

# Labour inspection and the informal economy

*This article aims to provide a practical account of the labour inspectorate role within the informal economy. It starts by examining the concept of labour inspection and the standards that the inspectorates have to monitor. It then explains the notion of the informal economy, describing the various situations in which informal enterprises and workers find themselves and how these relate to labour standards. Next, it looks at how labour inspectorates fulfil their roles in various informal labour situations. Finally, there is an analysis of the problems that the informal economy poses for labour inspection, and an observation of the trends.*

---

**José Luis Daza**

Specialist in Labour Administration  
Social Dialogue, Labour Law and Labour  
Administration Department (ILO)

---

**A**s an institution, labour inspection has the mission of monitoring compliance with labour standards. Labour inspection operates as a part of labour administration. Its role is usually identified with specific services within labour ministries, and is personified by labour inspectors. Labour inspection activity is exercised within workplaces, by which is meant those economic units in which there are labour relations – in other words, where a natural or a legal person employs others.

## Labour inspection and labour standards

Labour standards are a broad and complex field, usually embodied in a number of different legal texts of varying content. The monitoring of these norms may be assigned to one single administrative body, or shared across various sections of a labour ministry, or even in some cases, distributed across several specialized ministries and public agencies. Thus, this paper looks at labour standards as a very broad whole and analyses labour inspection as a func-

tion and an administrative system, rather than simply as an administrative body.

The diversity and coverage of labour standards makes it difficult to apprehend their full scope but, viewed broadly, they cover work relationships, pay, working conditions, occupational safety and health, industrial relations, social security, employment and vocational training. Bearing in mind that each country organizes its public administration in its own way, it is also sometimes difficult to gain an exact picture of what labour inspection is, which bodies are part of it, what its precise functions are, what its sphere of action is, how far its purview extends and what its powers are.

## Enterprises and workers in the informal economy

The term “informal economy” is widely used, but in some countries it was adopted very recently and not all use it in quite the same sense. Its connotations and nuances may also vary from one language to another. Ask what the informal sector is, and who the informal workers are, and

you will frequently receive answers that describe either particular situations or muddled amalgams of various situations that are often ill-defined and have few characteristics in common.

In 2002, the International Labour Conference noted that although there is “no universally accurate or accepted description or definition” of the term informal economy, it may be taken to refer to “all economic activities by workers and economic units that are – in law or in practice – not covered, or insufficiently covered, by formal arrangements. Their activities are not included in the law, which means that they are operating outside the formal reach of the law; or they are not covered in practice, which means that – although they are operating within the formal reach of the law, the law is not applied or not enforced...” (Conclusions concerning decent work and the informal economy, paragraph 3).

This concept of the informal economy covers two completely different situations:

- In the first case, the informality is due to the lack of a formal reference point: there is no applicable labour standard, and thus there are no obligations to be fulfilled, nor any rights to be respected or demanded.
- In the second case, the informality is due to non-conformity with a legal reference point: applicable labour standards do exist, but are completely or partially flouted. Obligations are not met and rights are not recognized.

Although the consequences for workers in each of these cases may seem to be the same, their origins are different. In the first case, when there is no standard applicable to a certain situation, the cause is the lack of legal provisions covering that situation or of a specific legal exclusion. In such situations, it is entirely appropriate to speak of “informality”.

The cause of the second situation – non-compliance – may be ignorance, as the content or even the existence of standards may not be known. But it may also be a

deliberate decision to not comply with the standards in order to avoid costs. In this regard, the 2002 International Labour Conference recognized that the law itself “discourages compliance because it is inappropriate, burdensome, or imposes excessive costs”. In these situations, many countries use the term “illegality”.

There are also situations not sufficiently taken into account by formal systems. For instance, there are cases where working conditions are regulated but social security is not. This situation is usually due to the poor development of social security institutions, and is generally linked to the presumption, or the reality, that those subject to the system, or who are supposed to be protected by it, are unable to pay contributions. Here too, the term “informality” may be properly applied, as indeed it may to the converse situation in which a group of enterprises or workers is included in a compulsory social security system but excluded from the regulation of working conditions.

