The Informal Economy in Rural Community Economic Development

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Introduction

This paper is about broadening our concept, as rural development practitioners and policy makers, of what the rural economy is and how people survive in it. It examines how what we do as rural development practitioners and policy makers to improve the quality of life of those in need might be different if we look first beyond the formal economy to the informal economy, and finally to the rural economy as a whole. This exploration is an attempt to think “out-of-the-box” and thus generate new, more powerful, solutions to persistent underdevelopment in rural communities.

What is the Difference Between the Formal and the Informal Economy?

The formal economy, or simply “the economy” as most of us refer to it, is that portion of natural, human, manufactured, and entrepreneurial capital used to meet our wants that we actually count. Measures like the rate of unemployment, the Gross National Product, the rate of inflation, the Producer Price Index, the rate of housing starts, etc. help us keep track of what is happening in the formal economy.

There is, of course, much economic activity we do not count.¹ The majority of this activity is considered to be informal and/or criminal in nature. This paper addresses the full range of non-criminal economic activity that we do not count, which includes self-provisioning, caring work, barter, unreported business transactions, sharing, and volunteer activity. The informal economy is often thought of as a kind of “safety net” for people who do not find a place for themselves in the formal economy. Research findings summarized in this paper dispute that characterization and raise deeper questions about how economic benefits are distributed.²

What is the Informal Economy?

The informal economy, known variously as invisible, shadow, secondary, underground, clandestine, undeclared, unreported, black, irregular, submerged, subterranean, etc. includes everything from household production and consumption (sometimes called self-provisioning) of goods and services (paid and unpaid) to interhousehold barter, sharing, volunteer work, subsistence production, unpaid labor and labor exchanges, unreported business transactions, and care giving to young and old. The informal economy is a part of everyday life and household survival strategies in rural (and urban) America, yet its contribution to well-being remains poorly understood and largely ignored by both practitioners and policy makers.

What is and is not part of the informal economy changes, depending on location, time frame, and social context.

Informality...is not an inherent property of specific activities (e.g. homeworking, window cleaning). Instead, whether an activity is informal or not is a social construction (Portes 1994) and all goods and services can be produced and distributed either formally or informally (Williams and Windebank 1998).

Increasingly, social scientists recognize formal and informal economies as complementary parts of a single system.

Within any given location, time period, and social context, any “economic activity which is not recorded in official statistics and which operates in the absence of administrative monitoring and control” (Leonard 1998) shall, for the purposes of this paper, be considered informal. It is important to note some portions of the informal economy are illegal by virtue of being unreported, while others are inherently criminal (e.g. drug dealing, money laundering, etc). This paper does not address the criminal economy, but limits itself to those activities which would otherwise be legal except for the fact that they are undeclared or unreported as well as all perfectly legal but informal economic activities.

Why Does the Informal Economy Matter?

It’s Big and We Couldn’t Sustain the Formal Economy Without It

While estimates of the size of the informal economy vary depending on how it is defined and how it is measured, they range from 28% of Gross National Product (Feige 1979), to 37-51% of the market economy (Murphy 1982), to
between $500 billion and $1 trillion in 1993 (Feige 1997).\(^3\) Bureau of Economic Analysis figures that include transfer payments, in-kind contributions, and noncash income, typically report personal incomes ranging from 10 to 25 percent higher than census data (Speer 1995). One researcher reported $90 billion in unreported taxable income from legal small scale enterprises and $10 billion from large corporations in 1981 (Witte 1981). Another reported household labor to be valued at one third of Gross National Product and one half of total disposable income (Burns 1977). A third researcher found that Americans failed to report $630 billion in adjusted gross income in 1995 which is 13.1 percent of total adjusted gross income, an increase of two percent since 1988. (Bartlett, 1998).

In many ways, the formal economy that we measure, see, and attempt to manipulate, is just the tip of the economic iceberg. Money and money-equivalents, ‘in-kind’ values, cannot accurately measure wealth or income in a money-poor but barter-and-borrow rich environment. Until a method is devised that can render subsistence-barter-and-borrow systems quantitatively comparable to the money system, there is little ability to estimate the real income or wealth of a state like West Virginia, even at the present day (Salstrom 1997).

There is no question, however, that the informal economy is large and that it forms an important piece of what keeps families alive and thriving and capable of participating in the formal economy as the need and opportunity arise (Nelson and Smith 1999).

So, if we want to take all our resources into account and look anew at all our development options, we need to broaden our perspective to include the informal economy.\(^4\)

**Our Formal Economy Numbers Don’t Tell Us Everything We Need to Know**

One of the trends of the last two-thirds of the twentieth century has been a growing reliance on economic statistics to define our collective sense of well-being. When the gross national product is rising at a reasonable rate, the unemployment rate is down, the rate of inflation is steady, productivity is up, we tell ourselves all is well. When any or all of these statistics turn sour, we become collectively uneasy. We’ve also come to believe that we can, in part, control our economic environment through policies aimed at affecting these numbers. Inflation too high? Raise interest rates. Unemployment too high? Lower interest rates. Without addressing the myriad complexities of macroeconomic decision-making, suffice it to say that the entire discipline, and the actions that stem from it, rely on collection and interpretation of economic data. The data we collect has come to define the economy for us and the economy, in turn, is defined by the data we collect.

The goals of the economy we have created in this way have been full employment, low inflation, and continuous growth measured through an ever increasing Gross National Product. Achievement of these goals has been largely equated with well-being and progress. We, particularly those of us in industrialized countries, have believed (more or less) in the achievability of these goals. Within the last twenty years or so, however, some have begun to question both the goals themselves and the extent to which they may ever be achieved, either domestically or worldwide.

