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## **BEYOND FORMALITY AND INFORMALITY**

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**Beyond Formality and Informality\***

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# **Beyond Formality and Informality**

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## **1.1 INTRODUCTION**

The constructed opposites of formality and informality have been a constant of the development discourse for more than half a century. They have anchored theoretical, empirical, and policy discussion in many disciplines as they have studied the development process. In the 1940s, the Dutch anthropologist Boeke (1942) developed a vision of a developing economy as a ‘dual’ economy, comprised of the market economy part of the world and a part which lay outside. In the 1950s, Arthur Lewis (1954) conceptualized an influential two-sector model of development in which one sector had modern capitalist firms that maximized profit, while the other sector was comprised of peasant households where the rules for sharing output were different. In the 1970s, the Harris and Todaro (1970) model in development economics brought the dual economy into the standard two-sector framework of equilibrium economics. In development studies more generally, however, the paper by Keith Hart (1973) and the ILO mission to Kenya (ILO 1972) established the importance of the dichotomy, and led to an outpouring of research and policy focus. It has helped to organize thinking, it has served to structure official statistics, and it has generated a series of policy measures to ‘help’ the informal sector.

Despite this pedigree, the usefulness of the formal–informal dichotomy has constantly been debated in the literature. Early critiques include that by Bromley (1978). Lipton (1984) defends the usefulness of the concept of the informal sector, but argues for care and nuance in application. Over the past 30 years, this ‘to and fro’ has continued as new evidence from new areas has been brought to bear on the debate. For example, detailed work, in the 1980s and the 1990s, on the management of common property regimes has shed new light on what were once considered to be ‘informal’ arrangements (McCay and Acheson 1987; Ostrom 1990; Bromley *et al.* 1992). Policies introduced to ‘formalize’ these arrangements have been criticized in light of their sometimes counterproductive consequences (Platteau 2004; Platteau and Gaspart 2003; Agrawal and Gupta 2005). In the last few years, the idea of extending formal legal property rights to the ‘informal’ sector has taken hold as a possible powerful policy tool to help the poor make the best of their assets (de Soto 1989, 2003; but see Alden Wily, chapter 15, this volume). In light of these developments, it is appropriate to consider once again the conceptual and empirical basis of the formal–informal divide, and to assess carefully its policy implications.

This chapter introduces a significant new collection of studies on formality and informality in developing countries. The chapters were originally presented at a major conference organized in Helsinki in September 2004 by the Expert Group on Development Issues (EGDI) at the Swedish Ministry for Foreign Affairs and the World Institute for Development Economics Research (UNU-WIDER). All of the chapters use the terminology of formal and informal, and some make use of the conceptual dichotomy to begin the discussion. Most of the chapters, however, highlight the basic thesis of this

chapter—that we need to move beyond formality and informality to make progress in understanding the realities of economic activities in poor countries, and to design policies to benefit the poor. The materials in these chapters, as well as the broader literature, form the basis of the arguments advanced in this introduction to the volume.

The plan of this chapter is as follows. Section 1.2 addresses the conceptualization of formal versus informal. Section 1.3 begins the discussion of policy by specifying the objectives of interventions in this area. Section 1.4 continues the policy analysis by examining some of the lessons learned and deriving recommendations for successful policy intervention, based on experiences in a range of countries and situations. Section 1.5 concludes by renewing the call for the development discourse to go beyond formality and informality.

## **1.2 CONCEPTUALIZING FORMAL AND INFORMAL**

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 analyzes. 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 time.

In his early defense of the informal sector (IS) concept, Lipton (1984: 196) set out the problem as follows: ‘The IS concept has become discredited on account of three alleged deficiencies: misplaced dualism, misplaced isolation and confusion’. He then goes on to specify each critique and to mount a defense against it. Misplaced dualism refers to the fact

that in practice there is no clear split between formal and informal; rather, there is a continuum. The defense is that a dichotomy can nevertheless prove useful in analytical terms. Misplaced isolation is the neglect of the fact that the relationships of the informal sector to the rest of the economy are not investigated. While this is a valid critique of some of the literature, as Lipton also notes, we agree with Lipton that this is not an inherent weakness of the dichotomy, but rather of the uses to which it is put.

