

INFORMAL ECONOMY ENTRY AND SOCIO-SPATIAL VARIATIONS: A FRAMEWORK FOR THEORY SELECTION AND APPLICATION

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ABSTRACT

Given current economic conditions, there is rising interest in informal economy entry modes and theoretical paradigms. Scholars must consider contextual and situational factors when ascertaining which theoretic prescriptions best explain reasons for entry. To address this gap, we use socio-spatial variations and Bhavé's Process model of opportunity recognition to examine three informal economy theories culminating in the development of a contextual framework that suggests appropriate theory selection for informal economy entry decisions. For policymakers wishing to increase the numbers of entrepreneurs transitioning to the formal economy, this framework may assist them in developing appropriate economic and regulatory policies.

Keywords: Informal Economy, Informal Economy Theories, Socio-Spatial Variations, Informal Entrepreneurs, Externally-Stimulated Opportunities, Internally-Stimulated Opportunities, Necessity Entrepreneurship

INTRODUCTION

The informal economy, commonly referred to as “undeclared,” “unregistered” or “shadow” economy [27], comprises nearly nine percent of U.S. GNP, and more than 50 percent of the GNP in many developing countries [16] [22]. We define the informal economy as any income generating (illegal but legitimate to some groups) activities unregulated by societal institutions through which actors recognize and exploit opportunities [5] [21]. Its membership includes both the poverty stricken and affluent. Some population groups participate out of necessity, while others exploit opportunity gaps emerging from formal and informal institutional incongruences [15] [21] [24] An expanding informal economy adversely impacts the formal economy through decreased tax collections, understated income, ineffective monetary policies, overstated unemployment rates, and unexplained currency growth [27]. A concerted effort is required from policy leaders to minimize the impact on the macroeconomy but public policymakers also need clarity on the motives and contextual factors prompting informal economy entry modes.

To guide researchers and better inform policymakers, we develop a Multitheoretical Informal Economy Entry Selection framework (MTIES). To establish a foundation for the MTIES framework, we summarize three theoretical perspectives on the informal economy: (1) socio-spatial variations; (2) entry motivations; and (3) external structural factors.

We address the following research questions:

1. Given socio-spatial variations, why do some individuals (i.e. Affluent, Middle-income, Poverty-stricken) located in various geographic locations (i.e. Urban, Suburban, or Rural) choose to enter the informal economy?
2. What are differentiating characteristics of necessity-based versus opportunity-driven entrepreneurship?
3. Which external structural factors (theoretical perspectives) best explain informal economy entry of some individuals?

Our framework is then created through the integration of literature on each of these three perspectives. Propositions are put forward and personal vignettes demonstrate the effectiveness and limitations of the MTIES framework. We conclude with a discussion of theoretical implications followed by recommendations for future research and policymakers.

LITERATURE REVIEW AND PROPOSITIONS

Socio and Spatial variations

Socio-spatial variation is based on two perspectives. *Socio variation* explains the characteristics and interaction of individuals with others in society, i.e. socioeconomic status, income levels, social values, norms, etc. [7] [13] [26] [28]. Studies by Williams [30] consider *spatial variations* as differences in locales and geographies (i.e. urban, suburban and rural). Individuals enjoying spatial proximity (i.e. urban) often share common experiences that render similar social norms, values and beliefs. Scholars note that there are marked differences in entrepreneurial activity and quality based on regional and entrepreneurial support mechanisms [2]. As such, we incorporate socioeconomic status (i.e. affluent, middle income, and poverty stricken) and locale (i.e. urban, suburban, and rural) as important contextual factors to consider when examining informal economy entry.

Motivations for Entry into the Informal Economy: Necessity versus Opportunity

Edgecombe and Thetford [7] emphasize that both women and men, the poor and non-poor, immigrants, the educated and the less educated, all engage in the informal economy. For some it is an economic necessity, their only resort or a better alternative to low-wage formal employment. Others are involved in informal work based on the pursuit of an opportunity to exploit some business opportunity for personal fulfillment, social obligation, or as a means of supplementing their primary income [7] [3]. Gerxhani [8] contends that many participate by choice because they find more autonomy, flexibility and freedom. Many are employees working for others, in sweatshops or out of their homes in contract relationships to producers [7]. But, many are also self-employed.

External Structural Factors: Theoretical Perspectives.

