

Informality and Work Status
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ABSTRACT

This paper is prepared as a contribution to the UNU-WIDER Project on “Transforming Informal Work and Livelihoods”. The paper is divided into three main sections: what we mean by informality and work status; why we should differentiate between work statuses; and what we can learn by analyzing work statuses and transitions between them.

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I. Informality and Work Status: What Do We Mean?

A. Informality and its components

For purposes of this chapter, *informality* is conceptualized as a general notion. It can be thought of as a job-based concept or an enterprise-based concept (ILO, 2019). The term “informality” as I use it in this chapter is a catch-all comprising informal economy, informal sector, informal employment, and formality/informality status.

I am not alone in bemoaning the lack of terminological precision. Guha-Khasnobis, Kanbur, and Ostrom, 2006, pp. 2-3):

Given the prominence of the formal-informal dichotomy in the development discourse, one might expect to see a clear definition of the concepts, consistently applied across the whole range of theoretical, empirical, and policy analyses. We find no such thing. Instead, it turns out that formal and informal are better thought of as metaphors that conjure up a mental picture of whatever the user has in mind at that particular time.

Still, we can make progress on clarifying a number of ideas.

The WIEGO-ICLS-ILO definition of the *informal economy* (WIEGO: Women in Informal Employment: Globalizing and Organizing; ICLS: International Conference of Labor Statisticians; ILO: International Labor Organization) is “the diversified set of economic activities, enterprises, jobs, and workers that are not regulated or protected by the state.” (WIEGO, 2020)

A separate concept is *informal sector*. The informal sector is defined as “units or enterprises that are not registered in the statistical or tax institutions and do not keep written accounts.” (Herrera et al, 2012). Because the WIDER informality project has adopted a job-based concept of informality rather than an enterprise-based one, the term “informal sector” will be used only in passing in this chapter.

A third concept is *informal employment*. Informal employment is of two kinds (ILO, 2018):

- (1) Self-employment in informal enterprises (small unregistered or unincorporated enterprises) including: employers, own account operators and unpaid family workers in informal enterprises; and
- (2) Paid employment (or what, in this chapter, is called wage-employment) in informal jobs (for informal enterprises, formal enterprises, households, or no fixed employer) including: casual or day laborers, industrial outworkers, unregistered or undeclared workers, contract workers and unprotected temporary and part-time workers.

Accordingly, the “Transforming Informal Work and Livelihoods” project formulates *informal employment* as a job-based concept comprising ‘all remunerative work (i.e. both self-employment and wage employment), that is not registered, regulated or protected by existing legal or regulatory frameworks, as well as non-remunerative work undertaken in an income-producing enterprise’ (ILO 2019).”

To illustrate the importance of choosing the precise notion of informality, take the case of India. There, the terms “organized and unorganized sector” are used in place of the more common “formal and informal sector”. Data show that half of the people working in formal sector entities in India (including firms, government office, and the like) are themselves employed informally in the sense of not being registered with the government or receiving the protections that others in the same workplaces receive (NCEUS, 2009).

The WIDER project is concerned with informal employment. Although many of the informally-employed are in the informal sector, many others are in the formal sector. Conversely, many but not all of the formally-employed are in the formal sector; some are formally-employed in the informal sector. Since our concern is with people working informally, we should focus on informal employment, recognizing that not all of it is in the informal sector.