Not all the formalities with which enterprises are required to comply have to do with labour law, and not all the rights demanded by informal economy workers concern labour rights or elements of social protection. If the requirements are imposed by law, and compliance with them is the essence of formality, then informality may appear to be a negative phenomenon – a matter of not being or not doing. Achieving a working concept of “labour informality”, so that it could serve as a reference point for action by a national labour administration, entails looking at a country’s labour standards as a whole and identifying precisely which types of enterprise and worker fall within their scope and which do not. Even though illegality is the opposite of legality, and formality may be synonymous with legality, illegality cannot always be equated with informality.

There are many national variations in this distinction between informality and illegality. Linguistic nuances are important, as they often point to different perceptions of similar phenomena

by different societies. For instance, it is usually said in developing countries that labour legislation is “not applied” in the informal sector, whereas in the developed countries, it is more commonly said to be “not complied with”. In contexts where the majority of the population live within traditional frameworks and the social rules do not correspond to the legal rules, of which they may simply be unaware, informal productive activities or units are not usually termed “illegal”. But in more developed countries, activities that are regarded, in juridical terms, as illegal as they do not comply with certain legal requirements or they violate some standards, may be popularly called “informal”. The terms applied to the informal economy are not always the same, but in Europe, when work or employment is concerned, terms such as “black economy”, “hidden employment”, “clandestine labour” and “undeclared labour” come up. The term most used to describe the labour impact, at least officially in European Union documents, is “undeclared labour”.

One of the main characteristics of informal activities in the developed countries is that they are hidden or clandestine. The most prominent effect of this cover-up is that workers are not registered for social security, and contributions are not paid. These situations sometimes go unnoticed when those affected remain invisible, as in the case of enterprises where most workers are declared but a few are undeclared, or camouflaged as self-employed, or as employees of another enterprise.

## Labour inspection and labour informality

### *Activities in which the law is not applied or not complied with in practice*

Setting aside the issue of undeclared labour and bearing in mind the different degrees of compliance with standards in each country, non-compliance with labour standards and with social security is fre-

quently found in domestic work, home work, rural work, and in micro- and small-scale enterprises.

**Domestic work (employees in the home).** The sector of domestic work (employees in the home) is recognized as problematic worldwide and one in which women undoubtedly make up the majority of the workforce. Only a few countries are without any regulatory framework whatsoever and in fact, many have special labour regulations and social security schemes for domestic workers. These special labour regulations involve many exceptions to the general legislation, as regards pay (the option of counting board and lodging as part of the wage), daily working hours and rest periods (compulsory attendance times, standby, restrictions on leaving the premises, calculation of night work, etc.) and termination of employment (broad definition of “just cause” and lower indemnity entitlements). The applicable social security provisions are usually based on reduced contributions and lower coverage.

The labour inspectorate conducts only limited checks in this sector. As employment within a family is not regarded as an entrepreneurial activity, business registration is not required for the hiring of domestic workers. Taxation is difficult as the inspection services do not generally have the legal right to enter private homes in order to make checks.

**Homeworking.** In most countries, home work is covered by regulations similar to those for any other labour relationship, except as regards working times and breaks, as the employer has no means of controlling these. As far as pay is concerned, piece rates are very common, and in some cases the wage received may be below the legal minimum. General social security schemes are usually also applicable to home workers.

Labour inspectorates find it difficult to check on home work, which in many cases is hidden and not declared by the employers, sometimes in collusion with the workers, in order to avoid paying contributions and taxes, or to disguise fraudulent contracts

or subcontracts. In many cases, only one employee is declared even when the latter's entire family, including children, work in the home. As inspectors may not have the authority to enter workplaces located within private homes, the task of supervision is therefore very difficult, unless there is access to the payrolls or bookkeeping records of the firms that contracted the home workers.

**Rural labour.** General or special standards are difficult to apply to rural labour, attributable to three general factors. First, in many countries rural people may be generally unaware of the existence or the content of applicable standards. One reason for this is that in many parts of the world rural populations have higher illiteracy rates and speak languages other than the official one in which legal standards are couched. Also, they tend to hold ancestral customs in higher esteem than legislation.

Second, as agricultural work is mostly performed by seasonal and temporary workers, the complicated and expensive documentation procedure may be a deterrent to their registration (the end of which, it must be remembered, is the deduction of taxes and social security contributions from their wages). Also they may not particularly want to contribute to social security if it cannot provide them with local, accessible health care services.