It has often been pointed out, for example, that our measure of Gross National Product includes both “goods” and “bads”—production of goods and services that improve our quality of life (education, preventive health care, housing rehabilitation), and production of goods and services that arguably do not (prisons, locks, housing construction that produces sprawl, health care for environmentally caused illnesses). Failure to distinguish the “goods” from the “bads” leaves us vulnerable to poor decision-making when it comes to maximizing well-being through economic interventions.\(^5\)

The importance of environmental values and externalities that exist outside the formal economy have become increasingly clear. Environmental values are the non-monetized goods and services we receive from nature that allow us to breathe, eat, recycle waste, and sustain life on this planet. Many of these goods and services are irreplaceable at any price, while we are just beginning to measure the value of those we believe we could replace if we had to. Robert Costanza and a number of colleagues estimated...
the value of the entire biosphere (most of which is outside the market) at US $16-54 trillion per year with an average of US $33 trillion per year. Global gross national product is around US $18 trillion a year. ⁶

Externalities are the costs and benefits derived from economic production and consumption that are not captured in market prices. For example, if a company produces hazardous waste as a byproduct of its manufacturing process and that waste is disposed of at little or no cost to the company, the cost of the impacts of the waste on society (ground water contamination, health problems, etc.) are not factored into the cost of the product. The artificially low product price induces excessive demand which, in turn, leads to further environmental degradation that remains unaccounted for. Lack of complete information results in poor decision-making that undermines collective well-being. Recognition of both environmental values and externalities is slowly but inexorably leading us to redefine our notions of economy. ⁷

When we cease to use money as our only ruler, we begin to realize that we live in a world of two economies, not just one. One is the formal marketplace measured by—and consisting mainly of—monetary transactions. This is the realm of supermarkets and shopping centers, offices and factories that the media calls the economy. The other economy is the informal networks of helping in families, neighborhoods, volunteer groups, and the like. What we call growth is often merely the transfer of a function from the informal to the formal economy, from an invisible pocket to a visible one. There is no net gain in output and often there is a loss in social cohesion and well-being (Cahn and Rowe 1996).

For example, in writing about the professionalization of caring, Deborah Stone observes:

When care is recast as an economic and bureaucratic good, deep norms about altruism, generosity, and cooperation are reshaped as well...When people care in a public context as employees of an agency and, in effect, as agents of insurance companies or Medicare and Medicaid, they are made to feel that their personal relationships with clients are illegitimate—something to be hidden, kept in check, restrained, best left unspoken...They talk about caring and their care giving work almost as if they were engaging in civil disobedience (Stone 1999).

The importance of social factors and relations on individuals' economic behavior has been traditionally ignored in conventional economics. The relationships between community members engaged in these (informal) exchanges are qualitatively different from the relationships between labourers and employers/customers. This applies even when money forms the basis of the exchange (Leonard, 1998).

The Formal Economy Alone Can't Meet All Our Needs

The tunnel vision that has resulted from our romance with economic statistics applies equally to the informal economy. Over the past twenty years or so, researchers have increasingly begun to question the assumptions of the formal economy and to inquire as to what role the informal economy may play in our present and future collective well-being. In part, this questioning began with a realization that the underlying assumptions of the formal economy—i.e. it is the only economy that matters and progress will result from incorporation of all resources into the formal economic structure—did not accord with reality. Contrary to the beliefs of formal economists, the world has not evolved in a straight line from an informal, exchange-based economy to a formal, market-based economy, nor is it at all apparent it will do so in the future. The informal economy is alive and well even in advanced industrial countries such as the United States, Great Britain, Germany, Canada, etc. (Sassen-Koob 1989, Standing 1989, Offe and Heinze 1992, Fortin et al. 1996, and others). Furthermore, the formal economy, by failing to achieve and sustain either full employment or comprehensive welfare provisions, has not lived up to our collective expectations for increased well-being.
For many years informal employment, although its existence was not denied, was assumed to be in decline and/or of little relevance for understanding and interpreting advanced economies and their prospects. Instead, an assumption prevailed that informal employment was a mere leftover from a previous era of production. Work and welfare would become increasingly formalized and result in an end-state of full-employment and comprehensive and universal formal welfare provision. However, the history of the past twenty years in advanced economies and beyond has taught us that such an assumption can no longer be accepted. Rather, a far-reaching restructuring of work and welfare has brought starkly into question the inevitability of continuing formalization and thus that full employment coupled with comprehensive welfare provision is the natural end-state of our development pathway (Williams and Windebank 1998 p.5).

The mass entry of married women into the formal labour market, growing levels of unemployment and the internationalization of the division of labour have created major difficulties for the welfare state programmes developed by many western industrialized countries. In attempting to deal with these crises, states have tried to dismantle, reduce or decline to implement welfare strategies and in the process opened up opportunities for informal economic activities. The crisis in welfare state policy and provision has coincided with a crisis in mass production. The long-term trend towards centralization has been stopped in its tracks by a newly emerging trend in the opposite direction. It is within this counter trend toward decentralization and flexibility that informal economic activity emerges as a central feature of the economic structures of most industrial societies as they approach the new millennium (Leonard 1998).

Attempting to make a hard and fast distinction between formal and informal employment risks distorting the accuracy of our view of the economy still further.

The formal/informal distinction was a valuable but somewhat crude first step in the attempt to come to grips with what is basically a form of individual adaptation to constrictions in economic life and well-being brought about by global and national economic forces and institutions. To speak of ‘informal personnel’ is to obscure the existence and activities of the ‘moonlighter’ or ‘Sunday person’ who is formally employed during normal business hours, throughout some, if not all, of the regular work week. And to speak of ‘informal activities’ denies the fact that virtually identical products may be sold or services performed by both formal and informal enterprises (Smith 1990).

To define informal employment solely as a marginal activity of the poor and excluded would be to do an injustice to the large number of informal workers who earn about the average formal wage and for the considerable number of formal employees who earn less than the average informal wage (Williams and Windebank 1998).

Economic activity should be defined in relation to its contribution to the production of goods and services for the satisfaction of human needs regardless of whether this production is channeled through the market or through the household. By treating household work and wage labour as separate issues, the full range of household economic strategies has been blurred and the continued importance of work which takes place outside formal employment has been undermined (Leonard 1998).

We have begun to recognize that the formal economy does not hold all the answers to sustainable well-being. At the same time, we have begun to understand something of the complex interplay between formal and informal economic activity which suggests that the informal economy will always be with us.
...The informal economy is an integral feature of the formal economy. As a vital component of the formal economy, the nature of informal economic activity changes and responds to transformations in the formal economy (Leonard 1998).

