The Informal Economy: Between New Developments and Old Regulations

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The growth of an informal economy in the large cities of highly developed countries prompts new questions about the relationship between economy and regulation today. As I shall employ the term, the “informal economy” refers to those income-generating activities occurring outside the state’s regulatory framework that have analogs within that framework. The scope and character of the informal economy are defined by the very regulatory framework it evades. For this reason, the informal economy can only be understood in terms of its relationship to the formal economy—that is, regulated income-generating activity.

The main theories of economic development—whether proffered by the modernization or the Marxist schools of thought—do not foresee the inevitable emergence of an informal economy in highly developed countries. Such theories do allow for criminal activities and underreporting of income in advanced economies; these activities do not signal the presence of any novel or unexplained economic dynamic. Income underreporting, for instance, is acknowledged as an inevitable response to the state’s implementation of a tax system. Nevertheless, the main theories of economic development have yet to adequately explain the phenomenon of the informal economy in advanced capitalist (usually urban) societies.

Until recently, theorization about the informal economy has focused on the shortcomings of less developed economies: their inability to attain full modernization, to stop excess migration to the cities, and to implement universal education and literacy programs.¹ The growth of an informal economy in highly developed countries has been explained as the result of immigration from the Third World and the replication here of survival strategies typical of the home countries of migrant workers. Related to this conception is the notion that “backward” sectors of the economy, such as the garment industry, remain backward (or even continue to exist) because a large supply of cheap immigrant labor is available. Both of these views imply that if there is an informal economy in highly developed countries, it is solely

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1. See, e.g., W. ARTHUR LEWIS, *THE THEORY OF ECONOMIC GROWTH* (1955).

attributable to Third World immigration and the existence of backward sectors of the economy, not to the nature of the current phase of advanced economies.

Rather than simply assume the truth of such an argument, we must critically examine the role that Third World immigration might or might not play in the informalization process. Although immigrants, insofar as they tend to form communities, may be in a favorable position to seize the opportunities presented by informalization, immigrants do not necessarily *create* such opportunities. Instead, the opportunities may well be a structured outcome of the composition of advanced economies. The argument presented here is that informalization must be seen in the context of the economic restructuring that has contributed to the decline of the manufacturing-dominated industrial complex of the postwar era and the rise of a new, service-dominated economic complex.² The specific mediating processes that promote informalization of work are: (1) increased earnings inequality, and the concomitant restructuring of consumption in high-income and very-low-income strata; and (2) the inability of providers of many of the goods and services that are part of the new consumption to compete for necessary resources in urban contexts, where leading sectors have sharply bid up the prices of commercial space, labor, auxiliary services, and other factors of production. The growing inequality in earnings among consumers, and the growing inequality in profit-making capabilities among firms in different sectors in the urban economy, have promoted the informalization of a growing array of economic activities. These shifts in earnings and profit-making capabilities are integral conditions for the current phase of advanced capitalism developing in major cities. The new, advanced services complex, typically oriented toward world markets and capable of generating extremely high profits, dominates these cities. The conditions giving rise to informal economies in these cities cannot be said to be imported from the Third World.

To explain the source of informal economies in advanced urban societies, I consider the differential impact that (1) immigration and (2) conditions in the economy at large may have upon the formation and expansion of informal income-generating processes. Each of these factors has specific implications for research and policy development. If conditions in the economy at large have a greater impact on the development of informal economies, then we need to deepen our understanding of the nature of advanced capitalism. But if immigration has the greater impact, then we may indeed find adequate the current development theories of advanced economies or the post-industrial society, which allow no room for phenomena such as informalization. Similarly, the primacy of immigration would suggest, at its crudest, that policymakers should control immigrant activity in order to eradicate the

2. This has been a central hypothesis organizing much of my research on the informal economy. See, e.g., SASKIA SASSEN, *THE GLOBAL CITY: NEW YORK, LONDON, TOKYO* 283-99 (1993).

informal economy. If, however, conditions in the economy at large are primary, as I argue, then policymakers should stop approaching the informal economy as an anomaly. They should instead view the informal economy as a necessary outgrowth of advanced capitalism. Rather than treat its components as isolated deviations from the norm, policymakers should recognize that a new norm has developed; rather than attempt to make this new norm fit the regulations developed decades ago, they should develop new regulations to fit this norm.

Elsewhere I have argued that it might be useful to think in terms of regulatory "fractures," rather than regulatory "violations." Increasingly, economic processes diverge from the model for which extant regulations were designed. As these divergences take on a recognizable shape of their own, it becomes meaningless to speak of regulatory violations; informal economic activity as here described is not a scattering of isolated deviations, but a recurrent pattern. The difficulty, if not impossibility, of acknowledging the existence of an informal economy in today's regulatory framework without criminalizing that economy is an instance of what I have referred to as a regulatory "fracture."³

In order to identify systemic links between informalization and structural conditions in advanced capitalism, I shall discuss the effects of major growth trends in shaping different types of jobs, firms, and subcontracting patterns that induce or are themselves susceptible to informalization.⁴ There is no precise measurement of informalization, and the evidence of this process cannot be culled from one neat set of data. However, pairing systemic trends with the available evidence provides us with a basic understanding of the patterns and scope of informalization and the conditions that foster its growth.

