

# Beyond the Shadows? Rethinking Informality in the Workforce

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## Abstract

The study attempts to draw on a commentary approach to comprehensively document the extensive theoretical landscape of the informal economy, drawing from an International Monetary Fund Report in 2021 and a vast body of existing literature. With over 60% of the global labour force participating in the informal economy, its multifaceted nature, encompassing a wide array of small-scale economic activities, presents a formidable challenge for economists and policymakers. Within this study, we critically examine and synthesise the prevailing theories, including the dualistic theory, Inclusive Theory, Structuralism, Neo-Liberalism, and Modernisation Theory, each offering distinct perspectives on the informal economy's intricacies. This article underscores the vital role of comprehensive literature reviews in advancing our understanding of complex economic phenomena, thereby contributing to the ongoing discourse on the informal economy and shedding light on its multifarious theoretical foundations and diverse definitions.

## Keywords

informal economy, dualistic theory, neo-liberalism, informality theories, shadow economy, inclusive theory

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## Introduction

With more than 2 billion global workers, or over 60% of the global labour force participation in the informal sector, it is a global phenomenon to understand the

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various theories and definitions in the vast subject (International Monetary Fund [IMF], 2021). The informal economy, which operates outside the umbrella of government regulation, makes it an important and wider subject to be studied with a deeper understanding of the theories and definitions associated with it. Though the vast population operating in the informal sector are on the small-scale economic activities. This makes it more difficult for economists to study it, and sometimes it is referred to as the 'Shadow' economy.

The working of the informal economy across different regions, states and continents makes it difficult to tailor the types, numbers and labour conditions in the informal economy. With more than 90% of the global workforce participating in micro and small enterprises (MSEs), the informal economy comprises a significant part. The work life of the labourer in the informal economy is often characterised as unsafe, unhealthy, low productivity and low or irregular incomes. Various studies cite the root cause of informality as poor regulatory government policies, low level of education, poverty and limited access to economic resources. However, informality has always been a challenge in the development of an economy. The shadow approach of the legal production of goods and services hidden from public authority and the nature of informality make it even more difficult to document, observe and measure its functioning in the economy.

Due to the lack of economic opportunities, lack of job security and low wages for the informal workers. The dualists argue for the exclusion of the informal sectors from sectors with no linkages with each other. Keith Hart, a British anthropologist who formulated the concept of the informal sector in his study on low-income activities amongst low-skilled migrant workers, found that the existence of the informal economy was the outcome of the dualistic tendency of the urban labour market.

In addition, the existence of both informal and formal economies is both a reality and an artificiality. The latter is capital-intensive and growth-oriented, and the former is labour-intensive in nature. However, the study of Hart (1973) isolates the informal and formal sectors as two distinctive aspects in an economy. However, further studies (Portes, 1983; Roy, 2005) challenge the dualistic approach and see informality from an inclusive lens. Therefore, in theorising informality, the inclusive theory views it from a more holistic and broader cross-country narrative to avoid generalisation of informality.

The nature of informality itself has its own layers. Determinants such as unemployment, underemployment, and poverty lead a large chunk of the population and labour force into informality; therefore, such components and elements from different structures frame the informal economy. The prospective study of the existence of informality in the rural and urban regions and also across different geographical regions makes the existence of structuralism more evident. Also, the evidence of 'Regular' informal workers, 'Causal' informal workers, unpaid informal workers, and industrial informal workers in the pyramid of the WIEGO Model of Informal Employment opens the door to documenting structuralism in the informal economy.