The Difference Between Growth and Development

The difference between growth and development has also been widely recognized. Growth implies a trajectory that will yield more of what you started with over time. Development implies a complex process through which the quality of life improves as judged by those who live it. Growth can be measured in a centralized data collection system—development, since it is in the eye of the participant, cannot. Increasingly, we are coming to realize that what our formal economy counts may not be all that “counts” for us. The goal of rural development is not necessarily growth, but rather what Robert Chambers, international rural development expert, refers to as “sustainable livelihood security.” He elaborates:

The many priorities and criteria of well-being of poor people vary from person to person, from place to place, and from time to time. Health is often, if not always, one. In addition, a common and almost universal priority expressed is an adequate, secure, and decent livelihood. Livelihood here can be defined to include a level of wealth and of stocks and flow of food and cash which provide for physical and social well-being. This includes security against sickness, against early death, and against becoming poorer. It includes, thus, secure command over assets as well as income, and good chances of survival...A phrase to summarize all this is sustainable livelihood security (Chambers 1994).

What Role Has the Informal Economy in Sustainable Livelihood Security?

The following section summarizes what we know of the informal economy based on the last several decades of research. We examine who participates, how the informal economy is accessed, barriers to participation, and the interrelationship of the formal and informal economy from both a structural and experiential perspective.

Who participates?

Many of us falsely assume the informal economy is peopled by those who lack access to the formal economy. This is not the case.

There is a general consensus among researchers into informal economic activity in most European countries and North American states that the unemployed are unlikely to participate in the informal economy. This is because of a variety of factors including the level of opportunities available, the extent to which informal employment is monitored by the state and other official agencies, the penalties for engaging in informal employment while officially classified as unemployed and the level and extent of welfare provision in different countries...The general concurrence among these studies is that the unemployed are less likely than the employed to engage in informal employment due to lack of skills, transport and capital and lack of opportunities due to the probability of living in poor localities where employment opportunities either formal or informal are likely to be minimal (Leonard 1998).

In fact, participation in the informal economy cuts across all income levels (Jensen, Cornwell, Findeis, 1995), and individuals frequently work both formally and informally (Williams and Windebank, 1998). For example, Eyler (1989) found that in an era of corporate downsizing and transnational capital flight, some white collar and management workers in the US turn to moonlighting as a way of experimenting with second careers or acquiring new skills and contacts in case these were needed due to the possibility of losing their full-time jobs (Leonard 1998).

What are the benefits?

The informal economy provides participants with a variety of benefits, which may include monetary income, goods and services, social satisfaction, and cultural connection. In
addition, the informal economy acts as an alternative distribution network in which those who do not have money to buy goods and services nevertheless are able to access at least some of what they need for both production and consumption.

The benefits of the informal economy are, like the economy itself, defined by context. For example, Kathleen McInnis-Dittrich studied 23 low income Appalachian women to determine their patterns of participation in the informal economy. All the women had participated in the informal economy both 12 months before the study and during it. The women earned about half their income from otherwise legal but unregulated activities such as housework, child or elder care, yard sales, recycling, or work in the tobacco fields. On average they earned $168 a month for 90 hours of work or $1.87 an hour. This money was essential to the survival of these women and their families. Opportunities for higher paying off-the-books work at sawmills, farms, etc. went to men.

The other half of the total income earned by these women was generated by fewer than 25% of them through illegal activities including prostitution, bootlegging, growing and selling marijuana, or selling stolen property. Women who earned money illegally rarely saw the money they earned (McInnis–Dittrich, 1995).

In contrast, when analyzing a mixed income sample of households, the Massachusetts Cooperative Extension Service estimated the average annual economic value of household-produced goods and services, including such things as food and meal preparation, laundry, home repairs and maintenance, child care, sewing, transporting, etc., at $22,776 per family per year. (University of Massachusetts 1984).

Other researchers have emphasized the non-material benefits of the informal economy. Participation in the subsistence lifestyle has payoffs beyond the physical needs it satisfies. In addition to serving critical roles in both supplementing income and providing a source of support during periods when monetary income becomes scarce or nonexistent, subsistence activities contribute to overall social well-being through a variety of social, cultural, and psychological functions (Glass, Muth, Flewelling 1989).

If the formal economy confers status and wages, the informal economy confers livelihood security and a community-based identity. Describing the informal economy in central Appalachia, Joseph Matvey notes:

The continuance of domestic production constitutes one alternative in that such practices enable families to close the gap between wages and human needs and wants...The retention of home production practices is not merely a tradition but an innovative ethic of a people who confront daily the force of structural currents impacting upon their region in underdevelopment...They are not purely economic functions nor are they always perceived as such, but material practices which act as a vehicle for social expression, cultural identity, heritage and the reaffirmation of community...Festivals are a crucial expression of sociality and social reinforcement—a reinforcement which centers itself around domestic production (Matvey 1991).

The distributional benefits and function of the informal economy are also significant.

Using household survey data from Detroit, Michigan, the authors argue that although individual exchanges may be small, taken as a whole, the social and irregular economy provide goods and services often unavailable or difficult to obtain in the regular economy. The irregular and social economies also distribute goods produced in the regular economy to local or marginal markets as well as consumes, distributes, and maintains products made in the regular economy (Ferman and Berndt 1981 as summarized in Feldman and Ferretti, 1998).

One of the most influential studies of how social relationships and networks operate to meet economic needs was carried out by Carol Stack (1974). Her research was located in a community experiencing severe economic depression. The economic insecurity experienced by residents was lessened through their extensive kinship and friendship networks which lessened
their dependence on formal sources to meet their daily needs. The most widely practiced strategies involved swapping, trading, and borrowing from one household to another. In this way, the scarce range of goods available in the community could be redistributed throughout a number of households. Services were also ‘swapped.’ Hence residents could trade their limited skills with the limited skills of other community members and in the process gain access to a wider range of services than their internal resources could cover (Leonard, 1998).

Appalachia’s main economic anomaly was that distributive relations remained less monetized there; they remained composed more of bartering and borrowing (Salstrom 1997).

Who gains access and how?

Research consistently emphasizes the role of social networks in gaining access to the informal economy. In some instances, these networks are primarily kinship-based. For example:

Morris and Irwin (1992) focused on the levels of support among four types of households: couples in which the man was securely employed, couples in which the man was recently recruited to employment, couples in which the man was long-term unemployed, and couples in which the man was out of the labour force...They found the density of support (the number of exchanges) was highest among the long-term unemployed. Much of the support available however depended on kinship rather than friendship ties (Leonard 1998).