3. See, e.g., SASKIA SASSEN, *CITIES IN A WORLD ECONOMY* (1994). A number of instances fit this notion of a problematic dynamic between regulation and economy. For example, I use the concept "fracture" to capture the specific dynamic produced by *global* processes operating in *particular* localities. One result of this development is that both "regulation" and "violation" become problematic categories and, at the limit, do not apply. We might think of the void analytically as a *border-land*, rather than a *border-line*—a terrain for action/activity that remains underspecified, at least from the perspective of regulation. Global cities are particularly strategic terrains for the emergence or shaping of regulatory fractures. See generally SASSEN, *THE GLOBAL CITY*, *supra* note 2; Saskia Sassen, *The Global Movement of Capital and Labor*, Paper Presented at the American Society of International Law, International Economic Law Interest Group Workshop on Interdisciplinary Approaches to International Economic Law (Feb. 24, 1994) (on file with author).

4. For a full account of research findings over the last ten years, see SASSEN, *THE GLOBAL CITY*, *supra* note 2; *THE INFORMAL ECONOMY IN LOW-INCOME COMMUNITIES IN NEW YORK CITY* (1987) (research report on file with Urban Planning Dep't, Columbia Univ.); Saskia Sassen & Robb Smith, *Postindustrial Growth and Economic Reorganization: Their Impact on Immigrant Employment*, in *U.S.-MEXICO RELATIONS: LABOR MARKET INTERDEPENDENCE* 372-93 (1992). All findings described in this Essay are based upon these earlier research projects.

I. SPECIFYING THE INFORMAL ECONOMY

We can only obtain an operational definition of the informal economy⁵ against the backdrop of an institutional framework for economic activity in which the state intervenes explicitly to regulate the processes and products of income-generating activities according to a set of enforceable legal rules. Nevertheless, the informal economy (as I use the term) does not include every transaction that happens to evade regulation. The concept excludes certain types of income-generating activities, such as teen-age babysitting, that we almost expect to escape regulation. What makes informalization a distinct process today is not these small cracks in the institutional framework, but rather the informalization of activities generally taking place in the formal economy. For example, a student of the informal economy would find a sweatshop most interesting because it operates against a background in which people expect such enterprises to comply with regulation. Today's sweatshops may look similar to the sweatshops of the last century. Yet, the implementation of various health and labor regulations since then is what makes today's sweatshops a different form of labor/employer relation than their counterparts of one hundred years past, when no such regulations existed and the vast majority of manufacturing took place in sweatshops. The type of social relation represented by sweatshop work is defined by its historical context, in this case one where the activity of manufacturing has been regulated for decades.

While there are certain activities that lend themselves more to informalization than others, it is not the intrinsic characteristics of those activities, but rather the boundaries of state regulation, that determine their informalization. As these boundaries vary, so does the definition of what is formal and what is informal. The informal economy is not a clearly defined sector or set of sectors. Neither is the informal economy a fixed set of activities undertaken solely for survival. Instead, the shape of the informal economy changes according to the opportunities created and constraints imposed by the formal economy. The key to an analysis of the informal economy, then, is not so much a precise description of the particular activities it encompasses at any given moment, as a description of the basic dynamics

5. The "informal economy" is one of several kinds of economic activity that fall under the rubric of the "underground economy." We can distinguish at least three very different components of the underground economy. First, the underground economy includes criminal activities, which by their very nature could not be carried out above ground. Second, the underground economy includes tax evasion on licit forms of income. In the United States today, the available information shows a large jump in the amount of unreported income, especially compared to the 1950's, 1960's, and early 1970's. The IRS projected in 1990 that the tax gap for 1992 would be \$114 billion, two-thirds of which is attributable to individuals. See INTERNAL REVENUE SERVICE, INCOME TAX COMPLIANCE RESEARCH: NET TAX GAP AND REMITTANCE GAP ESTIMATES, PUBLICATION 1415 (SUPP. TO PUBLICATION 7285) (Apr. 1990), cited in CONG. Q. RESEARCH, Mar. 1994, at 203. Third, the underground economy includes the informal economy, which contributes to the tax gap, but which is distinguishable from income underreporting.

that make possible or even induce informalization, despite regulatory policies and pressure from institutions such as labor unions and enforcement agencies.