Finally, the State itself does not usually have at its disposal a labour administration capable of informing, assisting and inspecting agricultural enterprises which, as a sector, is a frequent user of child labour. Thus labour standards are not enforced, occupational safety and health regulations are not known and the failure to declare workers goes undetected.

**Micro- and small-scale enterprises.** In every country, micro and small-scale enterprises have the highest rates of non-compliance with labour regulations, according to information from the labour inspection authorities. Non-compliance begins with the failure to declare a new business, to obtain the necessary permits, to provide the requisite employment documentation,

and to declare workers for social security purposes. This non-compliance with the initial registration procedures leads to substantive non-compliance: workers' rights such as the minimum wage are not recognized, safety regulations are not respected, and social security contributions are not paid. The first challenge encountered by labour inspectors is to detect the existence of these enterprises, identify their heads, and track them down. The next difficulty is in establishing and proving the nature of employment contracts or labour relations. Checks must then be conducted on working conditions and employer compliance with requirements such as the minimum wage. When one single inspection service is charged with supervising labour standards as a whole and is provided with the necessary means, this job is simplified. It is nonetheless a big task and one that largely depends on the cooperation of local authorities and on people prepared to denounce irregularities. When separate inspection services are involved, the task becomes more difficult and complicated, since different actors have to be coordinated and mobilized to apply different standards and procedures, in line with work assignments whose priorities may not always coincide.

### *Activities of persons or enterprises that are not regulated by labour law*

There are work situations that are generally outside the scope of labour laws in almost all countries, such as self-employment, or work within the family. Nonetheless, in the majority of countries, self-employed workers are required to declare their status to the appropriate agencies. In the developed countries, they are also compulsorily covered by the social security system. The obligation to declare and to pay contributions devolves upon the self-employed workers themselves, and they may be required to respect safety regulations in their own work. People working for their own families are generally regarded as self-employed, and when the self-employed are unregulated,

the family workers associated with them will also be unregulated.

In some developing countries, casual work is unregulated, as are micro- or small-scale enterprises employing less than a certain number of workers. The ceiling ranges from five to ten employees, and up to 20 in a few cases. The situation of casual workers is complex, as part of their work may occupy an "informal" space in the middle of more formal employment relationships. In some cases, casual work may be of such duration that it becomes equivalent to a temporary or seasonal job. In both cases, the casuals may be working alongside formal workers on permanent contracts within the same enterprise. The permanent workers will have full entitlements, while the casuals will have only their pay and, at best, some coverage against occupational accidents.

In the case of micro- or small-scale enterprises with a fixed maximum number of workers, the law itself exempts the employer from legal obligations. This situation exists primarily in Asian and East African countries. Three common variants may be found: first, micro- and small-scale enterprises that are not covered by any applicable labour regulation; second, those in which standards on labour conditions are applied, sometimes limited to pay and daily hours, without the application of occupational safety standards and social security requirements; and third, those from which only social security standards are excluded.

When there are no legal obligations that can be made of a responsible liable person or employer, labour inspection has hardly any field of action open to it. For example, a labour inspector will not be able to inspect the micro- and small-scale enterprises that are exempt from the application of labour standards and will have no means of requiring that certain safety measures be taken within a production process or that workers be given a payslip. Nor will an inspector be able to oblige the firm to register workers for social security. Any grievances from workers in exempted enterprises or employment relationships can be lodged

only through the procedures laid down by civil or criminal law.

In the case of purely informal working relations, the labour administration will generally refrain from taking any initiatives. At best, it may engage in information work aimed at preventing workplace risks or promoting voluntary social protection schemes.

### **Labour inspection problems posed by the informal economy, and the trends observed**

The first problem identified concerns the labour inspectors' knowledge of the standards and their application to different types of enterprises and workers. Inspectors need to have a thorough knowledge of the labour standards they are charged with monitoring, and with which employment relationships are supposed to comply. Nowadays, labour inspectors deal with many different kinds of enterprises, within complex production systems which make extensive use of subcontracting and labour intermediaries and cover a wide range of contract types. The solution is to be found first in the rigorous selection and training of inspectors and second, in administrative resources dedicated to handling information about enterprises, which means the creation and maintenance of registers or databases and sharing them with other units of the public administration.