Under the third critique, that of confusion, is the idea that the characteristics of this sector are not well spelt out. Nor, relatedly, are the entities that would fall into this sector. So we come to a situation where Harriss (1978: 1,077, quoted in Lipton 1984) says, 'It is for the initiates to spot IS and they know it when they see it'. Lipton's (1984) defense is that in standard sources (such as ILO 1972; Sethuraman 1976; Souza and Tokman 1976), only three key characteristics are used to define IS. These are: (1) 'substantial overlap between providers of capital and providers of labour in each enterprise' (pp. 198-200); (2) 'prevalence of perfect, or rather ... near-perfect, competition' (p. 200); and (3) 'IS consists largely of "unorganised," unincorporated enterprises, to which legal restrictions on employment (wage minima, regulations affecting working conditions, etc.) and on acquisitions of non-labour inputs (licenses, quotas, etc.) do not apply ...' (pp. 200-201).

However, in the literature since Lipton (1984), the tendency to use many different characterizations has persisted. A bewildering range of (often only implicit) definitions are used to discuss the formal and the informal. Reviews since Lipton (1984) have concluded that there are competing perspectives rather than a single dichotomy (Portes and Schauffler

1993; Cross 1998), and this view is supported by the most recent examinations of the literature (Christensen, chapter 3, this volume; Sindzingre, chapter 4, this volume). And discussions of the formal and the informal have been enriched considerably by the literature of the past two decades on (self) organization of common property regimes (Ostrom 2005), and by the push in some policy circles to extend property rights to groups of individuals who do not currently ‘enjoy’ such rights (de Soto 2003).

Not surprisingly, the views on the entities that comprise the informal sector also differ greatly. Lipton (1984) argued strongly for the ‘Family Mode of Production’ as a general category that fell naturally into this category. In official statistics, different countries use the terms differently in detail even when they might mean the same thing in a general sense (Muller and Esselaar 2004; Narayana, chapter 6, this volume; Sindzingre, chapter 4, this volume). The international official definitions, for example as codified by the ILO, have been expanding. The current official definition of ‘informal sector’ was adopted by the 1993 International Conference of Labor Statisticians based on characterizing an enterprise as informal. In 2003, guidelines were introduced to expand the definition to include informal employment outside informal enterprises, with an appropriate definition of the former (Chen, chapter 5, this volume).

From this mass of alternative uses of the terms and alternative characterizations, we would like to highlight two strands that are particularly relevant for the current policy dialogue. The first strand is the notion of informal as being outside the reach of different levels and mechanisms of official governance and formal as being reachable by these mechanisms.



This notion underlies many official definitions of ‘informal enterprises’ as those that are not registered and are legally outside the tax net. It also underlies many analytical investigations of enterprises and activities that operate illegally, in violation of formal state rules and regulations, even though informality and illegality are not considered to be equivalent in this notion. This notion also animates the lively policy debate on the extent to which the informal sector owes its existence to ‘overly constraining’ official regulations which lead to economic activity taking place outside this net, either by organizing so that the regulations do not formally apply, or operating in contravention of the regulations. And, of course, this is also the dimension that best captures different views on the benefits or otherwise of extending the reach of official structures to where they currently do not reach (e.g., legal property rights), or of reducing this reach (e.g. labour regulations).

The second strand that can be discerned in the discourse, and which we believe to be important in shaping policy responses, has to do with the nature of organization. The informal is often identified with ‘lacking structure’ and the formal with ‘structured’—the term ‘unorganized sector’ is often used. Other cross-cutting themes one finds are ‘simple’ versus ‘complex’ or ‘irregular’ versus ‘predictable’ (Hart, chapter 2, this volume). In the policy discourse, the association of the informal with unstructured has been a powerful impetus for interventions that have often led to disaster. A striking illustration of this is the attempt to nationalize forests in Nepal, based on the analysis that deforestation was being caused by the inability of small local communities to prevent environmental degradation (Ives and Messerli 1989). In fact, as we now know, the local communities had better structures in place to deal with the deforestation that was the result of population and other

pressures (Arnold 1993; Varughese and Ostrom 2001). These structures were not recognized, and were replaced by the formal state structures which proved to be ineffective and corrupt leading to even faster deforestation (Gilmour and Fisher 1991; Waltner-Toews *et al.* 2003). Now, the government of Nepal is trying to reverse its earlier policy and is turning many forests over to Forest User Groups that it organizes (Nagendra and Ostrom, forthcoming).