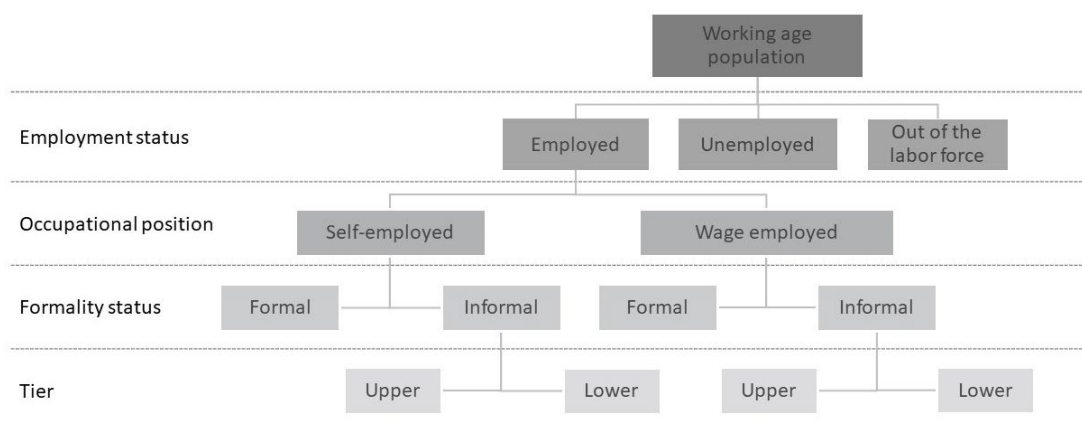
Data from the ILO (2018) and WIEGO (Bonnet, Vanek, and Chen, 2019) show that two billion of the world’s employed population aged 15 and over work informally. This represents 61.2% of global employment. Regions with above-average rates of informal employment are Africa (85.8%), Asia and the Pacific (68.2%), and the Arab States (68.6%).

B. Work status

The UNU-WIDER Informality Project uses the term *work status* to denote the kind of employment in which a worker is engaged. This project adopts a multi-faceted categorization scheme, not just a single classifying variable. Four variables – employment status, occupational position, formality status, and upper/lower tier – are used to determine work status. Each is defined below in Section II.

As examples, the chapters by Danquah, Schotte, and Sen (2019) for four African countries and by Gindling et al for Costa Rica and Nicaragua adopt the following schema:

Figure 1: A Six-Way Work Status Classification



Using these variables, the result is a six-category work status variable:

1. Formal self-employed
2. Formal wage-employed
3. Upper-tier informal self-employed
4. Lower-tier informal self-employed
5. Upper-tier informal wage-employed
6. Lower-tier informal wage-employed

The remainder of this chapter discusses how these work statuses might fruitfully be used.

II. Differentiating Between the Work Statuses

A. The limitations of employment vs. unemployment

The usual starting points for assessing an individual's labor market status are whether that individual is *in the labor force or not* and whether that individual is *employed* or not. An individual is defined as being *in the labor force* if he or she is working or looking for work. Individuals who are neither working nor looking for work are defined as being *out of the labor force*. This project focuses on individuals who are in the labor force.

For the labor market as a whole, the first measure reported by statistical offices and used by many analysts to indicate the goodness or badness of labor market conditions is the *unemployment rate*. The unemployment rate is the number unemployed taken as a percentage of the labor force (Note: not the working age population). At the time of this writing, the unemployment rate tells a terrible story: in recent months, countries throughout the world experienced unemployment rates not seen since the Great Depression, from which they are only slowly recovering.

The unemployment rate, as important as it is, is not the whole story. The reason becomes clear once one understands the definition of employment. By ILO guidance and standard international statistical conventions, an individual is counted as employed if he/she worked one hour or more for pay or fifteen hours or more not for pay in the reference week covered by the survey. Thus, only some of "the employed" are fully and gainfully employed. Others of "the employed" work less than full time, work fewer hours than they want to work, and/or earn so little per hour that despite working a standard work week or more, they do not earn enough to be able to achieve an adequate standard of living. Thus, countries around the world including the developing countries face an *employment problem* consisting of unemployment plus inadequate quality of employment as gauged by the preceding indicators. The ILO reckons that the number of working poor in the world is far greater than the number of unemployed: 700 million working poor in 2018 compared to 173 million unemployed (ILO, 2019). (Figures since the start of the COVID pandemic were not available on the ILO website as of 7/7/2020.)

A finer categorization of work statuses than employed versus unemployed provides the kind of fine-grained picture needed to analyze the employment problem that countries throughout the world now face. This categorization is developed in the next section.

B. Key distinctions among work statuses

As already noted, the Informal Work and Livelihoods project defines work status categories according to employment status, occupational position, formality status, and tier. They are distinguished as follows.