Networks are also established among friends and neighbors. In a study of 400 households in deprived neighborhoods of Southampton and Sheffield, England, Colin Williams and Jan Windebank found that,

Everyday life in deprived neighborhoods is characterized by an inability of households to get completed a large number of basic tasks that are necessary to maintain a reasonable quality of life. When households do manage to get these tasks accomplished, some 84.8% are conducted using primarily their own labour or that of friends, neighbors, and relatives, and 82.0% of households would like to engage in more activities for themselves and others (Williams and Windebank 1999).

Networks may also be a byproduct of involvement in the formal economy.

Because the members of good work households were enmeshed in broad networks of social support, they were well positioned to locate good jobs (should they find themselves ‘downsized’) and to carry out self-provisioning and entrepreneurial moonlighting projects (Nelson and Smith 1999).

For example, someone who sews on the side but has a formal job as a dental technician, is able to meet people on a regular basis who may become informal customers. People without formal employment have more limited opportunities to meet potential customers.

By virtue of their location within good job households, they also have access to networks of colleagues and friends who can help them locate other good jobs (Nelson and Smith, 1999).

Once a person becomes established in the formal economy, the likelihood of maintaining access increases by virtue of social networks.

In the informal economy, more so than in the formal economy, the utility of networks to an individual or household hoping for access depends, in large measure, on their capacity to engage in reciprocal exchange relationships.

Lowenthal examines how people with inadequate incomes meet their needs and survive in the context of diminishing resources and declining real wages. Although health care and housing may remain unmet, other needs are met by peoples participation in social networks and mutual aid systems...Economic transactions are embedded in personal networks which structure arrangements for the provision of goods and services. These arrangements operate in a social economy.
through principles of reciprocity and adequacy of response (Lowenthal, 1981).

Writing about Appalachia’s informal economy and the transition to capitalism, Paul Salstrom notes:

Within Appalachia, like elsewhere in the United States, almost all goods and services which were delivered beyond those intimate spheres carried an expectation that the receiver would feel obligated to sooner or later deliver something or equivalent value to the giver. Beyond the boundaries of “family groups” and of charity, in other words, almost no able-bodied people received favors except the people who also rendered them (Salstrom 1997).

The preconditions to establishing reciprocal exchange relationships include control over one’s time, the capacity to plan, and access to assets such as skills and equipment. In a study of rural households in Vermont, Nelson and Smith ask:

What is it about households with a least one good job that enables them to engage in these activities (self-provisioning and nonmonetary household exchange)? The answer is as self-evident as it is paradoxical: Self-provisioning consumes enormous resources before it can even begin to justify its expense (Nelson and Smith 1999).

Similarly, in rural New York, Cornell researchers find,

The rural households with low and modest incomes that we studied all had access to resources they could use for commercial ends, household provisioning, and recreational purposes. None of them can be accounted among the more disadvantaged rural poor (Gillespie, Lyson, Harper 1994).

[In rural Vermont] A set of conditions (e.g. having a second car, being close to grandmother or neighbor who could watch the children for less than market costs, work schedules that permit coordination, and being able to sustain geographical stability) stood behind the capacity of bad job households to allow at least one worker in a dual-earner bad job household to moonlight. The same set of preconditions underlies the propensity of bad job households to maintain a second earner and simultaneously to sustain high rates of self-provisioning (Nelson and Smith 1999).

McInnis-Dittrich identified four patterns of participation in the informal economy among a sample of low income women in Appalachia: the anticipatory pattern, the chronically disorganized pattern, the familial pattern, and the entrepreneurial pattern. Women who fell into the anticipatory pattern were “good turn women” who were respected, well-liked, and considered good people. They would anticipate the need for money by the end of the month and seek work in the informal economy to meet the need. They worked at legal activities and were able to do long-range planning for their limited resources, use a bank, and follow a budget. Thirty percent of the sample fell into this category. Women who were chronically disorganized were persistently unable to plan beyond the moment. They could never commit to a regular source of informal income, such as child care, because they might not be trusted to remember. These women sought income from the informal economy only in reaction to an impending financial disaster. Thirty percent fell into this category. Women living the familial pattern relied on intra-family transfers of money to survive. These women were generally young, passive, and dependent on others including men and family. Seventeen percent fit this pattern. Finally, the entrepreneurial women obtained most of their income from illegal activities. They had learned that, despite the impoverished environment in which they lived, there was money to be made in illegal activities, and they were proactive in pursuing these opportunities. They were younger and more aggressive than many of the other women in the sample and had little interest in legal activities. Most had police records, and all had lifetime experiences of sexual and physical abuse. Twenty-two percent of the sample fell into this category. (McInnis-Dittrich 1995).

McInnis-Dittrich’s work reveals the socio-structural underpinnings of participation in the informal economy. These underpinnings appear to be a composite of family patterns, early
experiences, personality type, and psychological profile. The degree of variation is notable, especially as it was found within a chronically depressed area in which, at a superficial level, all participants faced similar economic constraints.

Networks can also be established and maintained through structures such as periodic market systems and/or intermediaries between informal and formal markets such as storekeepers.

Drawing from ethnographic fieldwork in Kentucky, Halperin ... (finds) carefully cultivated kin and friendship networks provide access to goods and services outside the formal market. Regional and periodic marketplace systems also play a key role as alternative economic institutions for generating needed household cash from the sale of family-produced goods (Halperin 1990 as summarized in Feldman and Ferretti 1998).

Farmers’ markets, community celebrations, antique fairs, roadside stands, swap shops, etc. all provide vehicles for informal exchange, and, as such, are an important part of the economic ecology of community life. These types of venues may be crucial to the livelihood security of participants. Lack of such venues, or over-formalization, may create barriers to participation in the informal economy.

In rural Appalachia, as reported by Hicks (1973):

[S]torekeepers...are the intermediaries between the subsistence and the cash economy. They control the flow of goods and cash both into and out of the rural community. Storekeepers also compete with one another for clientele. For example, galax, a fern gathered by men, women, and children alike, and used as background greenery in flower arrangements, is sold to florists outside the community for cash. Storekeepers distribute galax to the outside by obtaining galax from clients and converting it into credit against a person’s account (Smith 1990).

In many rural communities, brokers who purchase green lumber from part-time sawmillers play a similar role. These intermediaries, with their greater knowledge of and exposure to the formal marketplace, while they do provide access to the informal economy by bridging with the formal economy, are often also in a position to exploit their suppliers.

**What are the barriers to entry?**

Although it may seem counterintuitive, the barriers to entry into the formal economy are in many ways mirrored with respect to the informal economy.