Exactly the opposite is true of the software industry of India, now recognized as a world leader. It flourished under the entrepreneurship of some highly skilled and far-sighted individuals, quickly becoming the fastest growing export sector of India. Its current reforms notwithstanding, India still remains a fairly regulated economy, but the government was surprisingly non-interfering as far as the software sector was concerned. Even until very recently, the industry's output and exports were categorized as 'miscellaneous' in India's national accounts (as opposed to being called 'manufacturing' or 'services'), such was the degree of informality. The initial abstinence of the government was indeed a blessing in disguise.

These two dimensions—the reach of official governance and the degree of structuring—need to be further specified and made precise,<sup>i</sup> but they provide an initial entry to a framework for capturing the many definitions that abound in the literature. In this conception, an economic activity can be characterized along two dimensions. The first is the extent to which it interacts with, or comes into the net of, the structures of official governance at the national or local levels.<sup>ii</sup> The question of whether an employer is

registered or not with a governmental unit would be a simple illustration of this dimension (see chapters 2-6 in Part 1 of this volume). The second dimension is the extent to which an activity and the interactions among its constituent individuals are structured according to a predictable framework (not necessarily one that is written down). Muller and Esselaar (2004), for example, refer to the casualization of employment as involving employees of both registered and unregistered firms who lack a written contract or any form of employee benefits. They find that a significant number of employees have a casual (e.g., unstructured) relationship with employers in South Africa.

The distinction between the two dimensions is not redundant. This is illustrated for example by the detailed empirical work showing the highly structured interactions within groups that manage common-pool resources, far removed from any interaction with official governance (Tucker and Ostrom 2005; Ostrom 2005). Moreover, for similar levels of connection with the state tax system, we see enterprises with very different types and complexities of internal structure.

The two dimensions do, however, interact. On the one hand, attempts by official governance to extend its reach, for example, by widening a regulation to an area where it was not previously applied, will in general lead to a response that may move some activities outside the reach of the regulation (legally or illegally). In so doing, it may well change the structuring of the activities that escape the official net. It has been observed, for example, that relationships within illegal activities are often very highly structured, sometimes more so than in legal activities, as a response to the risks of the activity in

question (Gambetta 1996). By the same token, some types of (re)structuring of activities make official intervention easier, or may even be predicated by the nature of the official governance frameworks. For example, as an enterprise expands, it can be monitored and taxed more easily. As another example, if an enterprise wants to become a publicly held company, it can only do so within the framework of existing company law, by definition.

Thus both dimensions are needed to adequately characterize activities and to analyze interventions. And it is not helpful to say that activities to one extreme of both dimensions—for example with high official intervention and highly structured interactions—are ‘formal’ while those at the other end are ‘informal’.

On the policy front, as the chapters in this collection make clear, the policy issue is not one of ‘greater’ or ‘lesser’ reach of government being better in general, as it is so often characterized, but one of the ‘right’ reach of government (Söderbaum, chapter 9, this volume; Shuaib 2004). This ‘right’ reach has to take into account (1) the objectives of intervention, (2) the implementation of the intervention, and (3) the response of the structuring of activities to this intervention—it being recognized that ‘more’ or ‘less’ structured does not necessarily correlate with ‘good’ or ‘bad’ (Nugent and Swaminathan, chapter 12, this volume).

What then are we to do with the terms ‘formal’ and ‘informal’? It seems clear that they cannot be suppressed—they are now too well ingrained in the academic and policy discourse. And, as Lipton (1984) argues, their continued use despite all the debates perhaps

suggests a continued utility. We would propose, therefore, especially in light of official statistical conventions already adopted, that the formal–informal continuum apply strictly to the continuum between relatively high and relatively low levels of the reach of official governance mechanisms, suitably specified and measured in each context. This relates the terminology directly to the policy discourse on the nature and extent of government intervention in economic activity. This is our preferred option. However, even in this case we would prescribe a health warning—informal does not mean unstructured and chaotic, and does not invite policy intervention on those grounds! More generally, we would keep the ‘reach of government’ as a purely descriptive term, leaving the issue of whether it is a good thing or a bad thing to be decided on a case by case basis, taking into account the self organizing structures that communities are capable of producing, within or without the reach of official structures.