External structural factors can be viewed from three perspectives. The structuralist perspective builds on [20] world systems framework describing an informal periphery of low wages and minimal economic activity where individuals are survivalists who out of necessity engage in labor-intensive activities, without job security or benefits [12]. The “rich formal sector extracts value from the poor informal sector” to lock in a persistent inequitable world system. Widespread poverty and unemployment cause structurally isolated communities to seek informal economic arrangements for “survival” [9]. The “underground economy enables poor communities to survive but can lead to alienation from the wider world [19, p. 385]. Because of the exploitative practices of globalization, and lack of regulations, informal entrepreneurs are forced to work in the underground economy

because they are unable to compete with low wage workers in foreign countries or find work given their limited education levels [5] [18]. The theme of neoliberalism is limited government, and political and social freedoms. Neoliberal scholars theorize that entry into the informal economy is a direct result of state and federal overregulation of the economy, increased taxation, and social legislation [5] [6]. These policies facilitated the rise of the welfare state which in turn prompts individuals and companies to escape its reach. Neoliberals see informality as free choice, which contrasts with structuralists who view informality as imposed constraint deeply rooted in economic structures [9]. Post-structuralism characterizes informal entrepreneurs as social and not economic actors [26]. This perspective suggests that informal entrepreneurship is a choice for social, redistributive, and identity reasons, and not purely financial [14] [17]. These social actors resist the perceived exploitation of workers and corruption under the neo-liberal global system [4] [23].

In the past, scholars portrayed these perspectives as mutually exclusive [1]. Recent scholars have taken a more integrative approach, e.g., [10] [26] began associating theories with certain populations of informal entrepreneurs (i.e. structuralists and deprived groups; post-structuralist and affluent groups). Still, Williams and Nadin [26] contend that relatively few researchers evaluate contrasting validity of rival theories in different contexts. We seek to fill that gap in the literature by developing a multitheoretic framework of informal economy entry, using the contexts of socioeconomic and spatial variations and external structural factors.

Selected Propositions:

Proposition 1: *The reasons why Affluent, regardless of spatial variation (urban, suburban, rural), enter the informal economy is best explained by the neo-liberal (i.e. freedom and control, avoid excessive taxes and bureaucracy), or post-structuralist perspectives (i.e. informal entrepreneurs start ventures for social/distributive reasons and not necessarily for economic gain).*

Proposition 2: *The reasons why Middle-incomers, regardless of spatial variation (urban, suburban, rural), enter the informal economy are best explained by the neo-liberal perspective (i.e. freedom and control, avoid excessive taxes and bureaucracy).*

Proposition 3: *The reasons why Poverty-Stricken, regardless of spatial variation (urban, suburban, rural), enter the informal economy is best explained by the structuralist perspective (i.e. for survival and out of necessity). [7] [15] [17] [25] [27] [28] [30].*

Proposition 4: *The structuralist perspective best explains the informal economy entry of necessity-based entrepreneurs [26] in all socio-spatial setting while the neo-liberal, or post-structuralist perspectives best explain the informal economy entry of opportunity-driven entrepreneurs in all socio-spatial settings. [8] [11] [15] [17] [18] [25] [27] [29].*

Proposition 5: *When necessity-based and opportunity-driven typologies are co-present, the structuralist and neoliberal, or, the structuralist and post-structuralist perspectives best explain the informal economy entry of each of the socio-variations in all spatial settings. The affluent and middle income, more often than not, pursue opportunity-driven informal work while the poverty-stricken, more often than not, pursue necessity-based informal work. [20] [24] [25] [29].*

THE MULTITHEORITICAL INFORMAL ECONOMY ENTRY SELECTION FRAMEWORK

In Table 1 we present the Multitheoretical Informal Economy Entry Selection - MTIES - framework which is developed using findings in the literature. The framework integrates informal economy literature showing common theories, and entry typologies. To develop the theoretic framework and

corresponding propositions, we compartmentalize *socio-spatial variations* in a 3x3 matrix (see Table 1) where columns listed from left to right are Urban, Rural, and Suburban. The rows from top to bottom are Affluent, Middle-Incomers, and Poverty-Stricken. The Propositions are distilled from the extant literature including several case studies and vignettes in the current study to provide the foundation for the MTIES framework.