Professors Manuel Castells and Alejandro Portes have identified certain elements of the work process, such as status of labor, work conditions, and form of management, as factors that often evade regulation in the informal economy. Although each of these elements may escape the state's institutional framework, the unregulated status of any one is neither necessary nor sufficient to characterize the overall work process as part of the informal economy.⁶ The status of labor, for example—the identities of the employees in an enterprise, whether aliens or citizens—does not determine the formality or informality of the enterprise. In principle, an undocumented immigrant may be employed in a fully regulated job in the formal economy in full compliance with the laws, while a legal citizen may be employed in an informal shop.⁷ While it is true that in the United States we have found a large number of undocumented immigrants in the informal economy,⁸ it is also true that many of the illegal homeworkers in the Netherlands, for example, are Dutch citizens,⁹ and many of the workers in the unregulated factories of Emilia-Romagna in Italy are Italian citizens.¹⁰ Thus, the expansion of informalization does not, in principle, depend upon the existence of an immigrant labor force. Furthermore, in terms of the conditions of work, informal work is, in itself, licit work. But if it is done in the home when there is a ban on doing such work in the home, or if it is done in factories which violate various codes, the work becomes illegal. A factory or a shop that fails to comply with health, fire, labor, tax, zoning, or other such regulations is part of the informal economy, even if all the workers are properly documented.

Measuring the size and geographical scope of the informal economy is particularly difficult because of its shifting boundaries and interaction with the formal economy. However, the measurement problem does not preclude analysis. Informalization is a process whose particular empirical content varies, but whose analytic meaning remains fairly constant when specified along the lines set out above. The process of informalization across different sectors reflects common trends that help to explain the mechanics of that process.

6. See Manuel Castells & Alejandro Portes, *World Underneath: The Origins, Dynamics, and Effects of the Informal Economy*, in *THE INFORMAL ECONOMY: STUDIES IN ADVANCED AND LESS DEVELOPED COUNTRIES* 11 (Alejandro Portes et al. eds., 1989).

7. Sanctions against employers under the Immigration Reform and Control Act of 1986, Pub. L. No. 99-603, 100 Stat. 3359, alter this proposition in those cases where an employer knowingly hires an undocumented worker. The informality then consists in the form of management.

8. See, e.g., M. Patricia Fernandez-Kelly & Anna M. Garcia, *Informalization at the Core: Hispanic Women, Homework, and the Advanced Capitalist State*, in *THE INFORMAL ECONOMY*, *supra* note 6, at 247; Saskia Sassen-Koob, *New York City's Informal Economy*, in *THE INFORMAL ECONOMY*, *supra* note 6, at 60; Alex Stepick, *Miami's Two Informal Sectors*, in *THE INFORMAL ECONOMY*, *supra* note 6, at 111.

9. See P. H. RENOY, *TWILIGHT ECONOMY: A SURVEY OF THE INFORMAL ECONOMY IN THE NETHERLANDS* (Faculty of Economic Sciences, Univ. of Amsterdam ed., 1984).

10. See Vittorio Capecchi, *The Informal Economy and the Development of Flexible Specialization in Emilia-Romagna*, in *THE INFORMAL ECONOMY*, *supra* note 6, at 189.

II. CONDITIONS FOR INFORMALIZATION IN ADVANCED ECONOMIES

The forms economic growth has assumed in the post-World War II era—notably capital intensity, standardization of production, and suburbanization-led growth—have contributed to the vast expansion of a middle class and deterred and reduced informalization. The cultural forms accompanying these processes shaped the structures of everyday life insofar as a large middle class engages in mass consumption and thus contributes to standardization in production. Large-scale production and mass consumption were conducive to higher levels of labor unionization and worker empowerment than had existed before World War II. It was in that postwar period, extending into the late 1960's and early 1970's, that the incorporation of workers into formal labor market relations reached its highest level.¹¹

The decline of mass production as the main engine of national growth and the shift to services as the leading economic sector contributed to the demise of a broader set of social arrangements, particularly a weakening of the larger institutional framework that shaped the employment relationship. This context is important in understanding the conditions for informalization in advanced economies. The groups of service industries that were the driving economic force in the 1980's were characterized by greater earnings and occupational dispersion, weak labor unions, and mostly unsheltered jobs in the lower-paying echelons.¹² Along with the decline in manufacturing, these trends altered the institutional framework that shaped the employment relationship in the 1980's. Changes in the employment relationship reshaped social reproduction and consumption trends which, as discussed below, have had a feedback effect on economic organization and earnings. While in the earlier period a similar feedback effect helped reproduce the middle class and formalization of the employment relationship, currently it reproduces growing earnings dispersion and the casualization of the employment relationship.

The overall result of the transformation of the economic structure is a tendency toward increased economic polarization. The ascendancy of finance and specialized services, particularly concentrated in large cities, creates a critical mass of firms with extremely high profit-making capabilities. These firms bid up the prices of commercial space, industrial services, and other factors of production, such as energy and business services. The high profit-making firms thereby make survival for firms with moderate profit-making capabilities increasingly precarious. My research indicates that even when moderate profit-making firms have a stable, or even increasing, demand for their goods and services from households and other firms, operating informally

11. BENNETT HARRISON & BARRY BLUESTONE, *THE GREAT U-TURN: CORPORATE RESTRUCTURING AND THE POLARIZING OF AMERICA* ch. 1 (1988).

