

An Introduction to Informal Economy and an Estimation of its Size in Iran

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Informal economy encompasses a variety of activities which may have nothing in common except that they are all hidden. But it is not suitable to put all these essentially different activities which take place for different reasons in one ambiguous generalized concept.

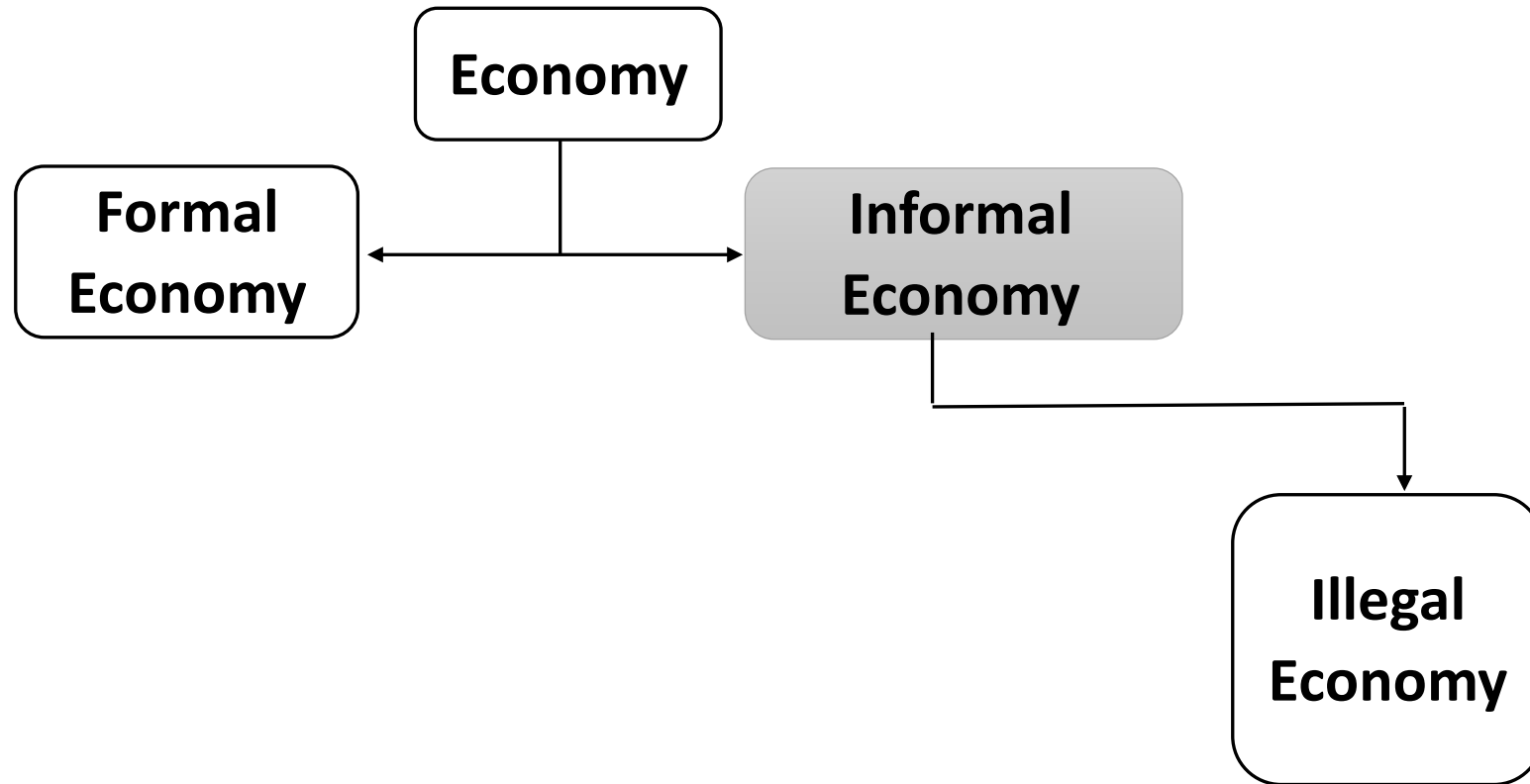
“A precise definition seems quite difficult if not impossible”

Schneider & Enste (2000: 3)