TABLE 1

		SPATIAL VARIATION					
		URBAN		RURAL		SUBURBAN	
		Necessity	Opportunity	Necessity	Opportunity	Necessity	Opportunity
S O C I O E C O N O M I C S T A T U S	AFFLUENT	Structuralist	Neo-liberal ↔ Post-structuralist	Structuralist	Neo-liberal ↔ Post-structuralist	Structuralist	Neo-liberal ↔ Post-structuralist
	MIDDLE-INCOMER	Structuralist	Neo-liberal ↔ Post-structuralist	Structuralist	Neo-liberal ↔ Post-structuralist	Structuralist	Neo-liberal ↔ Post-structuralist
	POVERTY-STRICKEN	Structuralist	Neo-liberal ↔ Post-structuralist	Structuralist	Neo-liberal ↔ Post-structuralist	Structuralist	Neo-liberal ↔ Post-structuralist

Figure 2. Multitheoretic Informal Economy Entry Selection (MTIES) Framework: Necessity-based and Opportunity-driven

Notes: ↔ Denotes the co-presence of necessity-based and opportunity-driven informal work and the multiple theories that may explain informal entry activities.

Bolded theories show which theory (along with structuralist and socio-spatial variation) most often describes informal economy entry when necessity and opportunity are co-present. For the poverty-stricken, when necessity and opportunity are co-present, neo-liberal or post-structuralist perspectives may describe (at equal rates of utility) informal economy entry (in tandem with the structuralist perspective and appropriate spatial variation).

Discussion and Conclusion

The MTIES framework, consistent with prior studies, suggests that theory selection is extremely circumstantial, particularly as it relates to locality and socioeconomic status. Our findings show plausible contextual application with the MTIES framework which includes entry typologies, necessity-based and opportunity-driven informal entrepreneurship. The framework also illustrates that more often than not, the informal activities of middle-incomers can be best explained using a neo-liberal perspective, and that irrespective to spatial variation, the informal activities of the affluent might be best explained using neo-liberal or post-structural perspectives in all spatial settings

Our second question asked whether the MTIES framework could sufficiently capture necessity-based and opportunity-driven entrepreneurship. We established through literature review, case scenarios and personal vignettes the ability of the framework to effectively classify the informal entry activities of entrepreneurs. As a case in point, the framework shows that informal work among poverty-stricken entrepreneurs may be best examined using a structuralist perspective, *but* at times, when necessity and opportunity are co-present; both the structuralist and neo-liberal, or the structuralist and post-structuralist perspectives may apply. The advanced MTIES framework might also be used with Williams and Round's [29] model to guide practitioners on the types of informal work that should be targeted either for transitioning to the formal economy, or eradication.

As informal economy entry levels rise, the reasons and contexts for entry and post-entry activities are of increasing importance to policy makers. We examined three prevailing theories of the

informal economy that predict entry using contextual factors. Given these factors, relevant theories might be chosen to better predict informal entrepreneurial activity in disparate environments. Our findings contribute to entrepreneurship literature in several ways. First, the MTIES framework integrates concepts from multiple disciplines (i.e. sociology, economics, management) to present a multifaceted model of informal economy entry modes within the confines of socio-spatial variations (i.e. socioeconomic status; urban, suburban, rural). Second, our framework serves to guide researchers' selection of appropriate theories for future research involving environmental and contextual factors. Third, given the scant literature, the framework may be the first to explore suburban informal economy entry modes with the integration of entry typologies, *necessity-based* and *opportunity-driven* entrepreneurship. Fourth, the framework can be extended to include macro, meso, and micro variables, which can include cognitive variables (i.e. affect), social norms, and attitudes. Finally, the MTIES model develops propositions that if converted to testable hypotheses, provide yet another contribution to the literature.

Limitations and Implications

As with any model, the MTIES framework is limited in that it focuses on factors relating to socioeconomic status, spatial variations, and structural factors. It does not examine cognitive factors such as values, customs and social norms, and culture. The MTIES framework suggests to public policymakers the importance of flexibility when addressing the complex dynamics that define informal economy entrepreneurship across the various socio-spatial contexts while avoiding broad-brushed approaches to curtail informal economy activity. This study assists policymakers in spatially diverse regions – urban, suburban, and rural – to consider optimal strategies based on their goals and available resources, and the socio-economic characteristics of various individuals and communities – affluent, middle-income or poverty-stricken – within their regions. Regulatory policies should focus on entrepreneurs with stronger proclivities towards formality. Perhaps, grassroots, community-based nonprofit organizations may be useful mechanisms from which to transition informal businesses to the formal sector.

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