Acknowledging the findings mentioned in the existing literature, this article aims to argue that informality can be viewed from different lenses through the

**Table 1.** Comparative Theoretical Analysis of Informality.

Theory	Core Idea	Strength	Limitation	Contemporary Relevance
Dualist	Informal sector as a survival mechanism	Highlights the poverty link	Ignores linkages with the formal sector	Limited
Structuralism	Informality linked to capitalist systems	Explains systemic inequality	Overgeneralization	Strong
Neo-liberal	Excess regulation causes informality	Policy insight	Overemphasis on state failure	Partial
Inclusive	Blurred boundaries between sectors	Realistic and flexible	Conceptually diffuse	High

sight of the mentioned theories. This article explicitly delves into the theories by critically synthesising dominant theoretical perspectives and contemporary development, by moving beyond statistical or descriptive study and rather to a policy-relevant understanding of informality. An overview of the theories is provided in Table 1.

To be precise, the article aims to address the following questions:

1. How do existing theoretical frameworks (dualist, structuralist, neo-liberal, and inclusive approaches) differ in explaining the persistence and dynamics of the informal economy across regions and sectors?
2. To what extent does the proposed continuum approach provide a more comprehensive and policy-relevant framework for understanding emerging forms of informality, particularly within the gig and platform economy?

The study is organised as follows: literature review, followed by theoretical foundations, understanding theories, the fourth section represents an explanation of rethinking informality, the fifth section explains the determinants, and it concludes with a discussion and conclusion.

## Literature Review

The informal economy, over time, has evolved from being perceived just as a residual part of the economic activity to a central and core component of the labour markets across the world. Various studies reflect that informality is just a by-product of the underdeveloped world, but it is a structure embedded in the modern economic system. It is estimated that around 60% of the global workforce is associated with informal employment (IMF, 2021). In addition, the IMF's measurement indicates that there are extensive studies in understanding informality, its employment, production and firm activities within the national accounting system. This academic study, in fact, challenges the prior classification of sectors into a dichotomous nature of just informal and formal sectors.

In addition, empirical studies have shifted the focus on improving the measurement and modelling of informality. Yao (2024) has introduced an augmented factor model that precisely captures the multidimensional nature of the informal economy, documenting the existing limitation of traditional proxy-based methods such as the Multiple Indicators Multiple Causes (MIMIC) model. The study registered that informality is correlated to macroeconomic variables such as institutional quality, inflation, and employment. Another important lens of study examines the relationship between informality and economic development. This study employs nonlinear econometric techniques that precisely impact informality across different stages of development (Medina & Schneider, 2019; Williams, 2023). These findings challenge linear modernisation assumptions. The literature also highlights the role of economic crises and institutional fragility in shaping informal economic activities (Elgin et al., 2021).

Conceptual debates remain central to the study of informality. A systematic review by Dell'Anno (2022) demonstrates the absence of a universally accepted definition, with over 100 conceptualisations identified in the literature. While most definitions emphasise the lack of regulation, taxation, and legal recognition, fewer studies incorporate social and institutional dimensions. Overall, the existing bodies of literature demonstrate a clear shift toward recognising informality as a complex, heterogeneous, and evolving phenomenon. However, significant gaps remain in integrating traditional theories with contemporary labour market transformations, particularly in the context of digital and platform economies.

## **Theoretical Foundation**

The informal economy's theoretical underpinnings come from a variety of schools of thought, each of which provides a unique account for how it came to be, persisted, and interacted with formal economic systems. When used alone, these frameworks show limitations but also offer important insights. According to the dualist viewpoint, the informal economy is a residual sector made up of excess labour that is not able to find formal work. This theory, which has its roots in early development economics, makes the assumption that there is little interaction between the official and informal sectors. Thus, informal activities are typically seen as survival tactics used by underprivileged groups.

Although this framework successfully draws attention to the connection between poverty and informality, it has come under growing criticism for failing to account for the interdependencies among various sectors. The idea of complete separation is challenged by empirical research showing that informal businesses frequently interact with formal businesses through supplier chains and subcontracting agreements (La Porta & Shleifer, 2014). This perspective holds that in order to lower costs and increase flexibility, informal labour is integrated into formal production systems rather than being eliminated. This framework emphasises systemic inequalities, highlighting how the formal sector relies on informal labour arrangements to remain competitive in global markets.