The following terms are used for a similar concept:

- Informal Economy (sector)
- Underground Economy (sector)
- Shadow Economy
- Non-observed Economy
- Non-registered Economy (sector)
- Parallel Economy (sector)
- Irregular Economy (sector)
- Black Economy
- Gray Economy

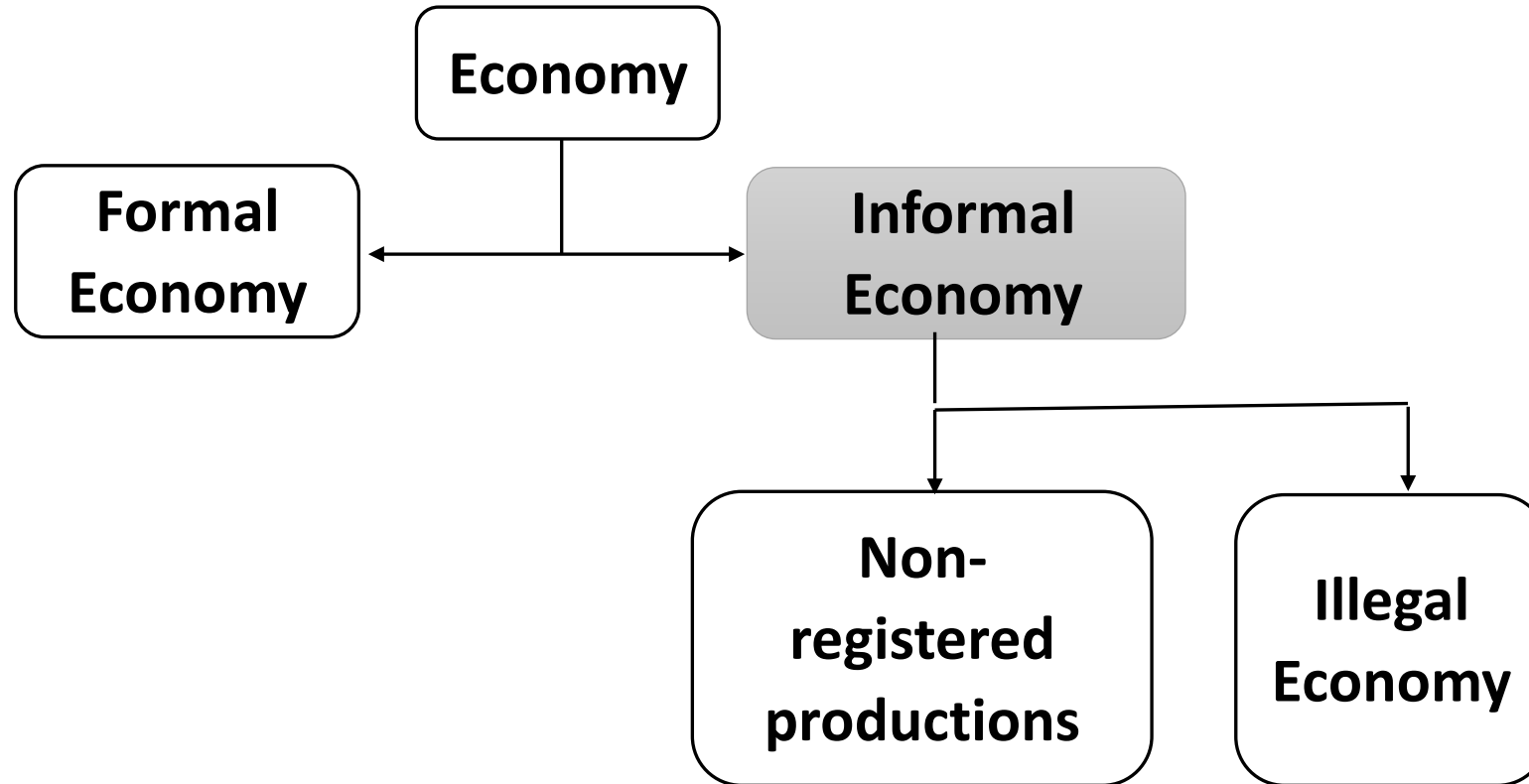
Classification of informal economy's activities



Illegal Economy

- Goods and services whose production, distribution and consumption are illegal; (like Narcotics)
- Illegal activities are not approved by lawmakers' decision. Examples of such illegal activities are different in time and between countries or even regions. For example alcohol is illegal in Iran but not in other countries; or marijuana was illegal before but now is permitted in some countries.
- Analysis of reasons and motivations for illegal activities locates in the era of criminal economy.

