Diagnosis of informality: Methodological note
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In June 2015, Member States and the social partners reaffirmed their commitment to address the challenges of informality through their collective adoption of the Transition from the Informal to the Formal Economy Recommendation, 2015 (No. 204). This new labour standard invites Members to design coherent and integrated strategies to facilitate the transition from the informal to the formal economy and recognizes the need for tailored approaches to respond to the diversity of situations and the specificity of national circumstances. To inform the design and implementation of laws and regulations, policies and other measures aiming to facilitate the transition to the formal economy, Recommendation No. 204 calls on Members to establish a proper assessment and diagnoses of factors, characteristics, causes and circumstances of informality in the national context (Recommendation No. 204, Para. 8). The Recommendation provides in the subsequent sections the range of issues to be covered in order to inform the design of coherent and coordinated interventions as part of integrated strategies.

The main objectives of diagnoses are to gain a better understanding of the informal economy (extent, diversity, causes and consequences) and of the context; to build a wide domestic consensus about the situation through a transparent and participative process in order to inform the design of coherent and coordinated interventions as part of integrated strategies.

Diagnoses of informality should ideally be conducted in the early stages of the formalization process, which could be done immediately after completing a series of sensitization and awareness-raising activities on Recommendation No. 204 and the concepts and realities of informality and formalization. These are important preliminary steps, which include the mapping of stakeholders and the establishment of a working group to manage the coordination of the diagnosis.

This methodological note will present a typical sequence of steps, from preliminary to post-diagnosis steps. This generic sequence allows for flexibility. It will define the scope of the different components of the diagnosis, with variations depending on national situations. A diagnosis may apply, as appropriate, to the whole economy or to specific sectors, groups of workers or economic units. It can focus on specific types of informality (such as undeclared work) or on particular policy areas (such as the extension of social security and the formalization of enterprises). Finally, the sequence and depth of analysis of certain components may also vary based on whether or not priority sectors, groups of workers or groups of economic units or types of informality are defined “a priori”.

The reasons for developing diagnoses are presented briefly in section 1. Section 2 outlines the overall process from the preliminary steps (pre-diagnosis) to the definition of priorities and policies (post-diagnosis). It presents different scenarios depending on national situations. Section 3 presents in detail steps 4–7 on the core components of the diagnosis.

1 This is not the only option and in practice it is not rare for diagnoses to intervene at a later stage, building on measures adopted earlier.
1. Reasons for undertaking diagnoses

Facilitating the transition to formality should start by recognizing the diversity of needs, motivations and working conditions that characterize the workers and economic units in the informal economy — but also in the formal economy — within a given country. The most salient drivers of informality vary from one group of workers or economic units to the other. The consequences in terms of working and living conditions also vary and so do the opportunities and the levers which will be relied on to facilitate the transition to the formal economy and reduce decent work deficits. This diversity has to be understood at the country level. The main objective of the diagnosis is to provide the necessary facts and evidence to allow national actors to reach, to the extent possible, a common understanding of the situation of workers and economic units in the informal economy in all their diversity and of what formalization processes may entail for different groups. This should enhance the capacity of national actors to reach an agreement on initial priorities and guide them in formulating policies that are tailored to the specific constraints, needs and capacities of particular groups.

At the same time, it is only through clear and trusted facts and evidence that the diagnosis will be in a position to build a common and shared vision of the informal economy. The participation and direct contribution of national actors in the information-gathering and interpretation processes is a necessary condition for building a consensus on the main results coming out of this diagnosis phase and thereafter on the priorities for action.

The ultimate objective of diagnoses is to support the gradual process of the transition to formality, that is, to reduce gradually and in a sustainable way the proportion of informal economic units and the share of workers in informal jobs, with the understanding (see ILO 2021a) that:

- Formalization can be pursued through three complementary channels which are the objectives of ILO Recommendation No. 204, namely: (a) creating decent jobs and sustainable enterprises in the formal economy; (b) transitioning workers and enterprises from the informal to the formal economy; and (c) preventing the informalization of jobs.

- Reducing decent work deficits in the informal economy is one of the results of formalization but is at the same time an enabling condition that facilitates the transition to formality and as such may be considered to be a part of the formalization process. Some workers and enterprises have the potential to formalize in the short term, while for others this is not yet a realistic possibility and the diagnosis should aim at highlighting those different groups. Addressing decent work deficits progressively reduces vulnerabilities and increases the capacity of workers and enterprises to seize economic opportunities and to enter into the formal economy in a sustainable way.

This objective can be divided into multiple subobjectives that address the specific needs of particular groups of workers and enterprises, tackling the different forms of informality (such as the formalization of informal sector units and the formalization of undeclared work) through appropriate measures. Diagnoses support the transition to formality and the transition to better working and living conditions by identifying the need for reforms, informing the design of policies and setting up the basis for their monitoring. They do so as well by supporting the development or reinforcement of coordination mechanisms in order to ensure the effective and coordinated participation of the multiplicity of actors as part of an integrated strategy.
2. Overview of the process: Preliminary steps, core components and post diagnosis

The diagnosis involves several steps to collect, analyse, share and discuss quantitative and qualitative information on the informal economy and create the conditions for reaching a consensus about the situation and agreed priorities.