When it comes to the explanation of continuing informality in labour-intensive industries and global value chains, structuralist theory is especially pertinent. However, it has a tendency to generalise these processes and might ignore micro-level variability and local variations (Chen, 2012). According to the neo-liberal viewpoint, excessive government interference, regulations, and high taxes are the causes of informality.

It asserts that people and businesses logically decide to operate informally in order to save money on formalisation-related compliance expenses. This method has been criticised for oversimplifying the causes of informality, even if it offers insightful policy information, especially with reference to regulatory reform. It frequently ignores systemic limitations such as restricted access to formal employment prospects, credit, and education (Williams, 2023)

Modernisation theory views informality as a transitional phenomenon that diminishes with economic development, industrialisation, and institutional strengthening. According to this perspective, the expansion of formal employment opportunities and improved governance will gradually absorb informal activities (Chen, 2012). However, recent empirical evidence challenges this linear progression. Informality persists and in some cases expands, even in relatively advanced economies, suggesting that modernisation alone is insufficient to eliminate informal economic activities (Medina & Schneider, 2019).

## Understanding Theories

In this section, we particularly aim to draw an overview of the theories mentioned in Table 1. The dualist perspective, rooted in early labour market segmentation theories, views informality as a residual sector disconnected from formal economic structures. However, empirical evidence increasingly demonstrates strong interdependencies between formal and informal activities, undermining this rigid separation.

Structuralism, or structuralist theorists, provide a more compelling explanation by understanding informality within broader capitalist social structural dynamics. They aim to highlight how formal firms rely on informal labour to reduce costs and integrate informality into global industrial sectors.

Further, neo-liberals document the role of excessive regulations; they tend to oversimplify the importance of policy regulation in the broader sense of the functioning of the informal labourers. This perspective neglects structural inequalities and labour market constraints. Inclusive approaches offer a deeper understanding by recognising the fluidity between formal and informal work. However, their conceptual breadth often comes at the expense of analytical precision.

## Rethinking Informality: Toward a Continuum Approach

The limitations inherent in existing theoretical frameworks, particularly their tendency to conceptualise informality as a distinct and residual sector,

necessitate the development of a more flexible and analytically robust perspective. Traditional approaches, such as the dualist and structuralist frameworks, often rely on binary distinctions between formal and informal economies. However, these rigid categorisations are increasingly inadequate in capturing the complex and evolving realities of contemporary labour markets. In response, this article proposes a continuum-based conceptualisation of informality, wherein economic activities are understood to exist along a gradient rather than within mutually exclusive categories. This continuum can be represented as:

Formal ← Semi-formal ← Informal ← Digital Informal

At one end of the spectrum, formal employment is characterised by full regulatory compliance, contractual security, and access to social protection mechanisms. Moving along the continuum, semi-formal arrangements emerge, where certain aspects of regulation or protection may be present but remain incomplete or inconsistently enforced. Further along, informal employment is marked by the absence of legal recognition, limited social security, and precarious working conditions. At the far end, digital informal work—facilitated by platform-based and technologically mediated systems—represents an emergent form of informality that often operates within formally registered entities yet reproduces informal characteristics such as income insecurity, lack of benefits, and ambiguous employment relationships.

This continuum framework emphasises several key dimensions. First, it recognises that economic activities vary in degrees of formality, shaped by regulatory environments, institutional capacity, and market dynamics. Second, it highlights the fluidity of labour mobility, wherein workers frequently transition between different points along the spectrum in response to economic shocks, technological changes, and livelihood strategies. Third, it acknowledges the coexistence and interdependence of formal and informal practices, particularly within globalised production systems where formal enterprises may rely on informal labour arrangements to maintain flexibility and reduce costs.