The project classifies workers according to *occupational position*, separating the wage-employed from the self-employed. It is important to do this because i) wage employees experience an employer-employee relationship, which the self-employed do not, and ii) policy interventions that might be suited for one of these groups are inapplicable to others. For example, maximum hours and minimum wage legislation can perhaps be enacted for wage-employees but they cannot be applied to the self-employed. If I am self-employed, how can the government order me to pay myself a specified minimum amount?

Formality status – whether formally or informally employed – matters most importantly for understanding which work statuses have more social protections than others. In the past, definitions and measurements varied widely across countries (Charmes, 2009). More recently, though, attempts at standardization have been made (ILO, 2019, pp. 10-12). Still, most country studies operationalize the informality variable using what is available in the country's household surveys. Examples in the literature are whether the worker has a work card in Brazil, whether the worker is registered with the social security system in Mexico, and whether the job provides for pension benefits in Argentina. Following this lead, the country studies in this project use country-specific definitions.

It should be noted that formality status and occupational position are two different things. Formal does not equal wage-employed, nor does informal equal self-employed, as has been done in some previous research (e.g., Kucera and Roncolato, 2008). Those of us who write about these things need to be careful to clarify which of them we are talking about.

Upper-tier informality vs. lower tier informality:

A third key distinction is the division within informality between *upper-tier and lower-tier informal employment*. Early work in the 1970s and 1980s conceived of informal work as essentially a free-entry option at the bottom end of the employment distribution; examples are the four ILO country reports evaluated by Thorbecke (1973), the books by Turnham (1971) and Squire (1981), and the theoretical model by Fields (1975). Later research, however, distinguished a second category of informal employment: informal work that required human capital and/or financial capital and could not be entered freely (Fields, 1990). I therefore advocated for the essential duality of informal employment along free-entry/restricted-entry lines. For a more recent review along similar lines, see Kanbur (2017).

C. Underlying labor market models

Today, the bare minimum number of categories for understanding developing country labor markets would be three. For example, a recent theoretical model has three employment states – termed wage employment, free-entry self-employment, and high-wage self-employment – plus unemployment (Basu et al., 2019). Having two types of informal work (or, alternatively, two types of self-employment) is essential to capture the reality that some workers are engaged in informal employment, not because they *have* to be but because they *want* to be.

The most important reason for drawing the distinction between upper- and lower-tier work is where they lie along a job ladder. The job ladder may be based on such factors as labor market earnings, non-

wage benefits, workplace protections and regulations, or some combination of these. Regardless of which components one chooses to focus on, lower-tier work can be thought of as being *below* formal wage employment on the job ladder, while upper-tier informal work may be *above* formal wage employment for some workers (though not all) – for example, those with a particular skill or taste for entrepreneurship or self-employment.

At the very bottom of a typical job ladder is unemployment, i.e., not working at all. Many of those who work informally - the majority, I think – do so because in the countries in which they live, unemployment insurance is limited or non-existent, and consequently being unemployed means having no income. Accordingly, these lower-tier informal workers have been given a variety of names including penniless entrepreneurs (Banerjee and Duflo, 2007), reluctant entrepreneurs (Banerjee and Duflo, 2011), entrepreneurs out of necessity (Poschke, 2013), engaged in informality as a survival strategy (LaPorta and Schleifer, 2014), and a strategy of last resort (Günther and Launov, 2011), among others.