One cannot simply view informal employment as a refuge for marginalized populations...Instead, there appears to be a heterogeneous informal labour market with a hierarchy of its own. This hierarchy, moreover, seems to reproduce, rather than mitigate, the socio-spatial inequalities prevalent in the formal labour market (Williams and Windenbank 1998).

Communities with weak or weakening formal economies tend to have weak or weakening informal economies as well.

The general consensus among these studies is that the unemployed are less likely than the employed the engage in informal employment due to lack of skills, transport, and capital and lack of opportunities due to the probability of living in poor localities where employment opportunities, either formal or informal, are likely to be minimal (Leonard 1998).

Barrier to entry and participation in the informal economy include lack of assets, money, time, and networks, and, an often misplaced fear of government intervention.

Jobless households are less able than employed households to get work completed and to improve their situation by helping themselves and others...The barriers preventing them from getting work done and from helping themselves and others are their lack of money, equipment, time, skills, confidence, physical abilities and social networks, as
well as their perception of the
neighbourhood and fear of being
mistakenly reported to the authorities
(Williams and Windebank 1999).

Ironically, the nature of the barriers to
participating in the informal economy mitigate
against participation by the poorest of the poor.
Informal work within the household needs more
than time. It demands skills and money to buy
the articles necessary to convert materials into
final products. Household income obviously
influences the ability of households to purchase
formal goods and services. If households can
easily afford the purchase of formal goods and
services then it seems reasonable that they will
have little incentive to engage in self-
provisioning. Yet, the studies outlined above
(Glatzer and Berger 1988, Smith 1986, Pahl
1984, Offé and Heinz 1992, Sassen 1996,
Mingione 1988) indicate that high income
households are those most likely to engage in
self-provisioning. To some extent this is tied up
with home ownership. High income households
tend to own their own homes and thus engage in
a wide range of DIY (do-it-yourself) house
maintenance and improvement measures...
Poorer households face a constant contradiction
between the rationality of increased self-
provisioning and a structurally limited capacity to
make use of it. (Leonard 1998).

The inability to reciprocate also poses a
significant barrier to participation in the informal
economy.

Intra-household co-operation was often
based on the principle of reciprocity.
Hence the needs of those unable to
reciprocate were left unmet (Leonard
1998).

Finally, the capacity to form networks at all
hinges on a certain amount of geographic
stability:

It is said that the decay of traditional
patterns of living in industrial societies is
bound up with increased social mobility.
But by the same token it is connected with
an increase of regional mobility. When
traditional links become more tenuous,
time has to be spent on forming contact
networks that are sought because of their
potential for increasing well-being—and
this need increases pari passu with regional
mobility. Where contact cannot be made
with such networks or where they remain
ineffective on account of fluctuating
membership, the individual then has to
satisfy any requirements he may have
through the market. So the less contact
there is, on account of mobility, with such
groups, the more dependent are
individuals on having money of their own
to make purchases (Offé and Heinze

The interrelationship of formal and informal
economies

At the macro level, the stronger the formal
economy, the stronger the informal economy.

The size of the hidden economy is
positively related to the size of the
measured economy and to inflation, while
unemployment is shown to have no clear
effect...Structural rather than cyclical
phenomena explain the growth of the
hidden economy (O'Higgins 1985).

At the micro level, a household's
relationship to the formal economy shapes their
potential and actual involvement in the informal
economy:
The household activities of bad job households were tied to the kind of employment that characterizes the household, but because bad work stood at the center of the household economy, both the direct and indirect links had different consequences. Perhaps most significantly, bad work undermined the capacity of the household to maintain the dual earner strategy as an ongoing achievement, especially when there were young children within the household. This was so because the instability of bad jobs constantly disrupted employment patterns, because the lack of paid time off meant that families could not respond to crises without jeopardizing employment, and because the wages paid were insufficient to cover the costs of employment...Contrary to the contemporary claim that households have lost their economic rationale, the way people sustain themselves goes far beyond the individual wage and requires a set of strategies based on familial relationships. The survival strategies of households emerge from and are grounded in the connections they have with waged labor (Nelson and Smith 1999).

Participation in the informal economy often requires goods that must be acquired formally. Glass, Muth and Flewelling (1989) describe adaptations in the informal economy in Alaska:

Most of the traditional subsistence gear has been replaced by modern equipment such as metal and fiberglass boats, outboard motors, or even large watercraft, sonar devices, guns, ammunition, steel traps, and the like. Food preservation has largely changed from the use of traditional smoking and drying processes to home canning and freezing. While all of these technological advances have added efficiency in harvesting and preserving, they have made the residents of rural communities more and more intertwined with the other sectors of the economy...Because the monetary income originates in the public and market sectors, contemporary rural communities in southeastern Alaska have developed truly integrated three-sector economies (Glass, Muth and Flewelling 1989).

Reliance on more modern equipment is not limited to Alaska. In rural New York, participation in self-provisioning often hinges on ownership of, or access to, a chain saw and a rototiller (Ratner 1984) and in rural Vermont, Nelson and Smith (1999) find, “One obvious link (between formal and informal economies) is that these so-called informal activities rely on the products of formally organized markets.” Often the goods produced in informal markets are distributed and sold through formal markets. Examples include clothing made in informal sweat shops and non-timber forest products harvested informally and sold to brokers who resell to export markets. Goods produced informally may cross over into the formal sector or may form the basis for continuing informal transactions. Sometimes informal production is an attempt to bypass expensive regulatory requirements and leads to exploitation of labor. While instances of exploitation can be found in both the formal and informal economies, there has been no research that suggests it is any more widespread in one than the other.

It is only by recognizing the commonalities between the positions of certain groups within the formal and informal economy that the forces which give rise to exploitative forms of labour can be more fully understood and challenged (Leonard 1998).

Several authors have emphasized the role of the informal economy in, in effect, subsidizing the formal economy, both historically and currently.

Local ‘subsistence-barter-and-borrow’ systems, based mostly on voluntary reciprocity, were brought to West Virginia by its earliest white settlers. When heavy industrialization began in West Virginia (about one hundred years ago), these traditional economic systems did not cease to function. Their continuation subsidized the state’s industrialization (Salstrom 1997).