Figure 1 presents the 10 steps of a typical or “generic” diagnosis of informality. This includes the preliminary or “pre-diagnosis” steps (steps 1–3), the core components of the diagnosis (steps 4–7) and the subsequent or “post-diagnosis” steps (8–10). There is a certain degree of flexibility in the way those 10 steps are implemented: both flexibility in the scope or depth of the different components and flexibility in the sequence that leaves some space for back and forth between steps. Those components are complementary in nature, meaning that the information collected in one component contributes to the interpretation of other components and is analysed in view of the results and information collected in other parts of the diagnosis. A diagnosis is not a collection of independent steps carried out by “free riders” but a coordinated exercise with overlaps and necessary “share points” to decide collectively how best to continue.

The overall process and national variations are briefly discussed in this section and the core components will be discussed in detail in section 3. Whatever scenario is adopted at the national level, the duration of the diagnosis process (steps 1–10) should not exceed six to eight months.
1. Awareness raising/sensitization activities: Recommendation No. 204 and the formalization process, the concept of informality and its measurement, and the meaning of the formalization process. Objective: to create conditions for a shared understanding of the notions of informal economy and formalization.

2. Establishment of a working group to manage the coordination and implementation of the diagnosis: Identification of stakeholders and their vision(s) of the informal economy and of the underlying causes [First step]

3. Identification of national priorities and the national policy framework

4. Assessment of the informal economy: Extent, characteristics and nature of the informal economy: Quantify the extent of informality and qualify the nature and composition of the informal economy. Include baseline indicators as part of the monitoring system

+ Broader assessment of the labour market and national economic situation

5. Factors and causes: Identification of the main drivers of informality and incentives for formalization

6. Mapping of actors involved and coordination mechanisms in place, if any

7. Identification and assessment of current policy approaches, specific programmes and measures and, whenever possible, their impacts. Including baseline information and indicators as part of the monitoring system

8. Validation tripartite meeting: agree on the situation (informality at the national level, drivers, actors; etc.)

9. Identification of priority measures and sequencing to facilitate the transition from the informal to the formal economy

10. Definition of action plan and design of road map

The process is divided into three main stages: pre-diagnosis: steps 1–3; core diagnosis: steps 4–7; and post-diagnosis: steps 8–10.
2.1 Preliminary steps (steps 1–3)

The main goal of steps 1–3 is to bring together the stakeholders involved in the formalization process. This is the opportunity to start mapping actors, assessing their respective views and understanding of informality and providing guidance and directions — based on international standards — in order to bring everyone as far as possible to a common understanding of what is meant by informality and formalization.

Step 1. Sensitization/awareness-raising activities on Recommendation No. 204 and informality

The process of formalization usually starts with a series of sensitization/awareness-raising activities on Recommendation No. 204 and informality (concepts, measurement and realities). These activities are typically completed before undertaking the diagnosis of informality. The main objectives of step 1 are to:

- **present Recommendation No. 204 and the core elements of the ILO approach to formalization, as highlighted in the Recommendation, that is the need to follow a threefold objective (not only targeting those trapped in the informal economy but also promoting the creation of jobs in the formal economy and preventing informalization of formal jobs); the need for an integrated strategy and therefore for policy coordination and coherence; the need to combine incentive and enforcement measures; and the need for social dialogue;**

- **assess the national vision(s) of the informal economy and its causes;** and

- **present the concepts of informality and formalization as understood in international standards, including statistical standards,** in order to foster a common understanding among national actors.

This step is often implemented by convening a national workshop that brings together representatives of ministries in charge of labour, social protection, vocational training, economy, finance, small and medium-sized enterprises (SMEs), agriculture, the national statistical office and enforcement bodies such as tax, social security and labour inspection bodies; representatives of workers’ and employers’ organizations dealing with the informal economy; representatives of a wide selection of organizations of informal economy workers; representatives of multilateral and bilateral organizations; and academics.

To various degrees, all these actors will be active contributors to the diagnosis and the key actors in the formalization process.

Step 1 allows also for a first round of identification of the actors that will be complemented at a later stage in the diagnosis (step 6). This early identification and involvement of relevant actors is an important factor for their future implication in the whole process. There is also a pedagogical issue. Experience has shown that the discussion of what constitutes informality, what formalization means and what formalization processes entail in terms of the policy areas to be combined in an integrated process helps national actors to realize the need for integration. The discussion helps to identify, collectively, the actors and institutions that have a role to play in the formalization process and it usually acknowledges the need to enlarge the circle of participants initially envisaged.

Finally, this is also the time to assess the situation at the country level regarding data: definition, data collection and analysis; and to identify gaps, in particular:

- **the existence of national definitions of informal employment and the informal sector and whether they are in line with statistical standards;**

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2 See in particular Recommendation No. 204; and in the statistical domain, ILO, Resolution concerning the measurement of employment in the informal sector (ILO 1993); and ILO, Guidelines concerning a statistical definition of informal employment (ILO 2003).

3 Careful consideration should be given to ensuring that those directly affected by informality are taken into account, where possible.
b. the existence of surveys, issues covered, scope and periodicity;

c. the capacity and practice in terms of analysis, dissemination and use of main results on the informal economy, in particular for policy purposes to support the formalization process.