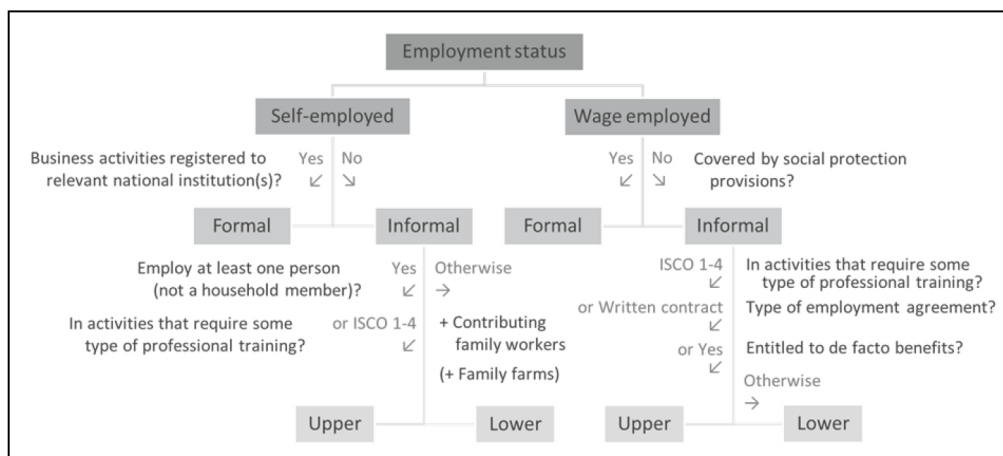
The literature offers two competing views of why people are working informally. The free-choice view is that all workers can choose whether to work formally or not, and the division of workers between formal and informal employment reflects these choices. Reasons for choosing one versus another include comparative advantage, heterogeneous preferences for independent work, the wish by some to avoid payroll taxes and other expensive regulations, among others. The segmented labor market view is that the number of jobs in wage employment is limited relative to the size of the labor force, and so even if all wage employment jobs were to be filled, much of the labor force would be rationed out of such jobs. See Maloney (1999, 2004) and Levy (2008, 2018) for the first view and Fields (2009, 2019b) and Basu (1997) for the second.

Empirical studies support a mix of reasons. Banerjee and Duflo (2011) studied poor workers in eighteen developing countries and found that fully half of the extremely poor in urban areas operate a non-agricultural business. Their interpretation is this: “Perhaps the many businesses of the the poor are less a testimony to their entrepreneurial spirit than a symptom of the dramatic failure of the economies in which they live to provide them with something better.” Another study concludes that two-thirds of self-employment in the developing world as a whole results from individuals having no better alternatives (Margolis, 2014). Another finds an approximately equal split in non-OECD countries (Poschke, 2013). Yet another finds that about half of those working informally in the case of Côte d’Ivoire are doing so by choice and the other half not (Günther and Launov, 2011). A World Bank study of Latin America concludes that the majority of independent workers are informal largely voluntarily, whereas the majority of informal salaried workers appear to be involuntary (Perry et al., 2007). See also the empirical studies reviewed in Basu et al. (2019).

D. Classifying workers into work statuses

The authors of the country studies for the Informality Project were given discretion on how to make use of the preceding variables to devise their own work status categories. The following is a flow chart displaying how Danquah, Schotte, and Sen used occupational position, formality status, and tier to assign individuals to work statuses. A textual presentation may be found on pages 6 and 7 of their paper.

Figure 2: Rules for Assigning Workers in Ghana, South Africa, Tanzania, and Uganda to Work Statuses



Source: Danquah, Schotte, and Sen (2019)

Let us turn now to some of the lessons learned by analyzing work statuses.

III. Analysis of Work Statuses

A. Learning from a single cross section

In a typical labor market study, we know the percentages of workers in each work status. Knowledge of these so-called “state probabilities” provides an essential snapshot of the kinds of work people are doing at a point in time. We learn, for example, that most developing country workers are self-employed rather than wage employed, that the percentage working in agriculture is much higher than the percentage working in services or manufacturing, and that the percentage working informally is much higher than the percentage working formally (Fields, 2012, 2019b; ILO, 2018). Note, though, that these patterns differ by region of the world, which links closely to per capita GDP; differences between i) East Asia, ii) Latin America, and iii) sub-Saharan Africa and South Asia can be understood accordingly (Gindling and Newhouse, 2014; Merotto et al., 2018).