In many areas today the informal economy is providing the goods and services that allow low
wage workers in the formal economy to survive. In Eastern Kentucky, Smith (1990) studied periodic marketplaces, one of which was located adjacent to a large shopping mall which sold many identical items for as much as ten times the price. She says,

It could be argued that the existence of such an alternative system of distribution is what makes it possible for the large numbers of working class people to live at the rural/urban interface. These workers provide the temporary labor for the growing numbers of (light industry) factories. Alternative sources for distribution of goods are essential in this context, otherwise people would have to either retreat back to the deep rural areas or move to the cities and become totally dependent upon cash from low level jobs or welfare. The fact that the interface provides so many livelihood alternatives, and that people utilize multiple strategies, is an indicator of pluralism that appears on the increase, and for the near future, likely to remain (Smith, 1990).

Nelson and Smith (1999) found the type of formal employment critical to the capacity of household members to engage in informal activities. One of the most important factors is control of time.

Ironically, substantial self-provisioning (like engagement in an on-the-side entrepreneurial activity) not only depends on additional formal labor market activity but also requires having time that can be bracketed and defined as discretionary...It is the ability to control time which is so important in extensive self-provisioning. This is a privilege reserved to those who have at least some good employment and, as a consequence, do not have to resort to waged moonlighting or staggered work schedules (Nelson and Smith 1999).

In this way, low-wage jobs that demand flexibility of their workers and do not provide reliable scheduling have a doubly damaging impact on households. Not only do they fail to provide a living wage, but, by introducing uncertainty over one's schedule, they prevent people from participating effectively in the informal economy.

The quality of a household's connection to the formal economy influences its informal opportunities in other ways as well.

A worker with a bad job in a grocery store can use the garbage thrown out at the end of the day to feed a pig being raised by a friend for half the profits. Or someone working at a car repair place can use the shop's equipment on their own car...The more jobs in the family, the higher the probability that these necessary perks will be available...Self-provisioning builds on employment and the more employment the better...Bad jobs limit self-provisioning, and without the ability to engage in that activity, bad work households with but a single earner are even poorer than wage levels would suggest (Nelson and Smith 1999).

Even a bad job provides more opportunity than no job at all. Yet achieving livelihood security requires more than a formal job. The more insecure and unrewarding the formal economic environment, the more likely are households to turn to the informal economy for support.

Expanding low income populations encourages the growth of informal economic activities by enhancing demand for low cost goods and services...Hence the parallel development of a market for high priced and low priced goods and services facilitates the trend toward informalization (Leonard 1990).

However, since the formal and informal economies parallel each other, as the formal economy deteriorates and job quality falls, the informal economy is also weakened.

Households become self-provisioning units, drawing on the informal labour supply of family members, and the communities in which households are located become locations for the development of reciprocal economic transactions as households attempt to
maintain some form of economic security in an increasingly insecure and changing economic environment (Leonard 1998).

“Attempt” is perhaps the most important word in the preceding sentence. Households that are better connected, more settled, and more prosperous, that have developed a variety of reciprocal exchange relationships over time, are far more likely to benefit from self-provisioning and exchange than the households that have the greatest need. As economic development practitioners, the challenge we face is how to shape a whole economy, inclusive of formal and informal arrangements, to provide livelihood security for all.

Implications for Policy and Practice

Unless we understand how informal sector workers and formal sector enterprises participate within a single economic system, policy recommendations will offer only speculative solutions to unemployment (Lozano, 1983).

From a macroeconomic policy standpoint, much of the concern about the informal economy stems from its negative impact on tax collections. Proposed policy “solutions” are weighted toward increasing formalization by controlling informal activities. Attempts to control informal economic activities tend to result in the exclusion of participants most dependent on the activities to begin with. For example, the Maxwell Street market in Chicago, one of the longest running and largest open-air markets in the country, had more than 800 vendors, low vendor fees, and attracted crowds of more than 20,000 before it was formalized by the City of Chicago in 1994. Now participation requires licences and permits, higher fees and increased controls. Less than half the vendors have made the transition to the new market (Martel 1996). This is not an isolated instance.

Many commentators (e.g. Lautier 1994) are now arguing that attempts to formalize informal employment have foundered in almost all cases where this has been attempted (e.g. Burkino Faso, Brazil, Ivory Coast, Columbia) and thus, paid informal activities cannot be formalized for developmental purposes (Williams and Windebank 1998).

Given that, from a development perspective, experiments in formalizing the informal sector have not been successful, where do we go from here? If one accepts the notion that formal and informal activities are complementary, that the boundaries between them are fluid rather than fixed, and that the best choice at any given time and place is that which most effectively provides livelihood security, then a key question becomes: How do we activate available resources to meet human needs regardless of formality or informality?

Approaches that recognize the importance of the informal economy to our individual and collective well-being and deliberately seek to protect and expand opportunities for reciprocal exchange include (but are not necessarily limited to) Time Dollars, co-management of natural resources, and Local Exchange and Trading Systems.

Time Dollars

Edgar Cahn and Jonathan Rowe have developed a system called Time Dollars that is being used to recapture time as a valuable resource. Time Dollars programs offer participants service credits based on time spent helping others.

They do for the informal economy of helping what money did for the commercial economy of barter; they free it from the tandems of you-and-me relationships and enable this time exchange to grow into a community of good works. They become a kind of scaffolding on which to rebuild the informal, household economy (Cahn and Rowe 1996).

Time Dollars programs encourage relationship building, reciprocity, and exchange. They appeal to both men and women and to many who are not otherwise engaged as volunteers. Time Dollars programs also appeal to recipients of services since they know they aren’t accepting charity or welfare, but rather allowing their helper to gain credits he or she can use. Time Dollars programs appear to “tap a different spectrum of motivation and concern—the desire..."
to help and be needed—that market wages either ignore or repulse” (Cahn and Rowe 1996).

Several states, including Missouri and Michigan, have enacted legislation in support of Time Dollars programs. Michigan’s bill focused on people who provide care for frail seniors in their homes and created a state bank to track the credits earned by service providers. Missouri offered a guarantee for the Time Dollars earned in the respite program. If the people who earned credits through the program can’t find another volunteer to help them when they need it, the state will pay for that help instead. The program has been successful.

Elderplan, an HMO in Brooklyn, New York, adopted the Time Dollars program in the mid 1980s. Time Dollars allowed members of the HMO to earn service credits by caring for other members. Elderplan allows members to use Time Dollars to pay for part of their HMO fee because active members who feel needed by others are less prone to disease, so they require less care from the HMO.