**Step 2. Establishment of a working group**

Step 2 consists of the establishment of a working group to manage the creation of the diagnosis and the definition of roles and responsibilities. Not all the participants in the awareness-raising activities will be directly involved in the working group, but these activities in step 1 should help to identify possible candidates for step 2.

**Step 3. Identification of national priorities and the national policy framework**

The identification of national priorities at this earlier stage is of particular relevance when no focus has been decided a priori for the formalization process and therefore for the diagnosis. The main objective of step 3 is to decide whether, based on national priorities and ongoing or planned policies, a specific focus can be identified as a starting point for the formalization process. The full assessment of national priorities will be completed in step 7 by the mapping and assessment of the current policies and general policy approach. For step 3, the following questions can guide national actors in the selection, if any, of a specific focus on certain workers, economic units or forms of informality:

a. Does the country have a formalization policy and if so, what are the key priorities?

b. What are the national priorities and national strategic policy frameworks (national development plans, poverty reduction strategies, budgets and so on) and to what extent do the national development strategies include formalization policies?

c. Do existing sectorial policies and related measures (such as fiscal incentives and infrastructure development) contain specific provisions to promote formalization?

d. Does the country have an employment strategy and if so, what are the key components that address informality?

e. Do existing social policies (such as on health, housing and pensions) take into account informal workers and economic units?

f. Are there, as part of national priorities, specific target groups (sectors, groups of workers or types of economic units) that could represent an incentive to focus on those groups as a priority for the diagnosis?

**2.2 Core components of the diagnosis: A flexible process (steps 4–7)**

Steps 4–7 on the core components of the diagnoses (presented in detail in section 3 below) may vary in scope and depth, depending on the selection (or non-selection) of priority sectors, groups of workers or economic units that is made before or at the end of the preliminary stage of the diagnosis. This selection has to be decided by national actors, ideally according to criteria that will be widely accepted by the actors involved. It is usually easier to get an agreement when the criteria to justify a selection are clearly defined and grounded in objective considerations. Such criteria could consist of an alignment with existing national priorities (contributing to and benefiting from ongoing efforts and searching for complementarities between policies) or could consist of an objective quantitative assessment of the units or workers that are more exposed than others to informality or are most represented in the informal economy (see detailed presentation of step 4 below).
Regarding the core components of the diagnosis, two main scenarios can be envisaged, as described below.

**Scenario 1. No priority group or sector is defined a priori**

A “light diagnosis” of informality is prepared in step 4, which is the quantitative assessment of the extent and nature of informality. This light diagnosis is comprehensive in the sense that it covers all types of workers, economic units and sectors. The primary objective of this first light diagnosis is to allow for the identification of workers and economic units or sectors that are most exposed to informality (higher rate of informality) or most represented in the informal economy (largest group in numbers) and therefore could be considered as warranting a priority.5

Based on the results of the light diagnosis, an agreement may be reached for an in-depth diagnosis (in steps 4–7) for specific agreed sector(s), group(s) of workers or enterprises, type(s) of informality or (possibly) specific policy area(s). Otherwise, if no agreement can be found for a particular focus, the light diagnosis will be retained until further priorities can be discussed in step 9. Experience has shown that the identification of specific groups that share common constraints leads to more operational conclusions than a diagnosis that seeks to cover the entire informal economy. It is unrealistic to claim to be comprehensive and at the same time able to formulate “tailored policy approaches” for the specific needs of the different groups of workers, units and sectors. By taking a broader approach, the preparation of a light diagnosis6 allows the collection of the information necessary to move the 10-step process along, leaving more specific details to be adjusted later without prolonging the discussion at this stage.

**Scenario 2. Priority group(s) or sector(s) are defined a priori**

An in-depth diagnosis from step 4–7 is carried out for the agreed sector(s), group(s) of workers or enterprises, type(s) of informality or (possibly) specific policy area(s).

### 2.3 Post-diagnosis phase: What is the diagnosis for? (steps 8–10)

In steps 8–10, constituents review the results of the diagnosis with the aim of validating them and deciding on priorities. Once the results are validated, constituents complete the diagnosis in step 10 by defining an action plan. These steps represent the “immediate raison d’être” for making the diagnosis.

**Step 8. Validation tripartite meeting**

Step 8 – the validation of results and the endorsement of the diagnosis report by the Government and the social partners at a high-level tripartite validation meeting – is a necessary condition for the process to be taken further by national actors. The participative approach adopted throughout the diagnosis process, the establishment of a working group and the compilation of information and data from and by national actors through nationally trusted sources can be seen as elements favourable to this national endorsement.

Reaching a tripartite agreement on the main characteristics, causes, circumstances and forms of informality in the country, possibly for a particular sector or group under focus, is an important step that allows for the definition of

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4 Either prior to the preliminary stage or during the identification of national priorities (step 3).

5 Concretely this means, on the basis of micro data from the latest labour force survey and establishment survey, to (a) assess the share of informal employment, whether in the informal or formal sectors or in households for different groups of workers (by status, occupations, detailed economic sectors) and the share of economic units in the informal sector based on the economic features of the unit (such as size or sector) to identify the workers and economic units that are most exposed to the risk of informality; and (b) assess the composition of informal employment and of the informal sector to identify workers and economic that are most represented in the informal economy.