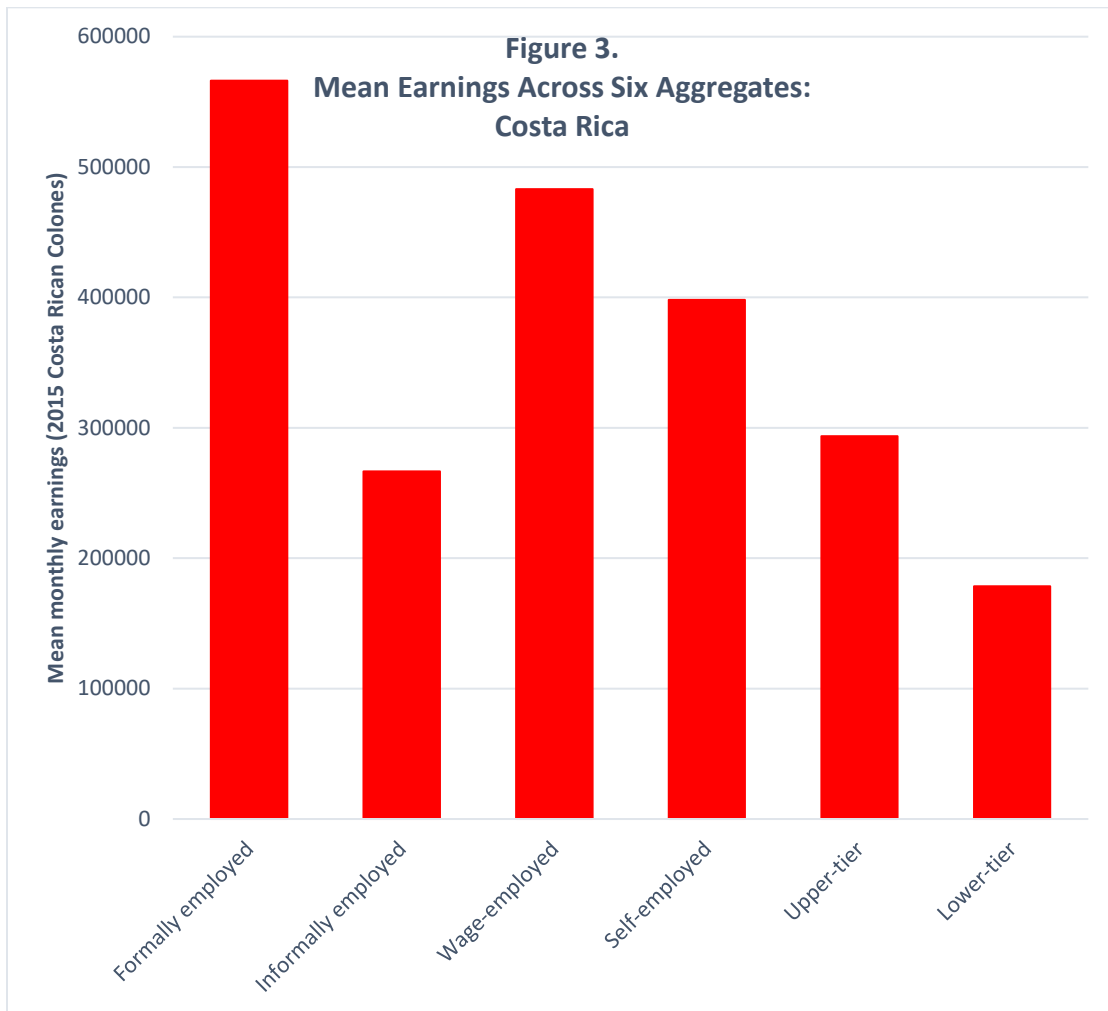
Of course, some job categories are better on average than others across a variety of measures: among them, earnings, social protection, and stability of employment. A single cross section for a given country can tell us which categories are the better ones. Note that different measures may give different rankings: for example, the same individual working in the public sector may enjoy greater job security though lower pay than she might have obtained in the private sector. Revealed preference suggests that such rankings vary across individuals within the same country.