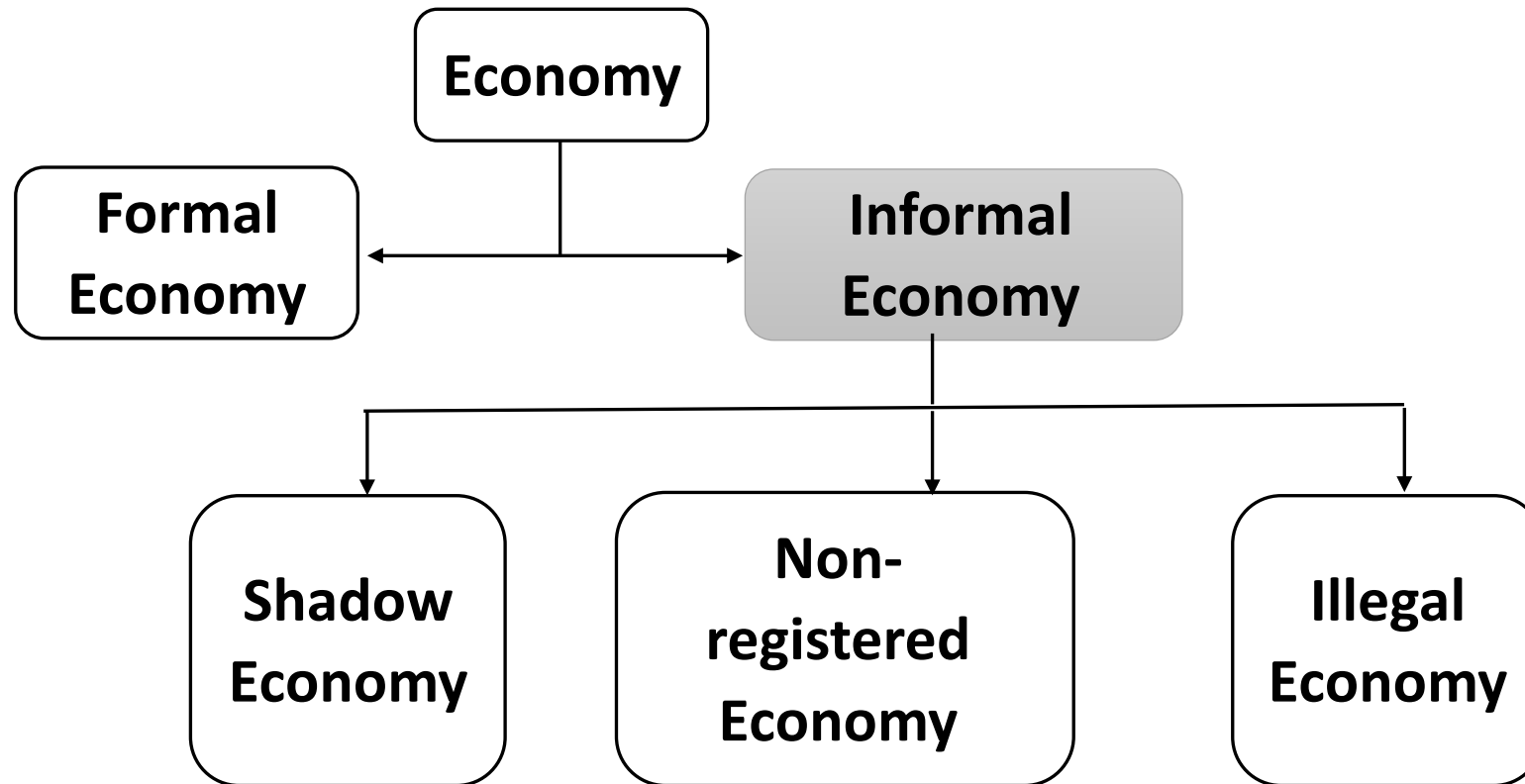
Classification of informal economy's activities



Non-registered Economy

- Economic activities which are essentially legal but remain unobservable due to underdevelopment of production processes or low economics of scale.
- Some of these non-registered activities like peddlers or unlicensed taxies are traded by money in markets while others like activities of housewives or do-it-yourself are done without money transaction.
- Based on countries' development stage, it is expected that these non-registered activities develop and fall in formal reports.