6 The development of more in-depth guidelines should address the different scenarios. What is covered by the “normal” versus “light” versions of the diagnosis for steps 4–7 should be clarified.
agreed priorities and accordingly the design of a strategy and a national action plan with policy recommendations, roles and responsibilities for the respective stakeholders and sequencing of implementation.

Step 9. Identification of priority measures

The goal of step 9 is to identify priority objectives and thereby agree on a definition of the set and sequence of short-, medium- and long-term measures that those objectives imply.

Setting priorities is necessary for various reasons that range from the complexity of the gradual process of formalization given the diversity of situations, policy areas and actors involved to the resources issues involved (in terms of both financial and human capacities). Setting priorities should be understood as part of a sequence. If one group is given priority now, another one will be covered later and will benefit from the experience acquired in the meantime.

Priority-setting is extremely complex as it means making a choice, at least in terms of “who comes first”. When more than 60 per cent of the world’s employed population is in informal employment and more than 80 per cent of all economic units are informal (ILO 2018a), it is important that this choice be based on evidence and tripartite consensus. Again, the participatory approach adopted throughout the process, the transparency at each stage of the diagnosis and the compilation of solid facts and evidence are designed to facilitate agreement on key priorities.

Step 10. Definition of action plan and design of road map

Given the multifaceted character of informality and the need for coordinated and coherent policies on several fronts, the strategy and action plan to be defined in step 10 should pay particular attention to the need for an integrated approach; the definition of roles and responsibilities; and the establishment or refinement of institutional coordination mechanisms.

As a general principle, care should also be taken to adhere to the guiding principles set out in Recommendation No. 204. In particular: (a) the road map and action plan should seek to adopt a balanced approach that combines incentives with compliance measures and (b) a participative approach should guide the overall process, with the government and social partners working jointly to achieve results.
3. The core components of the diagnosis

The four core components of the diagnosis (steps 4–7) are presented below. They compile and analyse the information to be presented and validated in step 8.

Step 4. Assessment of the informal economy: Extent, characteristics and nature of the informal economy

The objective of step 4 is to establish a profile of informal economy workers and economic units, while also considering the gender perspective. This step is primarily quantitative in nature, with an important role to be given to national statistical offices. It relies on existing data sources (national surveys and studies) and may be complemented by light surveys or qualitative assessments (interviews and focus group discussions), especially in the case of a focus on particular groups and for questions related to motivations and perceptions.

The main objectives of the informality profile are to answer five key questions, beginning with the following four questions:

Question 1. How many workers and how many economic units are in the informal economy and what are the prevalent forms of informality in the country? This includes measuring (and monitoring) Sustainable Development Goals (SDG) indicator 8.3.1 (Proportion of informal employment in total employment, by sector and sex) and providing a mapping of workers in informal employment (and as far as possible of informal economic units) in order to shed light on the type(s) of informality that prevail in the country. As an entry point and before further detailed analysis, an assessment of the composition of informal employment by type of production unit (in the informal sector, the formal sector or households) and status in employment (ILO 2018b) make possible a first link between identified groups and formalization policies. It allows the quantification of the respective shares of informal employment in informal sector economic units (calling for both enterprise formalization and formalization of jobs policies), formal enterprises (primarily an issue of formalizing jobs) or households (also an issue of jobs formalization but taking

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7 Step 4 often requires the analysis of micro data from national labour survey, ideally by the national statistical office with the support of the ILO when necessary. This can involve specific training sessions to accompany the process and build capacities to ensure the regular monitoring of the formalization process. A recommended set of indicators is provided in ILO, “Contextualizing Informal Employment: An Indicator Framework”, forthcoming.
into consideration the specific challenges associated with households as “employers”).

**Question 2. Which workers (and economic units) are the most represented in informal employment and the informal sector?** This includes indicators such as the distribution of informal and formal employment by personal and employment-related characteristics. The objective is to identify the largest groups (in numbers) but also those that are overrepresented in the informal employment compared to their overall representation in total employment (or formal employment). This is about assessing who they are (sex, level of education, age), where they live and work and which sectors and type of enterprises provide employment to the majority of those in informal employment. This informs the discussion about priority-setting as part of the process of formalization. It also provides important inputs to shed light on some of the drivers of informality and how best to reach workers in informal employment given their personal and employment characteristics.

**Question 3. Who are the workers and economy units most exposed to informality?** This is not about the composition but the incidence of informality for different groups. Adopting a workers’ perspective includes indicators such as share of informal employment in total employment for different groups, based on demographic and other personal characteristics and employment-related features. From an enterprise perspective, this includes the personal features of the owner and characteristics of the enterprise. In the absence of an “a priori” focus, this can help identify categories of workers, enterprises or sectors that warrant priority action.

**Question 4. What are the working conditions and living conditions among workers in informal employment compared to those in the formal economy?** The objective is to identify some of the main decent work deficits and other risks faced by workers and economic units in the informal economy compared to those in the formal economy. The assessment of working conditions includes indicators related to dimensions such as income security, employment security, working time, health and safety issues and levels of representation of workers and units. The assessment of living conditions includes the assessment of poverty and access to social protection (beyond the scope of employment-related social protection). It covers in particular the household dimension and the three sources of vulnerabilities at the household level.