### **1.3 OBJECTIVES AND COMPLEXITIES OF INTERVENTIONS**

At the broadest level our objective is to understand diverse ways of improving the well-being of the poor in poor countries. We recognize that poor individuals and others interact with each other and with the rest of society through two primary channels—self-organized groups and markets. The objectives of intervention can then be seen under two broad headings: (1) Improving the well-being of the poor and of society at large by improving the capacity of individuals to self-organize and address their collective action problems by themselves, and; (2) Improving the well-being of the poor and of society at large by addressing the problems that arise when individuals interact through markets.

These two objectives may be seen as addressing group failure and market failure, through better operation of self-organized groups and through better operation of markets. Of course, it goes without saying that the two objectives interact, with outcomes in one influencing outcomes in the other. The myriad of interventions that we actually see in practice can be assessed in the above framework. But why do some interventions achieve their objectives while others do not?

A key step is to focus in on the goals of such efforts and the specificities of time and place. We have repeatedly learned from many studies of policy processes, that no single institutional arrangement works across diverse policy areas or even diverse subtypes within a broad policy area (Joshi 1998; Korten 1980; NRC 2002). Copying interventions that worked well in one country may lead to a major failure in another country (Webb 1991).

For example, trying to find the best property rights for allocating forest resources (see Andersson and Pacheco, chapter 11, this volume) vary dramatically by the kind of specific forest problem one is trying to solve. Residual rights to a forest may be retained by individuals, private corporations, local indigenous communities, or local governments (Alden Wily, chapter 15, this volume). When there is pressure to move to commercial operations, local owners—whatever their form—may need to engage in contracting with a variety of professional organizations. Thus, not only are property rights to the residual income a major factor in sustaining resources or providing essential services to the poor, the type of non-governmental organization or for-profit entities that provide technical services are also a major factor. How their performance is monitored, what kind of

contracting law can be used, and many other factors affect whether local users are able to devise sustainable forest management plans, gain income, or reduce their risks (Dietz *et al.* 2003). Guha-Khasnobis and Ahuja (chapter 10, this volume) also stress the role of NGOs and micro-credit organizations in effectively organizing the poor to obtain specialized insurance plans from either private-for-profit insurance companies as well as from governmental insurance providers.

At any one juncture in the history of a policy field a need for an increased role of national, regional, or local government agencies or an increased role of local NGOs and other kinds of non-governmental organizations may exist. All of the organizations involved may be constituted under the laws of a country even though they may not themselves be governmental units. Thus, all of the organizational arrangements may be formal in the sense that they are registered, recognized, and predictable, but many of them may not be governmental in structure.

With a broad understanding of the goals of interventions discussed in this volume, and an eye for the complexities involved, we can try and synthesize the lessons of (positive and negative) experience with these interventions. The next section takes up this task.

#### **1.4 LESSONS LEARNED AND RECOMMENDATIONS**

The chapters in this volume, and many others in the literature beyond, provide a rich empirical account of the working, or not, of a range of interventions directed towards the ‘informal sector’. Some of these interventions try to extend the net of government

interventions into areas where they have not gone before. Others try to withdraw an intervention that exists. Sometimes these movements are referred to as increasing or decreasing the degree of ‘formalization’. The experiences indicate that no simple rule exists that increasing or decreasing ‘formalization’ necessarily improves or worsens the well-being of the poor or welfare of society at large. Three examples illustrate this basic point. Söderbaum (chapter 9, this volume) describes the experience of the Maputo Development Corridor which was created in 1995 by the Governments of South Africa and Mozambique to increase private investments in infrastructure and industry. The corridor has been, for years, a location where extensive informal trading, particularly by women, has flourished. Massive investments of private capital have been encouraged to build major physical infrastructure, without much concern for building the economic opportunities of those living in the area. The biggest of all investment projects under the MDC initiative is Mozal, which contributes around 5 per cent of the GDP of Mozambique and nearly half of its manufacturing output. Yet, Mozal’s linkages with the domestic economy, in terms of creating additional employment in the region, is minimal. For other inputs too, most of Mozal’s dealings are with foreign (South African) firms based in Mozambique, its purchases from domestic enterprises being restricted to water and energy, which have little spread effect. With Mozambique’s development strategy showing an obsession with mega projects, the ‘informal’ sector is seen almost as a hindrance, rather than a potential contributor to growth.

Nugent and Swaminathan (chapter 12, this volume), on the other hand, analyze the impact of formal governmental assistance to local health centers—*posyandus*—on the level of



volunteering by Indonesian women to these centers. They found positive effects on the level of volunteering and in the level of usage of the health center, of governmental investments (in the form of number of visits from paid medical staff and the number of medical instruments purchased with governmental funds).