Classification of informal economy's activities



Shadow Economy

- These activities are similar to formal acts but are hidden from the government for economic reasons; ex. evasion of tax or social insurance contributions.
- Sometimes economic agents hide their activities in response to numerous government interventions and regulations. In these situations, shadow economy is a substitute for corruption or rent-seeking. In other instances, shadow economy is not passive but an active strategy that complements corruption and rent-seeking.

Costs of acting informally

Informal entrepreneurs do not benefit from public goods and services such as police and judicial systems. Their hidden activity is in danger of predatory by criminals or detection and closeness by the government. Insecurity makes their financing expensive. As a result, they utilize a non-optimal labor/capital ratio and produce in lower scales.

Informal Economy and the role of Government

Illegal Economy: illegal goods and services like narcotics and prostitution are hidden because the government has the responsibility to fight them. Government is the one which draws the boundary between legal and illegal goods. Besides that, governments traditionally have the duty of protecting property rights and fight with criminal activities.

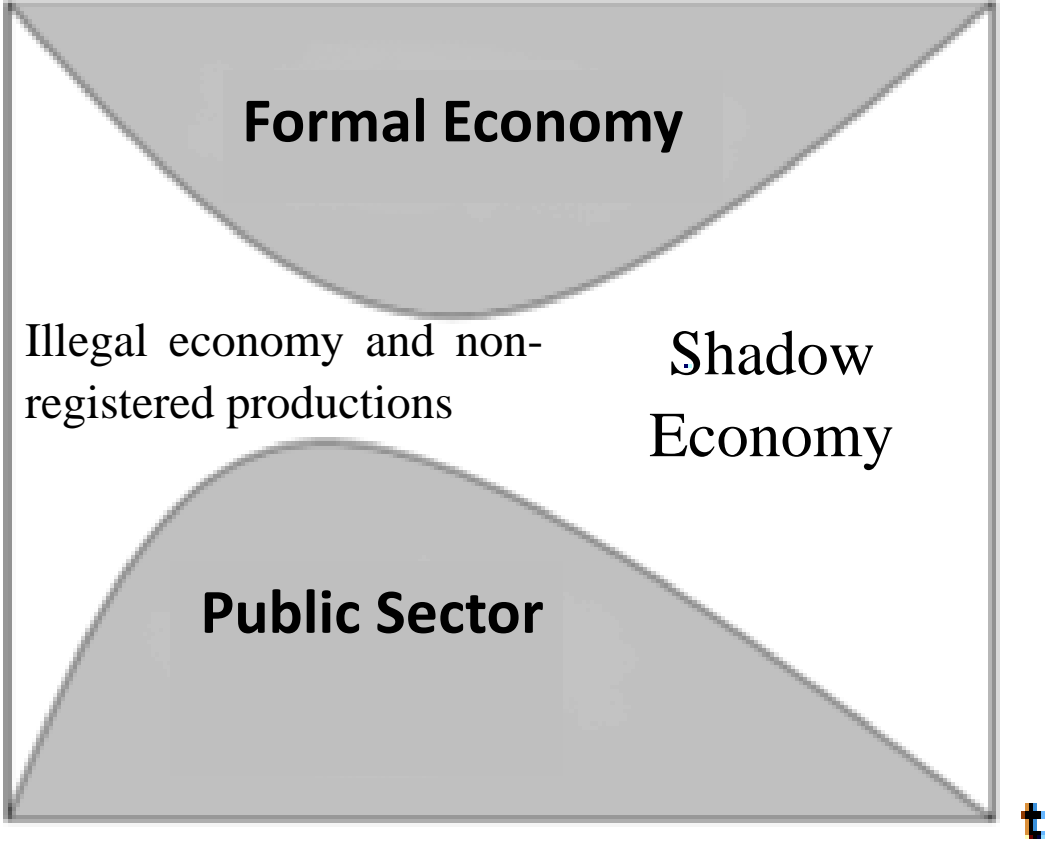
Informal Economy and the role of Government

In the class of non-registered productions, where economic activities remain unobserved due to their small scale and failure in registration, the role of government is profound. Governments traditionally have the duty of protecting property rights and preparing the environment for private businesses. In an uncontrolled and chaotic atmosphere, production takes place at low levels of organization with little or no division between labor and capital, and work relations are based on occasional jobs, kinship or personal relations.