Taking Costa Rica as a case study and focusing on labor market earnings, let us look at six aggregate groups:

1. Formally employed, regardless of occupational position and tier
2. Informally employed, regardless of occupational position and tier
3. Wage-employed, regardless formality status and tier
4. Self-employed, regardless of formality status and tier
5. Upper-tier informal workers, regardless of occupational position
6. Lower-tier informal workers, regardless of occupational position

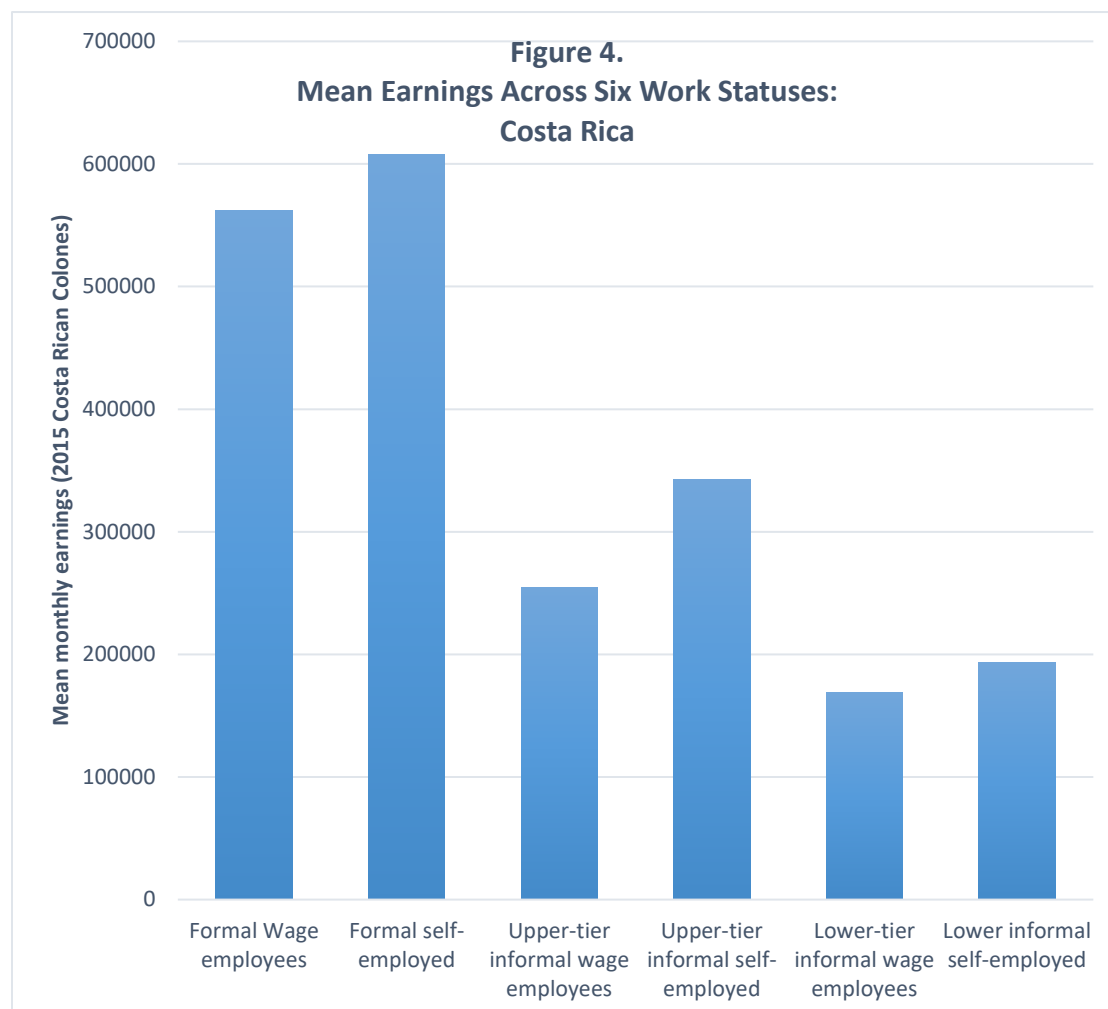
Comparing these aggregates, we see the following in Figure 3:

- Formally-employed workers earn more than informally employed workers
- Wage employees earn more on average than the self-employed.
- Upper-tier informal workers earn more than lower-tier informal workers.



Source: Special tabulation provided by T. H. Gindling, Catherine Mata and Diego Rojas.