On the basis of these four key questions, the aim is to answer additional questions that have a direct link with policies, such as:

**a. Which, how many and what proportion of workers call primarily for:**

i. the formal recognition of their employment relationship and employment (or even work) agreements linked to effective social and labour protections? This concerns employees and some dependent contractors in informal employment in the formal sector or in households, as well as unpaid trainees and volunteers in informal work in the formal sector;

ii. the formalization of their economic units, bringing them under regulation, with the advantages and obligations that this entails, including the extension of the scope of fiscal, labour and social security regulation to all enterprises without exception regarding the size, sector or other criteria, the legal recognition and registration of enterprises and compliance with legal requirements? This concerns independent workers and some dependent contractors in the informal sector;

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8 The three main sources of vulnerabilities refer to (a) the household composition in terms of employment: levels of informality of households (fully formal, semi-informal, fully informal households; see ILO and OECD 2019) and the proportion of economically dependent household members; (b) the level (and possibly the predictability) of income from all sources and all household members, including the assessment of poverty; and (c) social protection coverage through all types of benefits, whether individually or household-based, contributory or non-contributory.
iii. both the formalization of their jobs and, as a necessary condition, of the economic units that employ them. These concern employees and some dependent contractors in informal employment in the informal sector; and

iv. a reduction in their decent work deficits and a move to another status in employment in the case of contributing family workers?

b. Do workers in informal employment benefit from a certain level of protection (at the individual and household level)?

c. By contrast, is formality linked to adequate levels of protection?

d. Which are the workers and units with the potential to formalize in the short term? And by contrast, which are the workers (and units) for which formalization is realistically not the best option in the short term but for whom measures are required to create enabling conditions for (sustainable) formalization in the long term?

There is also a question 5 on the prevention of the risks of informalization. This question refers primarily to formal workers and units but is also of importance when supporting a sustainable transition to formality. This relates as well to the capacity of the economy to create and retain formal jobs and units.

As part of step 4 and contributing to step 5 on the drivers of formalization, a broader quantitative assessment of the context should include indicators related to the economic context and structural features of the labour market and of the economy – labour force participation; unemployment and underemployment rates; the composition of total employment by status in employment; sectors; occupations; employment by type of contracts; employment by size of enterprises and so on – in order to identify the prevalence and effect of the forms of employment more likely to be exposed to informality. This will also include some information about job creation by sector and whether jobs are in the formal or informal economy. This also covers the analysis of the level of GDP per capita, GDP growth and the sectoral composition of GDP.

Finally, this particular phase of the diagnosis should be used to set the baseline for a subset of selected indicators to be assessed on a regular basis to monitor formalization progress. To this end, the diagnosis offers the opportunity to assess the national capacity to produce such statistics on a regular basis as part of the monitoring and evaluation system (see box 1).

As mentioned earlier, the depth of analysis may vary. In the context of a light diagnosis, attention will be paid in particular to key indicators regarding the extent of the informal economy at the national level and to those indicators that allow for the identification of the workers and economic units that are most exposed to informality (depending on their status in employment, occupation or sector and size of enterprise, at a minimum).

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9 A methodological note will be developed for the assessment of the risks of informalization to complement this methodological note.
Box 1. Monitoring progress towards formalization

Take steps

The basis of the monitoring system forms part of the diagnosis of informality

The monitoring (and evaluation) system and the clarification of what should be monitored and evaluated – by whom, how and when – should be set up during the initial stage of the formalization process. While providing a solid analysis of the situation and its context, the diagnosis phase forms part of the development of the monitoring system in several ways. The diagnosis collects partly or fully the baseline information for subsequent monitoring and evaluation (steps 4 and 7 in particular). Sources of information and data-collection tools are identified. Issues to be considered for the monitoring system include the set of indicators to be selected, the responsible institutions, the periodicity and sustainability of the data-collection system and any gaps to be addressed. In addition, as for the overall process, stakeholders should be involved (and will be involved as part of the diagnosis) in the monitoring process starting from shaping and agreeing about what it should be. The actors active in the formalization process are those also actively involved in its monitoring. This will help to create understanding, ownership and commitment when making changes in the operational plan.

Scope

First, the scope of what should be monitored is determined by what the formalization process aims to achieve, in particular any decision about a specific focus on groups of workers or enterprises, types of informality or policy area. As mentioned above, this focus can be decided a priori and applied to the diagnosis from its initial stage or later in the process, including after the diagnosis when agreeing on priorities (see step 9 and figure 1).