Informal Economy and the role of Government

- Although government's active role is necessary in controlling the informal activities of the two extremes, namely the illegal economy and irregular production, the shadow economy in between takes place because of government over-regulations.
- Therefore, although beneficial, regulation of markets by government bears some costs. There is an optimal size of government.

Informal Economy and public sector (Schneider and Enste, 2000)



Measuring Informal Economy (MIMIC method)

Causes

X_{1t}

X_{2t}

...

X_{kt}



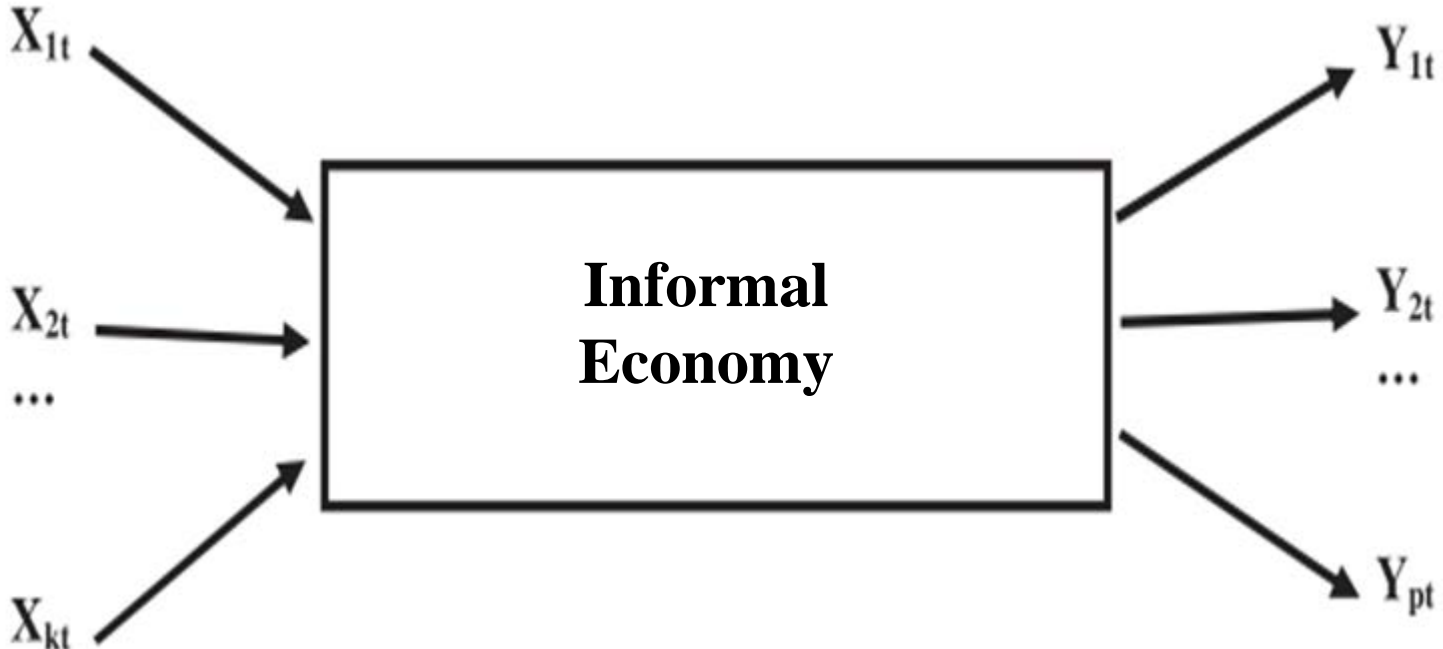
Indicators

Y_{1t}

Y_{2t}

...

Y_{pt}



The size of Informal Economy in Iran