Time Dollars is one example of an approach that helps people meet very real needs, increases connections, and activates time as an underutilized resource.

Williams and Windebank argue for adoption of an Active Citizens’ Credit scheme for Great Britain modeled after Time Dollars and suggest as a more comprehensive option a minimum guaranteed income for active citizenship paid via a tax credit system (Williams and Windebank 1999).

Co-management of Natural Resources

As the informal use of natural resources gains legitimacy, experiments have emerged in co-management whereby governmental bodies work with indigenous or simply local communities to help maintain informal economies as a part of a larger conservation strategy. These efforts tend to fall into three categories:

• Confronting external threats to the resources of community subsistence economies from competing demands and values. This requires political engagement, education, and sometimes mediation to achieve shared understandings of economic values and choices.

• Creating new and appropriate economic opportunities built around informal resource use strategies such as harvesting non-timber forest products and assisting in research related to resource depletion and management.

• Redirecting the flow of benefits from natural resources to communities such that communities can benefit directly from the resources they help to steward by developing infrastructure such as bed and breakfasts, outfitters, educational programs, etc. that generate economic returns to local communities.

These strategies engage local communities in defining traditional and evolving resource use patterns that are part of the informal economy, finding ways to support these uses while at the same time, improving resource conservation practices.

Establishing partnerships between government agencies and communities helps to build mutual awareness and better working relationships for dealing with complex modern day problems. More importantly, co-management arrangements offer another venue for achieving sustainable and self-defined approaches to progress (Kofinas 1993).

Local Exchange and Trading System (LETS)

LETS, founded by Michael Linton in Canada in the early 1990s, is a barter-based system that uses centralized credit accounting. It is designed to enable people to trade goods and services with each other where the national currency is in short supply, by providing a local unit of currency in which the value of trades is recorded. Members pay a small registration fee and then list the goods and services which they wish to offer and receive in a directory. Those seeking to trade come to mutual agreement on the value of the trade and then notify the central accounting system. Members receive a regular statement of the balance in their accounts. As of the mid-1990s, there were 164 systems in Australia, 350 in the United Kingdom, and about 20 in North America.

In a detailed study of LETS in Australia, Colin Williams found the level of trade per member drops slightly when there are more than
200 members and where the LETS covers a large geographical area. Distance inhibits members from providing services to one another. Initially, LETS members were predominantly people who favored alternative and/or green lifestyles, but newer LETS have been shown to have a far broader and more mixed base of participants. (Gran 1998). Coordinators estimated that approximately 1/3 of their members are not employed. As LETS have grown and the state has become active in their promotion, through, for example, giving out information on LETS when a person applies for unemployment compensation, unemployed who would otherwise become isolated from social networks have heard about them and joined. This suggests that LETS are able to meet needs that unemployed people cannot meet in either the formal or informal cash economy (Williams, 1997).

Time Dollars, co-management of natural resources, and LETS are described as a starting point for creative thinking about how we might integrate the informal economy more deliberately into our programmatic rural development efforts. Clearly, any of these will have to be tailored to the needs and possibilities of each place and/or organization into which they are introduced. None are simply band-aids. All require significant investments in time, energy, and patience to nurture and build the relationships upon which success depends.

Building the Principle of Connectivity into Our Work

Persistent underdevelopment, at its core, bespeaks a lack of relationship. People who are poor in America are people who are isolated. Isolated people lack choices. Isolated people lack livelihood security. Isolated people never develop the skills to enter into reciprocal exchange relationships. Socially isolated individuals are at two to three times the risk of dying prematurely compared to socially well-connected individuals (Kawachi 1999). Isolated people are no more likely to succeed in the informal economy than in the formal economy.

Research into levels of self-provisioning in West Germany found that household composition was the most significant factor in accounting for variations in self-provisioning among households and this remained the case when other variables such as income and class were taken into account. The lowest degree of self-support was found in one person households. While often these households lacked sufficient resources to purchase goods and services from the formal market, nonetheless they did not possess sufficient labour power to rely on self-production (Leonard, 1998).

Part of the appeal of programs like Time Dollars is that by “countering the isolating pathologies of money, [they] tend to restore the conditions of neighborly doing and therefore of health” (Cahn and Rowe 1996).

If we accept the profound relationship between poverty and isolation from both formal and informal economic opportunity, and the key role of connectivity and social networks in accessing and participating effectively in economy in any form, then how does this change the emphasis in our work as development practitioners?

Many economic development practitioners frame their goal in terms of the number of jobs that they can claim to have created. Some economic development practitioners have gone beyond asking how many jobs a particular business will create in their community to asking about the quality of those jobs. Our understanding of the relationship between the formal and informal economies suggests that quality is not only a matter of wage rates. Other quality-related questions we need to ask include:

- Will employees be able to control their own hours?
- Will the hours of employment, even if less than full-time, be stable and predictable?
- Will the employer assist in any way with child care?
- What type(s) of health care benefits will be provided?
- Will employees have access to tools, equipment, “waste” products, or other assets of the business for non-business use?
- Will employees develop skills useful in either the formal or the informal economy?
- Does the business encourage participation in social/professional networks?
The answers to these questions have a direct bearing on the total economic involvement of households and their capacities to create livelihood security for themselves. The more these questions are answered in the affirmative, the greater the likelihood that households will be able to mesh formal and informal economic participation effectively, and therefore gain net benefits from formal employment. The more they are answered negatively, the greater the likelihood that those who take the jobs will find it increasingly difficult to supplement their earnings through involvement in the informal economy, thus becoming twice poor.

Some economic development practitioners have also begun to ask, “Jobs for whom?” Is it good development policy to create more jobs than the local labor force can fill and thereby induce in-migration? Is it good policy to create jobs requiring skills the local labor force doesn’t have and is unlikely to have the opportunity to acquire? How do you create a mix of jobs in a community that provides for entry and growth? For the needs of full-time formal workers, and part-time workers, blue-collar and white-collar, home-based producers and factories, recognizing that it’s the richness of the mix that creates the best environment for meeting the full range of human needs?

To really answer the question, “Jobs for whom?” we need to know who lives in our communities, and how they are currently meeting and not meeting their economic needs. We need to recognize and accept that jobs, whether formal or informal, are not, by themselves, enough to induce improvements in well-being for those who are socially, economically, culturally, and, above all, personally isolated.