12. For a comparison of the distinct manner in which these processes took place in the United States, the United Kingdom, and Japan, see SASSEN, *THE GLOBAL CITY*, *supra* note 2, at chs. 8 & 9.

is often one of the few ways in which they can survive. In short, the sectors in which these firms operate may be thriving, demand may be sufficiently high to attract new entrants into the sector, but despite the high demand, the only way to succeed may be to operate informally.¹³ Alternatively, firms with limited profit-making capabilities may subcontract part of their work to informal operations. This alternative allows the contracting firm to operate formally *and* reduce its costs of operation.¹⁴

The polarization I have described does not simply constitute a quantitative transformation; it possesses the elements of a new economic regime.¹⁵ As indicated above, the tendency toward polarization assumes distinct forms in (1) structures of social reproduction; (2) organization of the labor process; and (3) spatial organization of the economy.

Increased economic polarization affects not only businesses, but also patterns of social reproduction and consumption. Although the middle class still constitutes the majority, the conditions that contributed to its expansion and political-economic power—the centrality of mass production and mass consumption in economic growth and profit realization—have been displaced by new sources of growth that feed the top and the bottom of the income structure. The expansion of a low-income population fuels the demand for very cheap goods and services; the informal economy can help satisfy that demand and, indeed, it can compete against low-priced imports in these markets. The expansion of a high-income stratum in cities promotes demand for customized goods and services; this market includes the rise of a designer culture in all forms of consumption, from food and clothing to furniture and home renovation. The production and/or distribution of customized goods and services frequently draws on the informal economy at some point in the work process.

The rapid growth of industries with strong concentrations of high- and low-income jobs has assumed distinct forms in the consumption structure, which in turn has had a feedback effect on the organization of work and the types of jobs being created. The expansion of the high-income work force, in conjunction with the emergence of new cultural forms, has led to a process of high-income gentrification that ultimately depends on the availability of a vast supply of low-wage workers.¹⁶ High-income gentrification is labor-intensive, whereas middle-income suburbanization is capital-intensive. The latter phenomenon is characterized by tract housing, road and highway construction,

13. These conclusions are based upon research described in note 4, *supra*.

14. Subcontracting chains that end in informal operations are very common in several industries, including apparel, construction, and cleaning services. See generally Christian Zolniski, *The Informal Economy in an Advanced Industrial Society: Mexican Immigrant Labor in Silicon Valley*, 103 YALE L. J. 2305 (1994).

15. See SASSEN, *THE GLOBAL CITY*, *supra* note 2, at chs. 9 & 10.

16. See SASKIA SASSEN, *THE MOBILITY OF LABOR AND CAPITAL: A STUDY IN INTERNATIONAL INVESTMENT AND LABOR FLOW* ch. 5 (1988).

dependence on private automobile or commuter trains, marked reliance on appliances and household equipment of all sorts, and large shopping malls with self-service operations.¹⁷ High-income gentrification replaces many of these capital-intensive projects with operations that rely heavily on workers, directly and indirectly. Similarly, high-income residents in cities depend to a much greater extent on hired maintenance personnel than do middle-class suburban households, with their concentrated input of family labor and machinery.

Behind the gourmet food shops and specialty boutiques that have replaced many self-service supermarkets and department stores in cities lies an organization of work that is very different from that prevailing in large, standardized establishments. This difference in the organization of work is evident both in retail and production phases. High-income gentrification generates a demand for goods and services often unsuitable for mass production or mass retailing. Customized production, small runs, specialty items, and fine food dishes are generally produced through labor-intensive methods and sold through small, full-service outlets. Subcontracting part of this production to low-cost operations, including sweatshops and households, is common. The types of firms and labor that serve this market are distinct from the large department stores and supermarkets that serve the middle-income market. Department stores and supermarkets typically sell standardized products, which they acquire from large, standardized factories located outside the city or the region. Proximity to retailers is of far greater importance to customized producers. These producers rely heavily on specific customer input in designing their product line, and their small scales of production raise the relative costs of transportation and national distribution. Furthermore, unlike mass production and distribution, customized production and distribution do not facilitate labor unionizing.