Second, the depth or extent of the monitoring system in terms of the indicators and policies to be monitored on a regular basis should be decided at the national level but should at a minimum:

- Measure and analyse a minimum set of indicators related to the extent and composition of the informal economy at the national level and the group of workers or economic units under focus (if any). This minimum set includes SDG indicator 8.3.1 on the proportion of workers in informal employment by sex and sector and related indicators of informality that can be derived from the same source (typically...
Step 5. Factors and causes: Identification of the main drivers of informality and incentives for formalization

Drivers of informality are multiple and transcend the world of work. They include drivers in the economic and social environment, such as the inability of the economy to create sufficient formal jobs, economic fluctuations negatively affecting the world of work, an inadequate regulatory framework, a weak enforcement system or a lack of transparency and accountability (see figure 2, left-hand panel). In addition, they include factors associated to some characteristics of workers as presented in the right-hand panel of figure 2. Drivers of informality can be transversal or specific. Transversal drivers of informality are those that relate to all (or a wide set) of manifestations of informality. A number of major determinants of informality beyond the world of work fall into this group, such as the capacity of the economy to generate sufficient good quality, productive jobs, in particular through a process of structural change or the functioning and incidence of labour market institutions. Specific drivers\textsuperscript{11} of informality are those that relate to particular and identifiable groups of workers or economic units, often translating into certain manifestations of informality. Domestic workers (ILO 2021b) for instance will face specific issues related to the fact that they work in private

\textsuperscript{11} The explicit exclusion of domestic workers, agricultural workers or self-employed workers from labour and social security laws is an example. Specific regulations or exclusion from regulation for specific occupational groups, professions, sectors or types of enterprises fall into this group.
homes, which are not necessarily considered as a “real workplace”.\footnote{The ILO (2021) provides ample examples of specific drivers of informality for domestic workers. These include the common cultural beliefs that what happens in the household is a private matter and outside state regulation; that the privacy of the household is sacrosanct and regarded as off-limits to labour inspectors; and that domestic workers are not considered as employee but rather as a “members of the family”.}

The experience of countries that have managed to successfully reduce informality shows that interventions are more effective when they are integrated and well coordinated to tackle the different drivers of informality, enabling them to address both the diversity and scale of the informal economy. The main objective of this major component of the diagnosis is to identify, at the country level, the most prevalent drivers of informality, whether transversal or specific to certain groups of workers or types of enterprises.
The analysis of drivers may be divided into three parts:

1. The analysis of the effect of the economic environment, mainly covered under step 4.

2. The analysis of micro-level determinants of informality or factors associated with some characteristics of workers or economic units that can make it difficult for them to access formal employment, such as a low level of education, discrimination, poverty and a lack of voice and representation and access to credit, services or markets. Some of those micro-level determinants can be quantified and will complement the quantitative assessment to be provided under step 4 of the diagnosis.

3. A review of the legal and regulatory framework and its application. This aims to collect information on how the existing framework limits or enhances the transition to formality given law in books and in practice and what informal workers experience and think about it. This is about the legal culture. As part of the objectives, this review should seek to identify the sources of the deficit of protection (for
workers and economic units) in terms of (a) the lack of legal coverage; (b) inadequacy in the level of protection provided according to the law; and (c) the non-application of the law in practice to support the development of the appropriate policy mix in this regard. The methodology to assess the role of law in the formalization of workers and economic units uses in particular the framework of legal culture combining "law in books", "law in practice" and legal consciousness (Vargas forthcoming). Because what defines workers and their employment relations as "informal" has to do with legal standards, it is necessary to study what the law says, as well as how the law is applied and why people sometimes turn away from the law. This requires looking beyond "law in books" to consider "law in society", considering the values, attitudes and patterns of the use and avoidance of law. Therefore, legal culture is a framework to describe patterns of use, compliance or avoidance of law, as well as people's ideas, perceptions and expectations about the law. The methodology relies on qualitative methods of data collection and therefore is interested more in understanding the complexity of the phenomenon than in seeking causal explanations (see box 2).

The review of the legal and regulatory framework and its application includes:

a. The assessment of law in books and law in practice:
   i. the inventory of what is in place and what the gaps in the legal frameworks;
   ii. the assessment of legal provisions and the adequacy of the regulatory framework (for example the scope of the legal framework in terms of types of benefits and eligibility conditions), including the assessment of the ability of social transfers to secure income or of the adequacy of compliance modalities; and
   iii. the assessment of enforcement systems, including labour, social security and tax inspections and the effective implementation of legal provisions; and

b. The assessment of legal consciousness, which is about the ideas and perceptions that informal workers have about the law and their ideas of justice and rights, which relate as well to the degree of transparency and accountability of public institutions and the associated trust of workers and entrepreneurs. This is based on semi-structured interviews of informal workers.

In case of a focus on particular groups, types of informality or policy areas, this review will logically follow the same focus. In the case of a comprehensive diagnosis and similar to step 4, the depth of analysis should be lighter. The main objective is therefore to identify major gaps in the legislation and the workers and economic units most affected; issues in terms of levels (legal) of protection provided; strengths and weaknesses of existing compliance mechanisms; governance issues on the institutional side and awareness and perceptions on the part of workers and enterprises. In addition, the results from step 4 on the workers and economic units that are most at risk of informality or face the most critical decent work deficits may provide directions to limit the scope of the review. Such a focus should be agreed by the working group.
Box 2  Informality as the result of three sources of deficit of protection

Recommendation No. 204 refers to the informal economy as: “all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements”. In other words, the share of workers in informal employment or the share of informal sector economic units in a country result from the combination of the three main sources of deficits of protection (see figures 3 and 4): (1) a lack of legal coverage (labour and social security coverage) [extent of legal coverage]; (2) a level of protection provided according to the law that is obviously too low or inadequate (for example, inappropriate thresholds to be eligible) to ensure protection [level of legal protection]; and (3) the non-application of the law in practice (either voluntarily or involuntarily) [level of compliance]; the latter resulting in part from the level of acceptance of laws and regulations [level of acceptance]. In the first case, the answer is the extension of legal coverage (reforming existing laws or adopting new laws) to categories not yet covered; in the second case, the issue is about enhancing access to improved levels of protection; and finally, the third case calls for a set of measures to be developed on several fronts, including: the legal side (adjusting modalities as defined by law to enhance effective compliance); improving enforcement mechanisms; and adopting measures to improve transparency and confidence in the system, taking into consideration legal consciousness or what informal workers experience and think about the law.