Sawyer (chapter 13, this volume) provides an entirely different view of the impact of more extensive government intervention when dealing with the problem of achieving peace after extended warfare. He finds that in the northwestern sections of Liberia, different ethnic groups rely on indigenous institutions, such as the *poro*, that are accepted across ethnic communities. These and other evolved mechanisms for conflict resolution and for organizing collective action, are slowly achieving a positive level of peaceful co-existence if not even productive entrepreneurship and interchange. In other regions of post-warfare Liberia, diverse groups have relied more on linkages to Monrovia to settle inter-group conflicts. Unfortunately, drawing on external relationships to the national capital has not enabled these communities to move ahead on the processes of reconciliation as rapidly those communities building their own mechanisms based on indigenous ways of coping with conflict. Rival elite groups have turned frequently to the Ministry of Internal Affairs and have focused more on who is selected for local government office rather than how to build schools, roads, and water systems.

Thus, while specifics matter greatly and no general rules can be formulated, a number of themes run through the chapters of this book which can perhaps be brought together as a

small number of lessons learned to serve as recommendations for future work or evaluative criteria that could be applied. These include:

- *Subsidiarity in a Multi-Level System.* Place the intervention as close as possible (in terms of level of government and/or geographically) to where it is meant to influence markets or groups, but imbed it in a larger system that supports the autonomy of lower level governments and provides them essential back-up services including conflict resolution.
- *Balance between 'Formal' Interventions and 'Informal' Practices.* In other words, 'formal' interventions are more effective if they are not meant to replace or 'crowd out' 'informal' rules, but help fine-tune them instead.
- *Implementation Capacity.* Design the intervention to be consistent with the implementation capacity of government, and the absorptive capacity of people it is meant to help.
- *Complementary Interventions.* Interventions that work are usually in the form of a package. Complementary measures are needed to support the core intervention for it to work.
- *Use Voting With Their Feet as an Evaluation Criteria.* If people try to move out of the net of an intervention in significant numbers, its presumed efficacy for their well-being must be questioned. If on the other hand people move into the net of an intervention (including when that intervention is reduced), this is a signal of its efficacy.

Let us briefly discuss each of these general lessons.

### *Subsidiarity in a Multi-Level System*

For all too long, recommendations for structuring formal governmental structures have focused either on the need for greater centralization at the national level or for more decentralization to the local level. This should not be thought of as an either-or choice. Rather future policies should address what responsibilities to place at what level of governance and how to design *multi-level* governance systems that work effectively to provide desired services, collect taxes, and resolve conflicts in a timely, transparent, and equitable manner. To improve the welfare of those facing poverty conditions, Di Gregorio *et al.* (2004) stresses the importance of federal systems rather than highly centralized or fully decentralized systems. Tyrannical leaders can gain power at any level of governance. Accountable governance usually requires mechanisms at higher or lower levels that enables citizens to hold officials at any one level of government responsible for their actions. Sawyer (chapter 13, this volume) also stresses the importance of enhancing polycentricity in evolving governance systems in post-conflict settings of Africa. Local communities can undertake many forms of collective action more effectively by drawing on their own evolved institutions rather than demanding centralized solutions.

In a multi-level system, then, a key is devolving authority to the lowest level that can take effective action related to the scale of a particular collective action problem. In regard to the registration of land, for example, Alden Wily (chapter 15, this volume) reviews the land registration systems throughout most of Africa and finds that smaller units with considerable autonomy and more accessibility to landowners, are cheaper, speedier and more effective (i.e., they increase the proportion of land that is actually registered). Simply

deconcentrating land registration is not, Alden Wiley finds, as effecting in achieving these benefits as moving the authority to undertake land registration to a semi-autonomous local unit of governance. The advice is: Go as close to the problem you are trying to help as feasible.

In a globalizing economy, the principle of subsidiarity also recognizes that for some purposes the appropriate level is international rather than any governance mechanism within a particular nation. Christensen (chapter 3, this volume) urges scholars and policymakers to abandon the Westphalian paradigm that assumes that sovereign national states are the world's primary policy actors. He argues that participants in the 'non-sovereign/informal sector' organized at international, national, regional, and local levels are major actors that are ignored by policy that focuses entirely on the role of sovereign actors. NGOs organized at multiple levels are participants in the construction of soft law through the negotiation of treaties or the recognition of customary practices. Soft law, as Christensen explains it, would be called 'norms' by some scholars since it reflects the aversion of many national governments to international law as such but the recognition by the same national governments that agreements at the international level must be negotiated and followed. So for larger scale problems, the principal of subsidiarity is that when the problem is genuinely international in scope, then one must go to the international level to try to solve it rather than remaining with an outdated concept of the sovereign state.