Then, using a six-way work status scheme similar to the previous one for Africa but different in some specifics, the Costa Rica study reveals that the highest-earning category is the formal *self-employed* and the lowest-earning category is the lower-tier informal *wage employees*:



Source: Special tabulation provided by T. H. Gindling, Catherine Mata and Diego Rojas.

This fine-grained pattern would not have been found if just the aggregates in Figure 3 had been used instead.

In addition to the question just asked and answered – which of the six work statuses pay more on average than others? – we could also examine other questions at a point in time. For example: How many workers are found in each of the six work statuses? Which personal characteristics are associated with employment in the different work statuses? Apart from cash earnings, how do the different work statuses compare in terms of non-wage benefits? As others' chapters come in, it will be interesting to see what answers they are able to provide at such a level of disaggregation.

B. Analyzing comparable cross sections

Moving from single cross-sections to comparable cross-sections, we can learn how the cross-sectional picture is changing over time. The results of a previous WIDER research study (Cruces, Fields, Jaume, and Viollaz, 2017) are revealing. Studies were conducted for each of sixteen Latin America countries (Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Honduras, Mexico, Panama, Paraguay, Peru, El Salvador, Uruguay, and Venezuela) along with cross-country analysis. We found remarkable progress in all three aspects of the growth-employment-poverty nexus across the Latin American region:

Growth: All sixteen countries achieved positive rates of annual growth of real GDP per capita during the 2000s, ranging from 1% a year in Mexico to 5.6% a year in Panama and Peru. The regional average for the sixteen countries was just under 3%, well above the annualized rate of growth of GDP per capita in OECD countries, which was 1.0% a year.

Labor market indicators: A number of traditional labor market indicators were used including the unemployment rate, mean earnings, the occupational mix of employment, the distribution of employment by occupational position, the sectoral breakdown of employment, workers' educational attainments, and the percentage of workers registered with the national social security system. The rate of improvement in labor market indicators was exceptional. All 16 of the labor market indicators improved in Bolivia, Brazil and Peru, 15 of the 16 improved in Panama, and the majority of the labor market indicators improved in all of the other countries studied except for one (Honduras).

Poverty rates: Using the 4 and 2.5 dollars-a-day poverty lines ('poverty' and 'extreme poverty'), we found reduced rates of poverty and extreme poverty in fifteen of the sixteen countries. On average, extreme poverty fell 45% while poverty declined 37%. Only one Latin American country registered an increase in its rate of poverty.

In short, the 2000s were a time of strong improvement in the growth-employment-poverty nexus in the great majority of Latin American countries. It is precisely evidence like this that leads me to conclude that economic growth of the right type is indispensable to improving labor market conditions and thereby reducing poverty.

As the reader will have noticed, these results are for the traditional labor market aggregates. It would be interesting to see what else could be learned by examining changes in employment and earnings for the six work statuses analyzed in this project, not only for Latin America but in other regions as well.

C. Examining transitions and changes using panel data

Panel data analysis gives us a basis for making statements about labor market transitions that are not warranted when using comparable cross sections. Suppose we were to find in comparable cross sections that the number of people in wage-employment in a country increased from 100,000 to 150,000. We *can* say that 50,000 more people were working in wage-employment in the later year than before. However, we *cannot* and *should not* say that 50,000 of the self-employed found wage-employment. The first is a statement about comparable cross-sections, the second a statement about panel data changes. It may have been, for example, that over time 70,000 of the self-employed moved into wage-employment and 20,000 of the wage-employed moved out into self-employment, producing a net increase in wage-employment of 50,000. To be able to make statements about gross flows (70,000 moves from self-employment to wage-employment, 20,000 moves from wage-employment to self-employment), we must have panel data.

Such panel changes must be evaluated carefully. Personally, I have no hesitation in judging that the larger is the number of positions in the upper rungs of the job ladder (in the previous example, the increase in wage-employment from 100,000 to 150,000), the better. However, I would not take a position on which is better: 50,000 moving up and no one moving down, versus 70,000 moving up and 20,000 moving down; I see arguments on both sides. For more on upward and downward movement and other mobility concepts, see my chapter (Fields, 2019c) in WIDER's forthcoming social mobility project volume (Iversen, Krishna, and Sen, 2020).