The expansion of the low-income consumer population in large cities has also contributed to the proliferation of small operations and the move away from large-scale standardized factories and large chain stores for low-priced goods. The consumption needs of the low-income population are met in large part by small manufacturing and retail establishments that rely on family labor and often fall below minimum safety and health standards. Cheap, locally produced sweatshop garments, for example, compete with low-cost Asian imports. A growing range of products and services, from low-cost furniture made in basements to "gypsy cabs" and family day care, is available to meet the demand of the growing low-income population.¹⁸

In any large city, there also tends to be a proliferation of small, low-cost service operations made possible by the massive concentration of people in

17. See PAUL BLUMBERG, *INEQUALITY IN AN AGE OF DECLINE* (1980).

18. See SASSEN-KOOB, *THE INFORMAL ECONOMY IN LOW-INCOME COMMUNITIES IN NEW YORK CITY*, *supra* note 4.

such cities and the daily inflow of commuters and tourists. Sheer numbers of people, as well as fierce competition and low returns, create strong inducements to open such operations. Under such conditions, the cost of labor is crucial and enhances the likelihood that there will be a high concentration of low-wage jobs.¹⁹

There are numerous examples of how the increased inequality in earnings reshapes the consumption structure and how this, in turn, affects the organization of work. The impact of the shift in demand appears in both the formal economy and the informal economy. (Recall that, by my definition, activities in the informal economy have counterparts in the formal economy.²⁰) However, the size of businesses serving either high-income or low-income customers is typically smaller than that of businesses serving the large middle class. The reduction in size, and the accompanying loss of economies of scale and scope, sometimes make it advantageous for businesses to operate in the informal economy, and often requires them to do so. Responses to this shift in demand include the increase in highly customized woodwork in homes and shops in gentrified neighborhoods, the increase in low-cost rehabilitation of homes and shops in poor neighborhoods, and the increase in homeworkers and sweatshops making either very expensive designer products for boutiques or very cheap products.

Income polarization is also expressed spatially. Services in the formal economy for high-income customers have proliferated, as have services in the informal economy for low-income customers. Taxi services and banking services illustrate this pattern. The creation of a special, fully registered limousine line that exclusively services New York City's financial district stands in stark contrast to the increase in gypsy cabs servicing low-income neighborhoods, where registered cab drivers typically refuse to go.²¹ The spatial impact of income polarization is also evident in the distribution of bank branches. A recent study presented to the New York State Legislature that addressed commercial bank branch closings and openings in the New York

19. This tendency was confirmed, for instance, by Sheets, Nord, and Phelps, who found that each 1% increase in retail jobs resulted in a 0.88% average increase in below-poverty-level jobs in the 100 largest metropolitan areas in 1980. See ROBERT G. SHEETS ET AL., *THE IMPACT OF SERVICE INDUSTRIES ON UNDEREMPLOYMENT IN METROPOLITAN ECONOMIES* 73 (1987).

20. See *supra* p. 2292.

21. See Elliot Sclar et al., *The Nonmedallion Taxi Industry*, in CITY ALMANAC (Fall 1988). The full research report is on file at the Urban Planning Department, Columbia University. As described in Saskia Sassen, *The Informal Economy*, in DUAL CITY: RESTRUCTURING NEW YORK 101 n.52 (John Mollenkopf & Manuel Castells eds., 1991):

[Sclar, Grava, and Downs] found that virtually every black or ethnic neighborhood had some form of 'gypsy' and 'livery' car service, and that these were typically run by members of the community: thus there are black, Puerto Rican, Haitian, Korean, and Hassidic Jewish 'livery' car services. They estimated the current livery car service fleet at 22,000 vehicles. While many of these are in compliance, many are not. None of the estimated 8,000 gypsy cabs, on the other hand, are in compliance.

metropolitan area²² revealed a wave of bank branch closings even larger than the one that took place in the early 1980's.²³ While the earlier rash of branch closings was concentrated in low-income areas, the latest wave affected the more modest segments of middle-income areas.²⁴ Five major New York City banks accounted for all but one of the closings of commercial branches in New York City neighborhoods with minority populations greater than fifty percent.²⁵ During the same period, branch services increased in the suburbs and in high-income areas in New York City.²⁶ Banks also opened numerous "personal financial centers" or "private banking centers" in affluent areas of New York City. In some of these branches a minimum account balance of \$25,000 was required to use the teller service. Bank closings and openings illustrate a strong trend toward offering fewer services to poor and middle-class neighborhoods, while offering an increased array of specialized services to affluent neighborhoods. One response to this trend in low-income areas can be seen in the rapid proliferation of formal and informal check-cashing operations and various forms of informal credit operations.

In sum, the kinds of growth trends described above favor the informalization of a broad range of activities. Inducements to informalization particularly evident in major cities include: (1) the increased demand for highly priced customized services and products by the expanding high-income population; (2) the increased demand for extremely low-cost services and products by the expanding low-income population; (3) the demand for customized services and goods or limited runs from firms that are either final or intermediate buyers, with a corresponding growth of subcontracting; and (4) the increasing inequality in the bidding power of firms in a context of acute pressures on land due to the rapid growth and strong agglomerative pattern of the leading industries. The continuing demand for a range of goods and

22. Franz S. Leichter, *Banking on the Rich: Commercial Bank Branch Closings and Openings in the New York Metropolitan Area, 1978-1988* (1989) (unpublished manuscript, on file with Urban Planning Dep't, Columbia Univ.).

