenses associated with regular employees (e.g., health, vacation, and other benefits).

### *Policy Options That Could Improve the Economic Well-Being of Low-Income Workers*

Low-income families that depend mainly on informal and nonstandard work are likely to find it difficult to improve their economic status. A few policy changes could shift some informal and nonstandard workers to formal, standard arrangements.

- **Increase informal workers’ access to occupational skills training.** Informal employment is

frequently periodic, part time, low wage, and low skilled. Workforce development programs and staff should be better informed about informal workers and take steps to reach those workers, provide them with labor market information, and help them access and pay for occupational training. Skills training could help low-skilled workers qualify for better jobs but often requires them to reduce their employment while participating.

- **Expand child care support for low-income part-time working parents.** Many voluntary part-time workers, particularly mothers, could be helped to move to full-time work with more subsidized child care and an improved supply of appropriate child care (e.g., for infants, before/after school, summer). Provision of child care could make it easier for workers in the informal sector and those in nonstandard work to move into regular, full-time formal employment.
- **Modify some immigrant worker provisions to acknowledge their role in the economy.** Immigration reform could bring more immigrants into the formal sector. If immigration provisions are modified to allow more individuals currently working informally to move into a status that eventually allows them to work legally in the United States, some portion may move to formal standard employment.
- **Establish policies that would reduce or eliminate delinquent child support payments for low-income individuals who make regular current payments for a given period.** Allowances should be made for those who become involuntarily unemployed.
- **Change some tax provisions to encourage formal employment.** Individuals formalize if they file income tax returns.
  - Expand the EITC to offset the payroll tax for lower-income workers. This change would reverse the disincentives that exist for some workers, particularly those without dependent children, and would have the added benefit of increasing the individual's countable Social Security quarters.
  - Encourage more informal workers to report as self-employed by a) increasing the self-employment tax deduction for low-income filers to encourage more contract and informal workers to file income tax returns as self-employed; and b) expanding the unemployment insurance program's coverage to include the self-employed or provide them with unemployment assistance under certain circumstances if they pay taxes.

- Encourage firms and employers to use standard rather than nonstandard work arrangements by revising how the IRS classifies low-paid workers as independent contractors and self-employed; revisions would provide incentives for some firms that now hire contract or temporary workers to convert them into standard wage and salary employees (Bassi and McMurrer 1997, 57–59). Business tax credits for employers who convert non-standard workers to standard workers might be one option.

In summary, some policy changes could change the incentives and disincentives and facilitate a shift from the informal to the formal sector and from nonstandard to standard work arrangements. In doing so, more workers could benefit from worker security and tax incentive policies initially designed primarily for formal employment. And more self-employed workers now outside the tax system (and therefore informal) could be brought into the formal sector.

## Note

1. Many analysts speak about the “informal sector” or of “informal jobs,” and the discussions can be from the perspective of employers or of workers (Lee, McCann, and Messenger 2007). In this brief, our unit of analysis is workers or jobs rather than employers.

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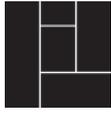
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