Disaggregation by work status can reveal a granularity that would otherwise have been missed. Recall that the World Bank study *Informality: Exit and Exclusion* cited above concluded that for Latin America the majority of independent workers (what in this project we are calling the self-employed) are informal largely involuntarily, whereas the majority of informal salaried workers (in our terminology, informal wage employees) appear to be involuntary (Perry et al., 2007).

When we are able to make use of panel data, as many (all?) of the country studies in this project do, we can quantify transitions and non-transitions between work statuses in general and the six-way work status variables in particular. Doing this is important for its own sake in understanding the extent of fixity or mobility between these categories, hence the subtitle of the Africa study "Dead End or Steppingstone?" Very recent papers by Danquah, Schotte, and Sen (2019) and Raj, Schotte, and Sen (2020) study transitions between the six work statuses. We will learn a great deal more from the Informality project country studies now in preparation.

Another reason to analyze transitions between work statuses is to help explain the observed panel data changes in labor earnings and other economic magnitudes. These changes enable us to perform what I regard as the most important kind of mobility analysis: the study of directional income movements. (Directional income movements are the increases or decreases in dollars, log-dollars, or some other measure of economic well-being.) From past research, we know that *change* in work status is an important determinant – and often the most important determinant – of the *change* in economic well-being of a worker and his/her family; see, for example, Fields et al. (2002) for a study of Indonesia, South Africa, Spain, and Venezuela.

Knowing the magnitudes of transitions and non-transitions can provide insights into policy questions, to which we now turn.

D. Thinking about policy questions

"For every problem, there is a solution that is simple, neat – and wrong."
Variously attributed to Mark Twain, H.L. Mencken, Peter Drucker, and others.

Much of our work is policy-relevant, including the papers being prepared for this project. However, we need to be careful: few if any "policy implications" are going to jump out at us.

First, if we ruminate about the preceding quotation, what is the problem we are trying to solve? Is it informality? Unemployment? Low labor market earnings? Poverty? Something else? I will assert that the overarching problem in the developing world is poverty, and that informality is of interest, because the informally employed are the lowest earners and therefore the most likely to be poor.

The data described above in the preceding sub-sections – from single cross sections, comparable cross sections, and panel data analysis – are indispensable in thinking about policy. It would surely be helpful to know the distributions of employment by work status, marginal percentages, earnings ladders, work status transition matrices, earnings change data, tabulations and regressions involving personal characteristics, and much more.

I would also suggest an additional approach to data: asking working people. Look at these workers (from Fields, 2012):



We can ask them questions like these:

- Have you registered your backyard auto mechanic shop with the government so that you can receive social security benefits? Why or why not?
- How much do you earn as a bicycle rickshaw driver? What could be done to enable you to earn more in this kind of work?
- Why are you earning your livelihood making and selling Zulu shields? Could you have been working in wage employment instead?
- Are you able to move out of this work? Why or why not?

Now, let's think about policy choices. Here are two different policy syllogisms.

First:

- We want to help the poor.
- The poor work mainly on family farms and in family businesses.
- Therefore, we should invest our development resources in improving incomes where the poor are, on family farms and in family businesses.

And second:

- We want to help the poor.
- The poor will remain poor as long as they remain in poor work statuses.
- Family farms and family businesses pay poorly relative to wage employment, particularly when the wage employment is in enterprises registered with the government.
- Therefore, we should invest our development resources in creating new wage employment in registered enterprises so that the poor can move to the parts of the economy where earnings and social protections are higher.

These two arguments lead to precisely *opposite* conclusions. According to the first, the available resources should be used on family farms and family businesses. According to the second, the available resources should be used to create new wage employment in registered enterprises so that the poor can get *out* of family farms and family businesses.

What should be done with the available resources? Just the first? Just the second? Splitting the available resources and doing some of each? Something entirely different, like formalizing the informal or investing in education and skills development?

The simple answer is that *none* of these is *necessarily* the right policy choice. Policy recommendations need to be founded on a sounder basis such as social cost-benefit analysis. We owe it to people like those pictured to try.

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