23. The earlier wave of closings left several poor and minority communities in the leading financial center of the country without any banking services.

24. From 1985 to 1987, 55 full-service commercial branches were closed, 34 in 1987 alone, the highest number of closings for any one year in the last decade. The previous peak was in 1983 with 38 closings. See Leichter, *supra* note 22, at Part II.

25. During this period, only two new full-service branches opened: one Chinese-owned bank in Chinatown and a small Black-owned bank (Freedom National Bank). The latter bank was the only branch opened in a New York City neighborhood with a Black population greater than 30%. In all counties with Black and Hispanic populations above the regional average, the ratio of residents to commercial bank branches increased. The Bronx, the borough with the highest Black and Hispanic populations by percentage, suffered the most severe reduction in its commercial branch network, a 20% loss from 1978 to 1987. Forty full service commercial branches were closed over that period. The residents-to-branch ratio in the Bronx increased by 30% from 1980 to 1987. Brooklyn, the borough with the second highest population of Blacks and Hispanics by percentage, saw a 14% increase in its resident-to-branch ratio from 1980 to 1987. Today, Brooklyn has the highest such ratio: 15,000 residents per branch. *Id.*

26. The seven percent increase in bank branch openings cannot simply be explained as a function of suburban population growth. In 1987, the resident-to-branch ratio was 12,000 to one in the outer boroughs and 3000 to one in the suburbs. *Id.*

services typically produced in firms with low profit rates, and that find it increasingly difficult to survive given rising rents and costs of production, promotes informalization in a broad range of activities and spheres of the economy. The existence of an informal economy, in turn, becomes attractive for firms seeking to reduce costs. Firms that do not necessarily need to operate informally in order to survive may nevertheless turn to the informal economy in order to increase profit margins and enhance flexibility.

III. PATTERNS OF INFORMALIZATION AND THEIR IMPLICATIONS: A SUMMARY

My field research in New York City²⁷ has revealed several recurring patterns in the process of informalization. The first pattern concerns the source of demand for informally produced or distributed goods and services.²⁸ Most of the demand for informally produced goods in the garment, furniture, construction, packaging, and electronics industries comes from firms that operate in the formal economy. Other informally produced goods and services cater to the communities in which such activities are performed. Immigrant communities are a leading example, and probably account for much of this second type of demand.

The second set of patterns I have identified concerns factors influencing the supply of, and demand for, informally produced and distributed goods and services. One of these factors is pressure in certain industries, notably apparel, to reduce labor costs, given massive competition from low-wage Third World countries. Informal work in this instance combines very low wages with substandard conditions.

One factor influencing supply and demand in the construction industry in New York City is the rapid increase in the volume of renovations, alterations,

27. On the basis of secondary data analysis, fieldwork, and interviews, I have found the following profile of the informal economy in the New York City area: (1) informal work is present in a wide range of industrial sectors including, with varying incidence: apparel, accessories, general construction contractors, special trade contractors, footwear, toys and sporting goods, furniture and woodwork, electronic components, packaging, and transportation; (2) such operations also take place to a lesser degree in activities such as packaging notions; making lampshades, artificial flowers, and jewelry; distributing; photo engraving; and manufacturing of explosives; (3) such operations tend to be located in densely populated, predominantly immigrant areas; (4) there is an emergent tendency for areas undergoing partial residential and commercial gentrification to displace "traditional" sweatshop activity (notably in the garment industry); and (5) there is a growing tendency for new forms of unregistered work catering to a new clientele to locate in gentrifying areas. See SASSEN, *THE GLOBAL CITY*, *supra* note 2, at ch. 9; *THE INFORMAL ECONOMY IN LOW-INCOME COMMUNITIES IN NEW YORK CITY*, *supra* note 4; SASKIA SASSEN & WENDY GROVER, *UNREGISTERED WORK IN THE NEW YORK METROPOLITAN AREA* (1986) (research report on file with Urban Planning Dep't, Columbia Univ.); Sassen & Smith, *Postindustrial Growth and Economic Reorganization*, *supra* note 4.

28. National household surveys reveal that in the mid-1980's, 83% of U.S. households used informally produced or delivered goods and services. Most of this consumption constituted home repairs (\$21.4 billion) and food sold informally (\$10.3 billion). U.S. DEP'T OF LABOR, *THE UNDERGROUND ECONOMY IN THE UNITED STATES*, OCCASIONAL PAPER SERIES ON THE INFORMAL SECTOR No. 2, at 11 (1992).

and small-scale new construction as many areas of the city that were once low-income, often dilapidated neighborhoods have been transformed into higher-income commercial and residential areas. In many other cities in the United States, such a transformation would have involved a massive program of new construction; in New York City, it was accomplished mostly by rehabilitating old structures. The volume of work, its small scale, its labor intensity and high skill content, and the short-term nature of each project all were conducive to a heavy incidence of informal construction and rehabilitation work.