Table 1. Guiding questions to assess how the legal and regulatory framework limits or enhances the transition to formality and perceptions

<table>
<thead>
<tr>
<th>The legal culture of informality</th>
<th>Extent of legal coverage</th>
<th>Level legal protection</th>
<th>Level of Compliance</th>
<th>Level of Acceptance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal Legal Culture</td>
<td>Law in books</td>
<td>Why are some groups of workers/units not covered by the law?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Why do some groups of workers/units covered by the law not have adequate level of protection?</td>
<td>Level legal protection</td>
</tr>
<tr>
<td></td>
<td>Law in practice</td>
<td>Why are some groups of workers/units covered by the law not protected in practice?</td>
<td>Level of Compliance</td>
<td></td>
</tr>
<tr>
<td>External Legal Culture</td>
<td>Legal Consciousness</td>
<td>How do informal workers/units experience and think about the law?</td>
<td>Level of Acceptance</td>
<td></td>
</tr>
</tbody>
</table>
Table 2. The three sources of deficit of protection leading to informality

<table>
<thead>
<tr>
<th>(1) Coverage of workers and economic units by laws and regulations</th>
<th>Extent of legal coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(2) Level of legal protection</th>
<th>Adequate level of protection</th>
<th>No adequate level of protection</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(3) Application des lois dans la pratique de l'activité économique et de l'emploi</th>
<th>Formal or Within the scope of the law and complying</th>
<th>Informal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>By choice</td>
<td>Informal</td>
</tr>
<tr>
<td>No</td>
<td>Not by choice</td>
<td>Informal</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(3) Application des lois dans la pratique de l'activité économique et de l'emploi</th>
<th>Formal or Within the scope of the law but not effectively covered and/or complying</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Informal</td>
</tr>
<tr>
<td>No</td>
<td>Informal</td>
</tr>
</tbody>
</table>

Step 6. Mapping of actors and coordination mechanism(s) in place, if any

Facilitating the transition to the formal economy requires acting on several of its drivers, some of which are beyond the world of work. This calls for coordinated action among several ministries and other public bodies, as well as close consultation and participation of the social partners and the informal economy organizations concerned. Steps 6 (mapping of actors) and 7 (review of policy approaches) are closely related. Information is collected through interviews and focus group discussions. The mapping of actors aims, first, to complete the preliminary identification of actors for the constitution of the working group in step 1; and second, to identify whether there is/are some coordination mechanism(s) and if so, how these work.

This component contributes directly to step 7, which deals with the identification and assessment of policies and policy approaches. In order to ensure a participatory, inclusive process in line with recommendation No. 204, the mapping of actors should be comprehensive and include members active in the formalization process from:

a. the government: ministries, institutions, agencies involved, directly or indirectly, in the formalization processes, including the reduction of decent work deficits at the national, regional or local levels;

b. social partners, that is workers and employers’ organizations; the principal organizations of the informal economy (representative of economic units, workers, specific occupations or sectors); and professional organizations; and

c. non-governmental actors, both international and national.
The mapping of actors should at least cover the identification of the main actors (ministries, institutions, agencies, organizations of workers and employers and so on) and for each of them:

**a.** the main domain(s) of intervention; objectives and priorities;

**b.** their visions on informality, the main perceived causes and consequences and interest in the formalization process; and

**c.** the main responsibilities, scope of actions and resources (financial and technical), which includes a quick overview of:

**i.** types of informality dimensions (for example fiscal issues; social security and labour law; effective implementation; and other issues) and formalization versus reduction of decent work deficits;

**ii.** main target group(s), for example SMEs, self-employed or employees and specific sectors;

**iii.** main realizations and programmes: past, current and planned, which are further discussed in step 7;

**iv.** their role in the formulation process and implementation of policies and programmes related to the informal economy, the reduction of decent work deficits and formalization; and the roles that may be envisaged;

**v.** their political strength at the national level;

**vi.** technical and financial capacities; and

**vii.** constraints to make their action more efficient; and needs to strengthen their capacity.

The coordination between actors, that is between several ministerial departments and other public institutions, is a necessary condition for the effective implementation of an integrated approach that aims to address different factors of informality at the same time or to enhance the complementarities between various interventions. The objectives of the diagnosis in this area are:

**a.** to identify whether there is a formalized coordination mechanism in place in the country or otherwise some informal coordination mechanism between the different actors, programmes and policies;

**b.** if so, to assess the institutional framework and operational modalities, which actors are involved and what their responsibilities are as part of it; special attention should be paid to the participation of or consultation with the social partners and the informal economy organizations concerned;