By moving beyond binary classifications, the continuum approach provides a more nuanced understanding of informality as a dynamic, hybrid, and context-dependent phenomenon. It is particularly useful in capturing emerging labour trends, including the rise of gig and platform economies, where the boundaries between formal and informal work are increasingly blurred. As such, this framework not only enhances theoretical clarity but also offers a more relevant foundation for empirical analysis and policy formulation in the context of rapidly transforming global labour markets.

## **Gig and Platform Economy**

One of the most significant developments in recent years is the rise of the gig and platform economy, which has fundamentally reconfigured traditional employer-employee relationships. Digital labour platforms such as ride-hailing, food

delivery, and freelance marketplaces operate through technologically mediated systems that match labour supply with demand in real time.

Moreover, platform-based work is characterised by algorithmic management, wherein digital systems allocate tasks, monitor performance and determine compensation. This form of control, while less visible than traditional managerial supervision, introduces new dimensions of dependency. Workers often have limited transparency regarding how algorithms function, thereby constraining their autonomy despite the nominal independence associated with gig work.

## **Determinants of Informality/Informal Economic Activities**

### *Absence of Government Regulations*

Informality, in economic terms, is frequently characterised by economic activities that operate outside the purview of formal government regulations and institutions. This includes businesses and labour arrangements that are not registered, fail to comply with taxation requirements, or do not adhere to established labour laws. Informal workers often engage in activities that are not officially recorded, leading to challenges in regulating and taxing these activities.

### *Lack of Social Protection*

Informal work is often associated with a lack of access to the social protections and benefits typically enjoyed by formal sector employees. This encompasses the absence of health insurance, retirement benefits, unemployment benefits, and other safety nets that can provide economic security to workers and their families.

### *Low Levels of Education and Unskilled Human Resources*

Informal labour markets are frequently characterised by lower levels of education and skills among participants. Workers in the informal sector may have limited access to formal education and training programmes, resulting in a workforce with fewer qualifications and lower skill sets compared to the formal sector. Moreover, informality is also closely linked to poverty and economic vulnerability. Many individuals turn to informal work out of necessity due to limited opportunities in the formal sector. This can result in precarious employment, income instability, and a higher risk of falling into poverty.

### *Unregistered Businesses/Enterprises*

In the realm of entrepreneurship, informality refers to businesses that operate without proper registration, licences, or adherence to formal business regulations.

Such businesses may operate in cash economies and avoid the oversight of government authorities.

### *Marginalisation and Exclusion*

Informal labour markets can marginalise and exclude certain groups, such as migrants, women, or minority populations. These individuals may face barriers to entering the formal workforce, leading them to participate in informal activities that offer limited legal protections and opportunities for advancement. In addition, informal employment or informal economic activities can encompass underemployment, where workers have part-time or irregular work that does not fully utilise their skills or provide a stable income. This can result in workers holding multiple jobs or engaging in sporadic, low-paying work to make ends meet.

## **Discussion**

The findings of this study highlight that the informal economy cannot be adequately understood through a single theoretical lens. Rather, it emerges as a complex, adaptive, and context-dependent phenomenon shaped by overlapping structural, institutional, and market-driven forces. The discussion builds upon the comparative theoretical analysis and the proposed continuum framework to critically examine how informality should be reconceptualised in contemporary economic discourse.

A key insight from the literature synthesis is that traditional theories—particularly the dualist perspectives offer a limited explanatory scope in the present global context. While the dualist approach successfully underscores the link between poverty and informality, its rigid separation between formal and informal sectors does not align with empirical realities. Increasing evidence demonstrates that informal and formal economies are deeply interconnected, with supply chains, subcontracting arrangements, and labour mobility blurring these boundaries. Thus, the persistence of informality cannot merely be attributed to exclusion from formal employment, but also to systemic integration within broader economic structures.

In contrast, structuralist perspectives provide a more compelling explanation by situating informality within capitalist production systems. The reliance of formal firms on informal labour to reduce costs and enhance flexibility illustrates that informality is not an anomaly but an embedded feature of modern economies. However, structuralist theories tend to generalise these dynamics, often overlooking regional variations and micro-level heterogeneity. For instance, informal work in developing economies may be driven as much by survival strategies as by capitalist exploitation, suggesting that structural explanations must be complemented by localised analysis.