Another important factor affecting supply and demand is the failure of enterprises operating in the formal economy to meet the demands of certain low-income consumers. Either their prices are too high for these consumers, their locations are inaccessible, or—where a service inherently requires the seller to come to the buyer, as in the case of taxicabs—the seller provides no service at all to low-income consumers. Informal operations step in to meet the demand that regulated suppliers have failed to meet. For instance, informal neighborhood centers provide child-care services, and low-cost furniture manufacturing shops supply local low-income residences.

The existence of a cluster of informal businesses in a neighborhood may eventually generate agglomeration economies that induce additional entrepreneurs to move in or set up businesses. One observes the formation of auto-repair “districts,” vendors “districts,” or clusters of both regulated and informal small-scale manufacturers in areas not zoned for manufacturing. These districts can become magnets; they signal to other would-be entrepreneurs that the costs of entry in certain neighborhoods are lower than in the formal economy, and that there is a market in those locations for their goods and services. If the informal businesses choose their locations according to proximity to a relatively cheap labor supply, they signal to other businesses the existence of an informal “hiring hall.”

A third set of patterns evident in the informal economy concerns the influence of locational constraints. For some firms, access to cheap labor is the primary reason for choosing a New York City location. While New York City may bring with it collateral benefits, such as access to the city’s final or intermediate markets, these firms are driven primarily by labor costs. Drawing on low-wage immigrant workers allows these firms to compete with Third World factories in markets with rapid production turnover times. New York City is not the only possible location for these firms. Several New Jersey counties have seen a rapid growth in garment sweatshops and home-work, as the Hispanic population has expanded.²⁹

For other firms, the choice of location is not simply a question of cheap labor supply. Many shops engaging in customized production or operating on

29. See NEW JERSEY DEP'T OF LABOR, STUDY OF INDUSTRIAL HOMEWORK (1988).

subcontracts are bound to New York City for some or all of the following reasons: (1) demand is local and typically client-specific; (2) the nature of the business requires proximity to design and specialized services and a quick turnover between completion of design and production; (3) the firms rely on the purchasing patterns associated with a highly dynamic overall economic environment; and (4) the firms cater to the specific tastes of local immigrant communities. Firms constrained by these factors must stay in New York City in order to have a clientele, whether of households or other firms. However, staying in New York City effectively means that these firms must operate informally. The high cost of doing business in the City, particularly the cost of land, can force small-scale customized manufacturers to set up shop in spaces not zoned for manufacturing.

A fourth pattern in the process of informalization concerns variety of jobs. Many of the jobs in the informal economy are unskilled, offering no training opportunities and involving repetitive tasks. Other jobs demand high skills or acquisition of a skill. The growth of informalization in the construction and furniture industries has required a re-skilling of workers in those sectors. There is no wage level typical of the informal economy. Generally, however, employers or contractors seem to save compared with what they would have to pay in the formal market.

IV. INFORMALIZATION AND POOR COMMUNITIES

My observations about New York City prompt two policy questions concerning the growth of informal economies in that city's low-income communities.

First, how should government deal with the growing informal economy? The easiest course of action is to criminalize all economic activities that evade regulation, imposing fines and closing the renegade operations. New York City has enacted such a policy.³⁰ City authorities closed newsstands and small restaurants in low-income communities. The result was disappearance of the few available economic activities and loss of the few public space anchors in these communities. From an economic perspective, criminalization makes no sense. Instead of criminalization, cities like New York must find policy formulas that help reduce the tension between these new economic conditions and a regulatory framework rooted in an earlier economic era. Such policy formulas would encompass a range of interactions between government and

30. The New York City Tax and Finance Commission developed and implemented this policy, the goal of which was to insure compliance with the City's tax laws by punishing evasion. Many of the targets were informal operations. See *New York State's Underground Economy: Untaxed and Growing*, Report, Comm. on Oversight, Analysis, and Investigation, N.Y. State Legislature (1982); New York City Dep't of Finance, *Unearthing the Underground Economy*, Report (1986); Deborah Sontag, *Unlicensed Peddlers, Unfettered Dreams*, N.Y. TIMES, June 14, 1993, at A1.

economy. As one illustration, zoning legislation might be used to address the polarization in profit-making capacities that has become systemic in advanced economies. Zoning laws could allow firms in low-profit sectors to compete for space and other inputs in a place like Manhattan. Thus, the so-called West Side Industrial Zone in Manhattan keeps rents low and makes it possible for a wide range of industrial services to locate in the borough, close to their clients.³¹ Rezoning to allocate greater space to corporate offices—a major goal of New York City government in the 1980's—would likely force many of these industrial service firms to close or go partially or fully informal.