*Balance between 'Formal' Interventions and 'Informal' Practices*

Sometimes in their eagerness to solve problems on the ground, government officials keep imposing more and more formal legislation without recognizing how this impacts on informal practices, how multiple and rapid changes introduce confusion, and why those involved eventually ignore the pronouncements of governments and work out some kind of arrangements on the ground which may be entirely contrary to what policymakers prefer. Imposed rules can crowd out norms and rules evolved in self-organized groups (Frey and Jegen 2001).

Roever (chapter 14, this volume) graphically accounts how officials in Peru—the country where de Soto (1989) started his analysis of the impact of overly formalized rules on the 'informal' sector—continued their past practices of imposing more and more rules on street vendors. The definitions of who is a street vendor differ across legislation, the nature of a fee to be imposed on a street vendor differs, how the fees were to be collected and, more important, what services the fees were to support, changed often within a few years. The executive decrees issued after the election of Fujimori to the presidency involved more definitions of key terms and less coherence. The end result has been a 'dizzying array of conflicting incentives' for the street vendors as well as for local officials.

Shuaib (2004) also looks at the inter-tie between government actions and the outcomes in regard to street vending in many developing countries. He specifically examines the features of the 'urban informal street food sector' (UISFS) in the urban landscape of many developing countries. Given the increasing volume of food sold by street vendors

throughout the developing world, finding ways of increasing the safety of the food sold in this manner is a recognized challenge. Shuaib focuses on the selling of ‘lunch packets’ by street vendors in Colombo, Sri Lanka as an important case to illustrate these problems.

In contrast to the efforts of Peruvian officials, the Colombo Municipal Council has not recently tried to adopt multiple formal rules (even though there are multiple legislative acts on the books that authorize regulation of food processes). Rather, the Municipal Council has recently urged street vendors to stamp their names and addresses on the lunch packets they offer for sale. They have worked with local NGOs to increase their own capacity to monitor the quality of food sold, and have generally gained more information about the sector. Shuaib recommends that the Council formally recognize an organization of food street vendors and work directly with them to increase the facilities provided for street vendors, to reduce the multiplicity of definitions used and thus the lack of coherent and workable rules, and generate more effective information for all of those involved.

From these and related literature, the general advice is: Try not to replace or ‘crowd out’ informal rules that are generally understood and may potentially be relatively effective, but help to fine-tune them instead. Don’t keep passing new legislation when past legislation is massively ignored on the ground (Alden Wiley, chapter 15, this volume). Find out what the problems are on the ground and involve those who will be regulated in a real discussion of the sources of problems and how new formal rules might solve the problems being faced.

### *Implementation Capacity*

The third lesson is to tailor the intervention to the capacity of the structure. This comes from some of the empirical work in the volume where they show that over regulation when the regulatory units are very weak and incompetent is a terrible thing. The same level of regulation in a competent governance structure appears to have a positive macro economic effect. Try to avoid the natural tendency to create complex legislation. Where possible, build up the capacity of local regional units so that they can handle the desired regulation. The advice is: Tailor the intervention to the capacity that exists or help to build the capacity before you do an intervention.

Nugent and Swaminathan (chapter 12, this volume) illustrate a positive example of this lesson. When the government of Indonesian provided active backing for the capabilities of local health centers, this increased capacity helped to generate still further levels of volunteer labour by women served by the centers. Thus, modest investments in capacity building leveraged more active participation in the provision of health care in local villages.

Andersson and Pacheco (chapter 11, this volume) also illustrate the differential impact of a massive decentralization programme adopted in Bolivia on the actual policies adopted by municipalities. Simply assigning formal property rights is not a sufficient policy intervention to insure that timber practices are improved and commercial income increased. Municipalities that were well connected to higher level government agencies that helped to increase their capacity as well as link to local users were more able to utilize effectively the

new property rights assigned to them. In none of the communities studied had local users acquired logging permits without substantial external technical support.