The second problem concerns the decisions to intervene in cases where standards are not complied with: in places, sectors and enterprises for which sufficient evidence of non-compliance exists or from which denunciations of non-compliance have been received. In some countries, the appropriate decisions have not been taken and the laxness of the administration has contributed to the growth of informality. The solution depends on decisions taken by the government at the highest level, with the support of the social partners. It should consist of guiding the inspection system by providing clear instructions to the inspectors. The instructions should

set criteria for deciding where to focus inspections, depending on the resources available, and should establish priorities which include paying attention to reports denouncing non-registration of enterprises and non-declaration of workers. As most of the irregularities occur in micro- and small-scale enterprises, inspectorate activities in many countries tend to focus primarily on such firms, in sectors with high rates of staff turnover and temporary employment, such as construction, hotels, and textiles and garments, as well as all types of transport and shops. In many cases, it is necessary to combine pre-programmed visits with visits to respond to complaints in order to cover as much ground as possible.

The third problem centres on difficulties encountered during the inspection visits themselves. These may include pinpointing the location of clandestine enterprises, tracing the head of the firm, identifying non-declared workers, finding ways of verifying the number of hours actually worked, calculating wages and social security contributions due, and proving possible social security fraud (which happens in certain instances, sometimes only through collusion between the employers and the workers). In many cases, only some of an enterprise's workers have been declared. In some cases, when the non-declared workers work for contractors or subcontractors, the labour inspectors must establish the chain of responsibility. Inspectors may also find foreign workers who do not have work permits, and children whose ages have to be checked. If the inspectors can refer to lists of workers in each firm, drawn from social security databases, the difficult task of proving irregularities becomes more straightforward.

A fourth, rather controversial, problem is how to regularize the situations of non-compliance that have been found and indemnify those whose interests have been prejudiced. Non-compliance must be dissuaded, but without putting the workers' jobs and the enterprises' survival at risk. The non-declaration of workers by some firms, and the concomitant avoidance of

costs, results in unfair competition for other firms. It also causes immediate economic prejudice to non-declared workers (e.g. wages below the minimum set by law, etc.) and jeopardizes their future social security benefits (due to the non-payment of contributions).

Faced with the dilemma between issuing a warning and applying sanctions, several countries have opted to submit the offending firms to procedures entailing the immediate payment of the wages and contributions owed, in addition to punitive measures. The sanctions applied are, in many cases, proportional to the number of workers affected and the size of the enterprise.

In some countries, awareness of the scale or growth of illegal work in the informal economy has led to the creation of administrative structures, inter-administration coordination systems, programmes or initiatives aimed at combating the various forms of illegal work. In France, for example, an inter-ministerial team was set up in 1997 to combat illegal work. It brings together various bodies in a committee which has a national commission, departmental commissions, and working groups. Similarly, a plan was established in Italy within the Ministry of Labour to bring unregularized labour out into the open. In Argentina, where there have been a number of successive programmes to regularize unregistered labour, 29 per cent of workers were found to be unregistered in the more than 90,000 enterprises inspected in 2005. In the United States, the federal labour administration and the different States have for many years run programmes and campaigns against exploitative firms, with the aim of ensuring respect for standards on working conditions such as those on minimum wages and the employment of minors. Some sectors, such as textiles and garments, conduct special monitoring campaigns, in view of the high number of immigrants who are in an irregular situation and prevalent disregard for the standards on working conditions they are facing. As these workplaces are part of complex

subcontracting chains, ways have been sought of resolving the problem by assigning accountability to the main contractors and to the distributors of the product. In a number of European countries, where a significant proportion of undeclared labour is performed by undocumented immigrants, regularization campaigns have been held, during which employers were encouraged to declare employment relationships, without risk of sanctions. In Spain, for example, more than half a million foreign workers were enrolled in the social security system during 2005, during such a campaign.

A different problem concerns the means to be used in order to promote decent working conditions for workers in firms that are

exempted from the application of labour standards, as well as for workers whose employment is unlikely to be regularized, and for the self-employed. In these cases, the labour inspectorate does not have a mandate to act, as its field of activity is limited to workplaces that are, by law, subject to labour standards. However, there is scope for purely promotional activities which can be carried out by other advisory labour administration services, and the labour inspectorate does not necessarily have to be involved. The inspectors should focus on those enterprises for which they are competent and on the standards that they are charged with monitoring, and thus increase the effectiveness and efficiency of labour inspection services.

---