**c.** to identify factors in the current institutional setting that represent constraints and obstacles to effective coordination, including the absence of the enabling conditions that facilitate effective coordination; and

**d.** to identify opportunities to fill those gaps and provide elements that could help to recommend possible options given the context and the different existing possible options for organizational arrangements.
Step 7. Identification and assessment of current policy approaches to reduce decent work deficits in the informal economy and facilitate the transition to formality

This last element of the core components of the diagnosis should build on the programmes already identified through the mapping of actors. The objectives of step 7 are to:

a. assess if and how the reduction of decent work deficits in the informal economy and the transition to formality are part of main national strategic policy frameworks such as national development plans, poverty reduction strategies and budgets or are the subject of particular policies;

b. identify and map the existing policy measures adopted to increase the ability of the economy to absorb informal economy workers and enterprises (inclusion) but also to strengthen the ability of individuals and enterprises to enter into the formal economy (insertion), which implies (ILO 2021a):

i. mapping and assessing interventions at two levels – at the level of workers and enterprises in the informal economy and at the level of the political and institutional environment;

ii. considering policies and measures that affect the environment/context in which economic activities take place, such as macroeconomic, commercial, industrial, tax, sectoral and infrastructure policies that influence notably productivity progress, business development, structural transformation and the generation of formal employment.

They also include policies that affect the transversal drivers of formalization, such as those that strengthen social security systems, compliance mechanisms or labour market institutions, social dialogue, access to financial and other business development services, access to education and skills, infrastructures and so on. It also includes policies targeting specific categories of enterprises (such as SMEs), groups of workers (such as domestic workers and platform workers) and types of informality (such as undeclared work in formal enterprises) or sectors;

iii. reviewing measures related to the legal and regulatory framework, measures to support compliance with laws and regulation based either on direct control measures (detecting, punishing non-compliance and incentivize compliance) or indirect control measures seeking voluntary compliance by changing perceptions, raising awareness, enhancing trust and fostering the culture of formality (see box 3); and

c. Get a better understanding of the main approach(es) opted with regard to the reduction of decent work deficits in the informal economy and to formalization and/or prevention of informalization;

d. Identify possible shifts in the type of policies adopted and the underlying reasons; and

e. Collect evidence (and any evaluations) when available on the effectiveness of each measure aiming at facilitating the transition of workers and economic units from the informal to formal economy; promoting the creation, preservation and sustainability of enterprises and decent jobs in the formal economy; and/or preventing informalization.
Additional questions that go beyond a pure identification of policies but has to do with their evaluation are:

a. How adequate are these formalization policies? How adequate are the policies aiming at reducing decent work deficits in the informal economy?

b. How are these policies translated into programmes?

c. How effective are these programmes in facilitating the transition to formality and reducing decent work deficits in the informal economy?

There is a broad diversity of possible interventions across a large range of policy areas. This component of the diagnosis is probably the most complex and potentially time-consuming. The idea is not to get a detailed description of all single programmes but rather to identify key policies and programmes, the key policy approach, gaps and space for improvements and also the key promising initiatives to build on. To do so, the mapping of policy measures can be structured along different criteria such as the type of measures in terms of policy approach (see box 3); key policy areas; target groups and so on. There is no best choice “a priori” on how to organize the assessment of policy measures. Elements related to the national policy framework or the choice of specific target groups may influence the way to organize this mapping.
Box 3. A mapping of formalization policies: Not a single best approach but a set of criteria to consider

A mapping by type of measures in terms of the policy approach to facilitate the transition to the formal economy allows the visualization of the overall approach adopted in the country and the identification of “gaps” compared to a balanced approach combining incentives with compliance measures as stated in Recommendation 204. According to this approach, policies are organized in the following categories of measures:

Direct controls, including:

- deterrent measures such as measures to improve detection (data matching and sharing, joined-up strategy and operations) and/or to increase penalties (Increasing sanctions, advertising penalties); and

- incentives measures that on the supply side include measures to simplify compliance, direct and indirect tax incentives, support and advice to start-ups for instance; and on the demand side include measures to promote the use of formal employment such as service vouchers, targeted direct taxes and targeted indirect taxes.

Indirect controls, which aim primarily at increasing awareness and trust acting on:

- changing the values, norms and beliefs of workers and consumers (education on tax: what they are for; normative appeals; education and awareness-raising on the benefits of formalization); and

- changing formal institutions (laws, regulations and codes) to enhance procedural fairness and justice, distributive fairness; and wider economic and social developments.

Other categories can be established based on key policy objectives (policy that affects the environment; policy that affects transversal drivers; policy that focuses on specific groups and so on) or policy areas (social security, enterprises, employment creation and so on).

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13 This typology can be found in Colin Williams, 2016.
4. Transversal issue: A participative approach

Ensuring a participatory approach is not a specific component of the diagnosis but a core principle of the entire process. In particular, the way the information is collected, shared and discussed should ensure, at all stages of the diagnosis, the active participation of employers' and workers' organizations and the informal economy organizations concerned in order to enhance their role in facilitating the transition from the informal to the formal economy. The starting point is their involvement at all stages of the formalization process. The diagnosis should seek to achieve a clear understanding of their views, current contributions and strengths and weaknesses, as well as how to make their contribution more effective.

References


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