Isolation is the number one barrier to livelihood security. Isolation is, in part, a structural problem, particularly in rural areas. For example:

Although the most prevalent mode of transportation in rural areas is the automobile, one of every 14 households in rural America has no vehicle. The percentage of rural elderly and poor without vehicles rises to 45 percent and 57 percent respectively. And 38 percent of the nation’s rural residents live in areas without any public transit service...The rural poor are one of the least connected sectors: only 74.4 percent of rural households with annual incomes less than $5,000 have phones (Economic Development Digest, April 1999).

Alongside the absence of structural connection through transportation, telecommunications, and now the internet among rural and urban disadvantaged people, we must recognize the often profound lack of social skills based on a lack of experience and models. People who do not know how to connect with one another have excruciatingly limited opportunities to engage in our economy in any form. Outreach, mentoring, social work, home visits, and similar deliberate efforts to create connection are essential in addressing the roots of persistent poverty. This quote, from a woman who grew up in poverty in the mountains in Appalachia, explains the importance of one-on-one contacts:

To me what brings you out of poverty is not anything that the school system does. It’s not anything that bureaucracy does. It has more to do with a mentor. You have to have somebody there. I don’t think that a person necessarily knows they’re a mentor at the time. But there has to be something introduced to that person’s life before they can see there’s a different world...A lot of these people that live in poverty with nothing think that’s normal, that’s expected—because that’s all they’ve ever known. If that’s all you’ve ever known all of your life, how can you know there’s anything different? (Duncan 1999).

Development practitioners need to form alliances with social workers, community organizers and informal networks of caring, to learn together how best to find and include isolated people in the web of relationships that create livelihood security. We must recognize and address the social skill prerequisite required for connectivity and the experiences one must have to develop social skills, and provide venues in which these can be developed. These venues must not be segregated by class or experience. The more practitioners can support those who assist individuals in creating networks that bridge class, neighborhood, race, community, the richer the opportunities for economic
participation. Exchange networks, whether barter-based or time-based, must bridge,

[Both the social divide between people who have ‘a lot of time and little money’ and those for whom the reverse holds true, as well as between the potential suppliers and takers of different categories of services, as well as spanning the temporal divide between different age groups (Offe and Heinz 1992).]

Development practitioners must acknowledge the central role of facilitating connectivity in our work. The work of ensuring sustainable livelihoods for all cannot succeed in segregated pockets with programs targeted to only those we perceive as disadvantaged. Programs must provide the opportunity to link across class, race, gender, place of origin, etc. to foster opportunities for personal development and exchange that will, with encouragement, lead to opportunities for economic exchange and participation.

And, finally, we must treat informal economic activity as valid and valuable in its own right, and not exclusively as a stepping stone to formal employment. Many practitioners in micro-enterprise development, particularly in natural resource areas, are struggling with this as they discover the extent of informal economic activity and both the perceived and real barriers to formality. For example, one practitioner working to organize a cooperative of rabbit growers found potential participants fearful of “the system.” Because they were afraid, they didn’t want anyone to know what they were doing. Many of the assumptions they were making about their own vulnerability to regulations and taxation were wrong, but fear of “the system” made them unwilling to ask questions. The development practitioner, whose role was to formalize the group into a cooperative, began to realize this would not be a productive approach. First, it was necessary to build trust, then to help the group test their assumptions, and finally, to work with them to weigh carefully the pros and cons of formalizing versus remaining informal.

Other research has shown that,

[Women perceive their income from household production as necessary...and view child care needs and policy regulations as constraints to enterprise development (Shifflett and Hoskins 1985).]

As practitioners, we should welcome the opportunity to assist those we work with in understanding the reality of formal economic requirements and in making informed choices regarding their approaches to livelihood security. This task should be approached with an open mind and not with an agenda of formalization. In some instances, formalization will make sense; in others it will not. By ignoring the significance of informal activities to livelihood security, we risk destabilizing the security of those we are attempting to help. There are many instances in which informal economic activity may provide flexibility, social insurance, and a sense of belonging, as well as material benefits that are unavailable to participants in the formal economy.

Opportunities for informal and formal economic involvement may look very different from one community to the next, as the nature of what is available and the rules governing behavior and possibility vary. To ignore informal opportunities and benefits and to instead privilege formal opportunities, however inadequate, may be to undermine both sectors of the economy and further impoverish people. On the other hand, recognizing the role of informal economic activity in the lives of individuals and households, provides a base around which formal employment may be usefully structured. Practitioners who are willing to recognize and accept the legitimacy of informal livelihood security may find opportunities to assist in overcoming barriers to formality where appropriate and to build a more robust informal sector where formality is not appropriate.
Endnotes

1 This includes a shadow economy created by the public sector through off-budget spending estimated at $32.2 billion in 1981 (Bennett and DiLorenzo 1982).

2 Another aspect of the economy that we typically do not count is the value of services provided by the natural environment. Environmental services are, in some real sense, the basis of all economic activity, as without them the basis for life as we know it would disappear.

3 For an excellent discussion of the range of methodologies used to study the informal economy and their relative strengths and weaknesses, the author recommends Informal Employment in the Advanced Economies by Williams and Windebank.

4 Several authors have explored the notion of the “whole economy” using heuristic devices such as totem poles and layer cakes (New Internationalist Issue 278; Henderson 1981). These constructions show nature as the base upon which the social (non-market) economy, the underground (market) economy, the public sector and finally the official private sector market economy are built. They reinforce the fact that without the personal, neighborly, and familial activities of the informal economy, we would be hard put to produce qualified laborers for the formal economy.

5 There has been a great deal of discussion, going back at least 30 years, on the need to adjust our measures of the economy to reflect “bads” and quality of life issues. Readers are directed to If the GDP is Up, Why is America Down? by Cobb, Halstead, and Rowe, Atlantic Monthly Magazine, October 1995 for a sample. There is also a considerable literature on alternative measures, including the Genuine Progress Indicator (GPI) and the Measurement of Economic Welfare (MEW).


7 See, for example, recent work by Paul Hawken, William McDonnough, and others on natural capitalism.

8 An individual who holds a waged job that is defined as year round, full time, and “regular” is provisionally classified as having good employment. Good jobs include stability, benefits and an arm’s length relationship with the employer. “Bad jobs” are part-time, seasonal, or specifically designated “temporary”. Bad jobs are unstable, and lack benefits.

9 Typology from Kofinas 1993.
Bibliography