Policies such as zoning certain areas specifically for low-profit-sector use could be designed so as to induce an "upgrading" of informal activities by bringing these activities within the regulatory framework while minimizing costs to entrepreneurs. Upgrading is likely to demand greater flexibility in the implementation of existing codes and acknowledgment by city officials that compliance may require several phases. Lower thresholds of regulatory compliance would be applied to new, small-scale businesses in low-income communities than to well-established businesses that have had an opportunity to recover start-up costs. To encourage compliance with modified regulations and enforcement practices, city officials might offer informal operations technical and financial assistance as part of the long-term upgrading process. Beyond mildly accommodating policies, one might even envision a more drastic redrawing of regulatory frameworks, on the theory that current developments have rendered the old frameworks obsolete.³²

The second question prompted by my study of New York City is: Why should we bother to upgrade the informal economy in low-income communities?

The informal economy is one of the few forms of economic growth evident in these communities. With the decline of manufacturing and the ascendancy of finance and specialized services, economic growth has become disproportionately concentrated in central business districts and suburban office complexes. Economic growth, one might conclude, has abandoned low-income communities. We need to find anchors to regenerate these communities, to reconstitute neighborhood sub-economies. This task becomes particularly important absent any sign that mainstream patterns of economic growth will find ways of locating growth in these communities. Informal economies bridge the divide between new high-income middle-class neighborhoods and low-income neighborhoods, a divide widened by the flight of the middle class from the cities. Furthermore, informal economic activity fights the spread of crime and delinquency born out of despair and the absence of options.

31. See COLUMBIA UNIV., PROGRAM IN URBAN PLANNING, DEVELOPMENT AND PRESERVATION IN MANHATTAN'S CHELSEA (1986) (on file at Urban Planning Dep't, Columbia Univ.).

32. See Edgar S. Cahn, *Reinventing Poverty Law*, 103 YALE L.J. 2133 (1994).

We must harness the economic energy represented by small-scale ventures, and we must upgrade them. Upgrading can only happen through the support of government or public-private partnerships. Much has been said about enterprise zones, which give incentives to firms to move *into* a neighborhood. I would propose concentrating instead on low-income "community zones," which would support firms *already operating* in low-income communities. Community empowerment zones, proposed by the current administration, go a considerable way in this direction. Destroying the incipient mini-complex of neighborhood firms represented by the informal economy is, I think, a mistake, because neighborhood firms are one of the few forms of economic growth evident in these communities.

CONCLUSION

The roots of the informalization of various activities are to be found in the currently prevailing characteristics of the economy in general and of large urban economies in particular. The decline of the middle class, the growth of a high-income professional class, and the expansion of the low-income population, have all had a pronounced impact on the structure of consumption. The organization of work, in turn, has evolved to meet the new consumption demand. Part of the demand for goods and services feeding the expansion of the informal economy comes from the mainstream economy and from the fragmentation of what were once mostly homogeneous middle-class markets. Another part of this demand comes from the internal needs of low-income communities that are increasingly incapable of buying goods and services in the mainstream economy.

A second major trend is the growing inequality in the profit-making capacity of different sectors. The ascendance of high-profit industries, such as finance and specialized services, as the dominant sector in major urban economies has raised the price of commercial space and other business costs in the downtown districts of large cities. Small, low-profit firms can hardly afford to compete for space, even when they enjoy an effective demand for their products or services in the city. One way of reconciling these contradictory conditions is to go informal, i.e., to use spaces not zoned for commerce or manufacturing, such as basements in residential areas, or to use spaces that are not up to state-mandated health, fire, and safety standards.

A third major trend concerns the organization of space in today's economy, particularly in large cities. The leading sectors of the economy tend to be concentrated in downtown city districts and in suburban office complexes. There is hardly any economic growth taking place in low-income communities. This unbalanced spatial distribution of growth is much stronger today, as it has been over the last fifteen years, than in earlier historical

periods. The emergence of semi-formal neighborhood economies has been one response to this imbalance.

These trends in consumption, profit-making capacities, and spatial organization indicate that the expansion of the informal economy in the United States is rooted partly in conditions that are integral to the contemporary phase of an advanced market economy such as that of the United States. The approach to the informal economy that policymakers should adopt depends, at least in part, on whether the informal economy is attributable primarily to structural characteristics of advanced capitalism or is instead an anomaly attributable to Third World immigration. Simply criminalizing informal work may be effective if the informal economy is essentially an anomaly. But if, as I have argued, informalization is embedded in the structure of our current economic system, particularly manifest in large cities, then criminalization may not be the most effective policy. Informalization emerges as a set of flexibility-maximizing strategies employed by individuals, firms, consumers, and producers in a context of growing inequality in earnings and in profit-making capabilities. Its expansion invites us to focus on the broader fact of a growing set of problems in the relationship between new economic trends and old regulatory frameworks.