### *Complementary Interventions*

The fourth lesson is that a successful intervention really needs multiple backup services in terms of information, courts, larger scale contexts, social capital, etc. Loayza *et al.* (chapter 7, this volume) conclude from their cross-country analyzes that high levels of regulating goods and factor markets is a major negative factor effecting macroeconomic performance. Many regulations act as barriers that disrupt the processes of private investment in new technologies for being more efficient and the need for resource reallocation to keep up with dynamic process. Their general finding is that governmental regulation tends to reduce economic growth. They find, however, that the quality of regulation—as measured by the institutional framework within which regulation is occurring—makes a big difference. In those countries where the broader institutions themselves are evaluated in World Bank studies as of high quality, the same regulations that produce bad outcomes in most countries are actually effective in the countries with high quality general institutions.

Guhu-Khasnobis and Ahuja (chapter 10, this volume) provide a specific example of the effectiveness of a multi-organization package. In their study of the insurance for informal economy workers in India, they point out how difficult it has been in the past to offer insurance to those who are poor and earn irregular income. And yet, it is just such a population that is most in need of insurance. Insurance for low-income workers is feasible only when it can be provided in a very cost-effective manner that is designed specifically to



meet the needs of those at risk. By working with ‘nodal agencies’ in the form of an NGO, a women’s group, a trade union, a micro-finance organization, or an organization of micro-entrepreneurs, the transaction costs of delivering insurance, receiving payments, informing users of benefits, etc., are dramatically reduced.

*Use Voting With Their Feet as an Evaluation Criteria*

The fifth lesson has to do with a test of whether current formalizations are working or not. The test is the extent to which people are willing to be within the net. Basically, we can see street vendors, small businesses and people who might gain formal ownership to their structures voting with their feet. If they decide to register, pay whatever taxes there are, etc., they are voluntarily coming within the net and this is a good sign. Thus, if you change the structure to benefit group a, b, or c, one of the criteria is whether voluntary compliance is increasing or not. The advice is: A good test of whether an intervention is helpful or not is to know how many of the relevant population try to be outside of the net.

Lensink, McGillivray, and Thi Thu Trà (chapter 8, this volume) studied the effects of financial reforms in Vietnam. Traditionally, Vietnam always had a vibrant informal financial sector, which fulfilled the credit needs of a large section of the population. Among other things, the reforms changed the composition of the formal and informal activities. However, they find that the relative importance of lending has gone up in what still remains as the ‘informal’ part of the financial sector.

The growing literature on informal trade (e.g., Pohit and Taneja 2004), provide examples where traders prefer to remain outside the ambit of official trade, because it is too costly and often beyond their logistical capacity to comprehend and hence comply with ‘rules’. A reflection of this is found in the current WTO negotiation on trade facilitation. In principle, the negotiation is meant to enhance trade. However, the uncertainty regarding the costs that developing and least developed countries will have to incur to implement the outcome of this negotiation has resulted in plenty of apprehension in such countries, who may simply decide to walk out of it.

## **1.5 CONCLUSION**

The debate on what exactly constitutes informality and formality continues, more than half a century after the distinction was first introduced, and more than three decades after it took centre stage in the development policy discourse. We point to the multiple definitions and characterizations and come to two conclusions on the formal–informal divide—one negative and one positive. The negative conclusion is that the tendency to associate ‘informal’ with ‘unstructured’ and ‘chaotic’ must end. Such an association is conceptually unsound, empirically weak, and has led to policy disasters as the state reached to provide ‘structures’ where it was presumed that none existed before. The positive conclusion is that we can fruitfully use the terminology of informal–formal to characterize a continuum of the reach of official intervention in different economic activities, especially since official statistics already use variants of such a criterion. However, it is to be clearly understood, as is made abundantly clear in the chapters in this volume, that ‘more’ or ‘less’ reach is not necessarily ‘better’ or ‘worse’. Different types of intervention work best in different

circumstances. The general principles outlined in this chapter, drawn from an array of detailed empirical investigations, suggest strongly that we should move beyond formality and informality, and tackle directly the policy interventions that will help the poor to unlock their potential through groups and through markets.

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## Notes

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- i Loayza *et al.* (chapter 7, this volume), for example, note that there are at least 7 areas of a firm's activity that are potentially subject to regulation: entry, exit, labour market relationship, fiscal burden, international trade, financial markets, and contract enforcement.
- ii Christensen (chapter 3, this volume) points out the importance of the international level as well.

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