Neo-liberal interpretations, which attribute informality primarily to excessive state regulation, introduce an important policy dimension but remain insufficient in capturing the full complexity of the issue. While regulatory burdens can indeed discourage formalisation, this perspective tends to oversimplify the problem by placing disproportionate emphasis on state inefficiencies. It neglects deeper structural inequalities, labour market rigidities, and socio-economic barriers such as education and access to capital. Consequently, policy prescriptions based solely on deregulation risk exacerbating worker vulnerability rather than addressing the root causes of informality.

The inclusive approach attempts to bridge these gaps by recognising the fluidity between formal and informal work. It acknowledges that workers and enterprises often operate across multiple economic spaces simultaneously. This perspective is particularly relevant in today's globalised and digitalised economy, where hybrid forms of employment are increasingly common. However, the broad and flexible nature of the inclusive framework can sometimes reduce analytical precision, making it challenging to derive clear empirical or policy conclusions.

Against this backdrop, the continuum approach proposed in this article offers a more nuanced and integrative framework. By conceptualising informality as a spectrum rather than a binary category, it captures the gradations and transitions that characterise real-world labour markets. This framework is especially useful in understanding semi-formal arrangements, which are often overlooked in traditional analyses. These include workers who may have partial legal recognition or intermittent access to social protections, reflecting the incomplete nature of formalisation processes in many economies.

Moreover, the continuum model is particularly effective in addressing the rise of the gig and platform economy. Digital labour platforms have introduced new forms of work that challenge conventional definitions of employment. Although these platforms operate within formal regulatory environments, the nature of work they generate often mirrors informal characteristics such as income instability, lack of social security, and ambiguous employment relationships. This hybridisation underscores the inadequacy of binary classifications and reinforces the need for a spectrum-based understanding.

Another important dimension highlighted in this discussion is labour mobility across the continuum. Workers frequently transition between different forms of employment in response to economic shocks, seasonal variations, and personal circumstances. For example, an individual may engage in formal employment during certain periods while relying on informal or gig-based work at other times. This dynamic movement challenges static categorisations and calls for longitudinal approaches in both research and policy design.

The determinants of informality further reinforce the multidimensional nature of the phenomenon. Factors such as limited education, lack of social protection, unregistered enterprises, and socio-economic marginalisation interact in complex ways to sustain informal economic activities. Importantly, these determinants are not isolated; they are deeply interconnected and often mutually reinforcing. For instance, low educational attainment can restrict access to formal employment,

which in turn perpetuates income insecurity and limits opportunities for skill development.

In conclusion, this discussion underscores that informality is not merely a residual or transitional phenomenon but a fundamental component of contemporary economic systems. The continuum approach provides a valuable conceptual tool for capturing its complexity and evolving nature. By integrating insights from multiple theoretical perspectives, it offers a more comprehensive and policy-relevant understanding of informality. Future research should build on this framework by incorporating empirical analyses across different regions and sectors, particularly focusing on the long-term implications of digital transformation on labour markets.

## Conclusion

This study rigorously employs a commentary approach, grounded in an extensive scholarly literature corpus, to comprehensively investigate the intricate theoretical framework underpinning the informal economy. Additionally, it explores multifaceted definitions, spanning from regulatory absence to limited social protection and low educational attainment in informal labour markets, highlighting the multifarious challenges posed by informality. In conclusion, this column underscores the pivotal role of comprehensive literature reviews in enhancing our grasp of complex economic phenomena. Through critical examination and synthesis of these theories and definitions, it enriches the ongoing discourse on the *informal economy*, emphasising the far-reaching implications for economic development and societal well-being. Addressing its multifaceted dimensions and challenges necessitates continual exploration and well-informed policymaking.

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